

December 3, 2010

**VIA ELECTRONIC DELIVERY**

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

**Re: Proposed Rule — Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions (RIN 3038-AC15)**

Dear Mr. Stawick:

UBS Global Asset Management (Americas) Inc. (“UBS Global AM”)<sup>1</sup> appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (“CFTC’s”) proposal entitled *Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions*, proposing amendments to CFTC Regulations 1.25 and 30.7 (the “Proposal”).<sup>2</sup>

UBS Global AM commends the CFTC for seeking to “better ensure the preservation of principal and maintenance of liquidity of customer funds.”<sup>3</sup> However, UBS Global AM wishes to suggest several modifications to the Proposal relating to the ability of Futures Commissions Merchants (“FCMs”) and derivatives clearing organizations (“DCOs”) to invest customer funds in money market mutual funds (“money market funds”). Specifically, UBS Global AM respectfully disagrees with the proposed 10% limitation on investment in money market funds and the proposed 2% limitation on investment in money market funds in the same fund family, and submits that imposing those limitations would be contrary to the CFTC’s stated purpose in proposing the amendments to Regulation 1.25.

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<sup>1</sup> UBS Global AM is an investment adviser registered with the US Securities and Exchange Commission (the “SEC”). As of September 30, 2010, UBS Global AM had approximately \$147 billion in assets under management. UBS Global AM is a member of the UBS Global Asset Management Division, which had approximately \$578 billion in assets under management worldwide as of the same date. UBS Global AM provides a variety of investment solutions for its clients and serves as manager, advisor or sub-advisor to over 100 funds registered with the SEC, including 25 money market funds regulated under Rule 2a-7 under the Investment Company Act of 1940, as amended (the “1940 Act”). UBS Global AM is an indirect, wholly owned subsidiary of UBS AG. UBS AG and its affiliated companies (collectively, “UBS”) include a leading global wealth manager, a top tier investment banking and securities firm, and one of the largest global asset managers. UBS operates in over fifty countries and from all major international financial centers.

<sup>2</sup> *Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions*, 75 Fed. Reg. 67,642 (Nov. 3, 2007).

<sup>3</sup> *Id.* at 67,644.

As discussed in more detail below, money market funds provide investors a greater degree of diversification and liquidity than many investment alternatives for which the CFTC has proposed higher issuer concentration and total investment limits. UBS Global AM submits that a more reasonable percentage limit on money market fund investment (if, indeed, any at all is required) might be 50%, with a 10% limitation on investment in any one fund. Our comments and recommendations are explained below in detail.

Due to their very nature and regulatory structure, money market funds are optimally suited to minimize credit, liquidity and market risks, preserve the availability of customer funds, and be quickly converted into cash. The CFTC recognizes the importance of investing customer funds in a manner that minimizes exposure to credit, liquidity, and market risk, preserves the availability of funds for customers, and enables investments to be quickly converted into cash at a predictable value.<sup>4</sup> The Proposal was designed specifically to strengthen Regulation 1.25 to better ensure the preservation of principal and liquidity of customer investments. Money market funds are ideally suited to meet each of these important goals.

Rule 2a-7 under the 1940 Act mandates compliance with strict guidelines with respect to a money market fund's portfolio of investments, including specific requirements as to credit quality, liquidity, maturity, and diversification.<sup>5</sup> In the wake of the 2008 liquidity crisis, Rule 2a-7 was amended by the Securities and Exchange Commission to further "tighten [the Rule's] risk-limiting provisions."<sup>6</sup> As discussed in more detail below, amended Rule 2a-7 imposes strengthened portfolio quality standards, new liquidity standards and shortened maturity limits, further reducing the credit, liquidity, and market risk associated with a money market fund's investments.

- Money market funds minimize credit risk.  
*Rule 2a-7 Imposes Requirements Designed to Minimize a Fund's Credit Risk.* Money market funds are required to invest in assets of the highest credit quality, which are by definition subject to low credit risk. Rule 2a-7 limits the portfolio holdings of money market funds to securities that are "Eligible Securities."<sup>7</sup> Eligible Securities, in turn, may be either "First Tier Securities"<sup>8</sup> or "Second Tier Securities."<sup>9</sup> Under

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<sup>4</sup> Id. at 67,643.

<sup>5</sup> For a discussion of Rule 2a-7, see *Money Market Funds* by Kevin K. Babikian, Douglas P. Dick, and Jack W. Murphy, in *Financial Product Fundamentals and Mutual Fund Regulation*, Practising Law Institute (updated May 3, 2010; previous editions published in January 2001, March 2008, and October 2009).

<sup>6</sup> *Money Market Fund Reform*, SEC Rel. No. IC-29132 ("Amended Rule 2a-7 Adopting Release") at text accompanying n. 607.

<sup>7</sup> Generally, Eligible Securities are short-term securities that, at the time of acquisition, have received the highest or second highest short-term debt ratings from the requisite nationally recognized statistical rating organizations (NRSROs) or, if unrated, have been deemed to be of comparable quality. Under Dodd-Frank, the SEC is required to remove references to the NRSROs from its rules by July 21, 2011. The SEC currently anticipates proposing and adopting amendments to its rules to implement this requirement during the period January through March, 2011. See *Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act — Upcoming Activity*, available at <http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml>.

<sup>8</sup> First Tier Securities are: (i) securities that have received the highest short-term debt rating from any two NRSROs (or an unrated security of comparable quality), (ii) securities that are

amended Rule 2a-7, a money market fund may not invest more than 3% of its total assets in Second Tier Securities, may not hold more than 0.5% of its total assets in the securities of any one second tier issuer,<sup>10</sup> and may not hold any Second Tier Securities that have a maturity greater than 45 days.<sup>11</sup>

*Portfolio Diversification Lowers Credit Risk.* Money market funds are diversified investments. Rule 2a-7 generally prohibits a money market fund from investing more than 5% of its assets in securities of any one issuer, except in certain circumstances.<sup>12</sup> The credit risk associated with any one money market fund investment is accordingly spread across numerous issuers, obligors, and types of securities. This diversification is critical and provides a much greater degree of credit risk protection than is available through many “single credit source” alternatives (e.g., a bank CD at an amount in excess of FDIC coverage). Moreover, it would be difficult for an FCM or DCO to replicate this level of diversification when investing client funds.

*Independent Credit Analysis and Due Diligence Further Reduce Credit Risk.* Money market funds enjoy the benefits of the robust due diligence process provided by their portfolio managers and investment advisers, who are required to (i) provide independent credit analysis of each fund’s portfolio investments before purchase, and (ii) monitor each investment as long as the fund holds the investment in its portfolio. This due diligence and analysis minimizes a fund’s dependence on credit ratings, and significantly contributes to minimizing the credit risk of the fund’s portfolio.

- Money market funds minimize liquidity risk.

*Daily Redemption.* Money market funds, like other mutual funds, provide FCMs and DCOs with the ability to redeem their investment on a daily basis, thus providing a high degree of liquidity consistent with the purpose of Regulation 1.25.

*Portfolio Liquidity Requirements.* Money market funds are subject to specific liquidity requirements designed to enable them to meet significant redemption requests easily and without having to sell securities into a declining market.<sup>13</sup> As noted above, money market funds hold only highly liquid assets with short-term maturities. Moreover, under amended Rule 2a-7, money market funds may not hold more than 5% of their net assets in “illiquid” securities.<sup>14</sup> Money market

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issued by another registered money fund, or (iii) “Government Securities” (as defined in Rule 2a-7).

<sup>9</sup> Second Tier Securities are Eligible Securities that do not qualify as First Tier Securities.

<sup>10</sup> Rule 2a-7(c)(4)(i)(C).

<sup>11</sup> Rule 2a-7(c)(3)(ii).

<sup>12</sup> Rule 2a-7(c)(4). Single state tax-free money market funds are subject to this requirement only with respect to 75% of their portfolios. See Rule 2a-7(c)(4)(i)(B). Taxable and national tax-free money market funds may invest up to 25% of their total assets in the First Tier Securities of a single issuer for a period of up to three business days after the acquisition thereof. See Rule 2a-7(c)(4)(i)(A).

<sup>13</sup> See Amended Rule 2a-7 Adopting Release, *supra* n.6, at section II.C.

<sup>14</sup> Illiquid securities are securities that cannot be disposed of within 7 calendar days at approximately the price at which the fund values those securities.

funds are also required to meet new minimum daily and weekly liquidity requirements: All money market funds must be able to convert at least 30% of their portfolio securities into cash or cash equivalents within 5 business days, and taxable money market funds must be able to convert at least 10% of their portfolio securities into cash or cash equivalents within 1 business day. In addition to these minimum liquidity requirements, money market funds must also comply with an overriding requirement that each fund hold sufficiently liquid securities to meet foreseeable redemptions.<sup>15</sup> Taken together, these requirements create a high degree of assurance that money market funds in which client money is invested will be able to meet redemption requests promptly and on a same-day basis.

- Money market funds minimize market risk.

*Stable \$1 NAV.* Money market funds undertake to provide investors with a stable net asset value or share price of \$1 per share. This stable NAV helps to ensure the protection of principal against market risk. While there is no guarantee that a given money market fund will always be able to achieve its goal of providing a stable net asset value, historically money market funds have been very successful in doing so.

*Portfolio Maturity Limits.* The portfolio maturity limits imposed by amended Rule 2a-7 are designed to help minimize the market risk associated with a money market fund's investments. Under the rule, money market fund portfolios are subject to a maximum dollar-weighted average maturity (WAM) of 60 calendar days, decreasing exposure to risks related to longer term investments, such as market risk, volatility risk, interest rate risk, liquidity risk and wider credit spreads. Amended Rule 2a-7 also limits the dollar-weighted average life (WAL)<sup>16</sup> of a money fund's investments to no more than 120 calendar days, limiting the spread risk associated with longer term adjustable rate securities, particularly in volatile markets.

*Stress Testing.* As amended, Rule 2a-7 also requires periodic "stress testing"<sup>17</sup> of each money market fund's portfolio in order to assess whether the fund could maintain its stable NAV per share upon the occurrence of specified hypothetical market events. Periodic stress testing helps to ensure that each money market fund will maintain a stable net asset value, and further protects the fund against market risk.

- Money market funds preserve the availability of funds for customers and can be quickly converted to cash at a predictable value.

Investing in a money market fund also enables an FCM or DCO to meet another of the CFTC's goals with respect to customer investments because of their stable net asset value and the liquidity of their assets. As discussed above, money market

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<sup>15</sup> Rule 2a-7(c)(5). The SEC stated in the Amended Rule 2a-7 Adopting Release that this provision may require money funds to maintain greater liquidity than the minimum required by the new daily and weekly liquidity requirements. Amended Rule 2a-7 Adopting Release, *supra* n. 6, at text accompanying n. 190.

<sup>16</sup> WAL is calculated without regard to a security's interest rate reset dates.

<sup>17</sup> The stress testing requirement of Rule 2a-7 was based on a proposal described in the ICI's money fund report. See ICI, "Report of the Money Market Working Group" ("ICI Report") (Mar. 17, 2009), *available at* [www.ici.org/pdf/ppr\\_09\\_mmwg.pdf](http://www.ici.org/pdf/ppr_09_mmwg.pdf) .

funds are the ideal investments for an FCM or DCO seeking to preserve the availability of customer funds and enable investments to be quickly converted to cash at a predictable value.

- Money market funds provide investors with benefits that are not readily available through investments in individual instruments.

*Diversification.* As discussed above, money market funds are subject to heightened diversification requirements. Because they are so diversified, money market funds provide the ability for an investor to access a broad portfolio of high quality securities to achieve the benefits of those investments while minimizing the associated risks. Importantly, a money market fund offers the advantage of a greater level of diversification than an average investor could achieve by investing directly in securities. Prime money market funds typically own dozens of individual securities.

*Operational Benefits and Cost Savings.* Money market funds provide minimal exposure to credit, liquidity, and market risks and the benefits of a diversified portfolio, all in one investment. To achieve the same level of diversification, an FCM or DCO would have to invest in multiple securities (most likely, buying in smaller lots than a fund would), conducting time intensive and costly due diligence on each, and directly incurring the related transactional and staffing costs for each such transaction. Money market funds can provide greater efficiencies and potentially higher yields/returns than can be achieved by investing directly in individual securities. Large investments by funds generally obtain better rates than would be available to smaller investments. Institutional money fund expenses are relatively low, especially compared to the overhead costs of directly managing a comparable portfolio of securities.

- Money market funds provide a more secure investment than many of the other types of investments that would be permitted in higher investment amounts under proposed amended Regulation 1.25.

*CDs, Commercial Paper, and Corporate Notes Carry More Inherent Risk Than Money Market Funds.* Under the Proposal, up to 25% of customer funds would be permitted to be invested in non-negotiable bank certificates of deposit (“CDs”), and up to 5% of customer funds could be invested in CDs issued by the same bank. CDs are similar to money market funds in that they generally provide stability of principal. However, CDs from a single bank in amounts in excess of the Federal Deposit Insurance Corporation (“FDIC”) guarantee limit (currently, \$250,000) are subject to the risks posed by the stability and solvency of the issuing bank. Banks were not immune to the credit crisis, as is demonstrated by the number of bank failures reported by the FDIC in recent years: 148 year-to-date in 2010, 140 in 2009, and 25 in 2008.<sup>18</sup> Bank CDs issued by these failed institutions would have been protected as to principal only in amounts up to the FDIC limit.

Moreover, CDs do not provide investors with same-day liquidity as money market funds do—investments in a CD are generally “tied up” until the CD matures (although they may be redeemable prior to maturity subject to a penalty, typically

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See the FDIC Failed Bank List, *available at* <http://www.fdic.gov/bank/individual/failed/banklist.html> (last updated Nov. 23, 2010).

calculated as a percentage of principal). Investments in a money market fund, on the other hand, can be redeemed daily at net asset value. Despite the inherent limitations of CDs, the Proposal would allow up to 25% of customer funds to be invested in CDs issued by as few as 5 banks, each of which would be subject to the risk of bank failure. At the same time, despite the diversification of risk and other benefits provided by money market funds, the Proposal would permit only 10% of customer funds to be invested in all money market funds, with only 2% in money market funds sponsored by any one investment adviser.

The Proposal would also permit investment of up to 25% of customer funds in commercial paper, and a further 25% in corporate notes or bonds, provided that such commercial paper, corporate notes or bonds are fully guaranteed as to principal and interest by the Temporary Liquidity Guarantee Program ("TLGP") administered by the FDIC. While the TLGP provides a government guarantee as to the repayment of unpaid principal and contract interest if the issuing insured depository institution fails or if a bankruptcy petition is filed by the respective issuing company, the program does not protect against changes in value due to fluctuations in interest rates. During the period of time until its maturity, such paper is subject to market risk. As market interest rates rise, the current market value of the paper drops, as investors demand a return on the investment that is commensurate with higher interest rates. While an investment in a money market fund that maintains a stable net asset value would shield investors from this market fluctuation, a direct investment in a security, even one guaranteed by the TLGP, would provide no such protection.

It should be recognized that even with "guaranteed" investments, there may be no assurance on when the investor will actually receive the payment. For example, an investor holding a certificate of deposit in an amount below the insurance limit may benefit from FDIC insurance should the issuing bank fail; however, it might take some time for the investor to complete the claims paperwork and to have the claim processed and paid by the guarantor. Thus, even a guaranteed investment could present liquidity problems.

*Money Market Funds Have a Strong History of Success as High Quality, Highly Liquid Investments.* The comprehensive protections Rule 2a-7 has provided to money market funds since its adoption by the SEC in 1983 have greatly contributed to their success. Money market fund assets have grown over 2000% since the adoption of Rule 2a-7, to over \$3.8 trillion as of May 2009, with an estimated \$405 trillion flowing into and out of money market funds over the years.<sup>19</sup> Money market funds are integral to the US economy and serve to assist capital formation while providing investors a valuable choice with unparalleled transparency (e.g., the SEC's new requirements for all money market funds to post monthly on their web sites detailed information regarding all portfolio holdings). Money market funds are relied upon by retail and institutional investors alike as a low-cost, efficient cash management tool because they provide a high degree of liquidity, stability of principal value, and a market-based yield.<sup>20</sup> From the adoption of Rule 2a-7 until the recent credit crisis in 2008, money market funds successfully operated without

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<sup>19</sup> See ICI Comment Letter, *infra* n. 22.

<sup>20</sup> See *id.*

any kind of federal insurance or access to liquidity facilities, with only one instance of a fund "breaking the buck."<sup>21</sup>

*Money Market Funds Successfully Weathered the Credit Crisis.* During the 2008 credit crisis, which triggered numerous bank failures referenced earlier, the failures of prominent financial institutions such as Lehman Brothers, and the near-failures of government sponsored enterprises such as the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, one money market fund, the Reserve Primary Fund, broke the dollar share price.<sup>22</sup> Several other money market funds successfully responded to challenges resulting from the unprecedented stresses placed on the financial sector through private-sector credit support or capital infusion arrangements, as evidenced by the string of no-action letters published on the SEC's web site during the crisis. Public confidence in money market funds remains strong: according to the ICI, investors added over \$1.1 trillion to money market funds during the period June, 2007 through May, 2009. Moreover, consistent with the recommendations of the ICI, as outlined in the ICI Report,<sup>23</sup> and the Administration's white paper on financial services regulatory reform,<sup>24</sup> the SEC has amended Rule 2a-7 to further enhance its protective, risk-limiting provisions. These amendments (many of which are described above) further enhance the protections the rule has provided, and the safety and security of money market fund investments.

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<sup>21</sup> The Community Bankers U.S. Government Money Market Fund broke the buck in September 1994 because it had a large percentage of its investments in adjustable-rate securities that did not return to par upon an interest rate readjustment. That fund ultimately paid investors \$0.96 per share. As a result of that incident, the SEC amended Rule 2a-7 to prohibit money market funds from investing in the types floating rate securities which caused that fund's failure.

<sup>22</sup> The Reserve Primary Fund broke the buck in September 2008. That fund has not yet liquidated, but is expected to pay shareholders approximately \$0.98 per share, which would result in a 2% loss of principal. This principal loss is less than the interest income paid out by the Reserve Primary Fund during the 8.5 months prior to its breaking the buck. See Peter G. Crane, email re Comment on "Advance Notice of Proposed Rulemaking for Regulations 1.25 and 30.7" ("Crane Data Comment Letter") (June 2, 2009), *available at* [www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/frcomment/09-006c001.pdf](http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/frcomment/09-006c001.pdf), and Investment Company Institute ("ICI"), Comment Letter to David A. Stawick re: Advance Notice of Proposed Rulemaking for Regulations 1.25 and 30.7 (July 21, 2009) ("ICI Comment Letter"), *available at* [www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/frcomment/09-006c005.pdf](http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/frcomment/09-006c005.pdf). While the U.S. Treasury Department instituted a temporary guarantee program after the failure of the Reserve Primary Fund, that program was limited to insuring shareholder assets in participating money market funds as of the close of business on September 19, 2008. The program was initially in effect for a three month period, but was subsequently extended through September 18, 2009.

<sup>23</sup> *Supra* n. 17.

<sup>24</sup> See *Financial Regulatory Reform, a New Foundation: Rebuilding Financial Supervision and Regulation*, Department of the Treasury (June 17, 2009) 74 FR 32688 (July 8, 2009), *available at* [www.financialstability.gov/docs/regs/FinalReport\\_web.pdf](http://www.financialstability.gov/docs/regs/FinalReport_web.pdf)

### Recommendations and Conclusion

In light of the historic safety of money market funds and the specific benefits they provide to investors, we believe that the percentage limitations that have been proposed on the use of money market funds by FCMs and DCOs are unwarranted, and would unduly limit an FCM's or DCO's ability to access investments that minimize credit, market and liquidity risk while providing stability of principal and the ability to convert quickly to cash at a predictable value. Moreover, such limitations would also limit access to the often higher yields that money market funds have historically provided, as compared to other investments permitted under the proposed amendments to Regulation 1.25. When the US economy normalizes, money market funds may prove especially beneficial since they have historically provided investors with a greater degree of protection against the negative impact of higher levels of inflation.

Should the CFTC determine nonetheless to include an asset-based percentage limitation on investments in money market funds in the final regulation, UBS Global AM submits that a more reasonable percentage limit might be 50%, *i.e.*, two times the proposed limitation on investments in commercial paper, corporate notes, and CDs, reflecting money market funds' greater levels of diversification and liquidity. UBS Global AM also recommends against the imposition of any percentage limitation on Treasury money market funds, which are comprised solely of instruments which may be invested in directly under the Proposal and which are well-diversified. Additionally, UBS Global AM recommends against the imposition of any "family" limitation, as each money market fund has its own portfolio of investments, and is a separate issuer of securities. In this regard, we respectfully suggest that the CFTC consider an "issuer-based" limitation, for example, a 10% limitation on investment in any one money market fund (or group of "feeder" money market funds investing in securities through the same "master" portfolio in a "master-feeder" arrangement). (We would not suggest any limit on money market funds investing in Treasury securities and repurchase agreements backed by Treasuries.)

UBS Global AM appreciates the opportunity to comment on the Proposal. Again, we commend the CFTC for its efforts to strengthen Regulation 1.25 to better ensure the preservation of principal and liquidity of customer investments. However, we believe that, as discussed above, the proposed limitations with respect to investments in money market funds should be modified to allow FCMs and DCOs to continue to access these high quality, highly liquid investments. Accordingly, we urge the CFTC to consider our suggestions in adopting a final regulation.

Respectfully submitted,

UBS Global Asset Management (Americas) Inc.

By: /s/ Keith A. Weller

Keith A. Weller

Executive Director & Senior Associate General Counsel

cc: UBS Global Asset Management -

Mr. Joseph Abed, Managing Director, Head of US Distribution -  
Short Duration Fixed Income

Mr. Robert Sabatino, Managing Director, Head of US Taxable Money Markets

Mark Kemper, Esq. – Managing Director, Head of Legal - Americas

Jack W. Murphy, Esq., Dechert LLP