

January 14, 2011

The Honorable Gary Gensler  
Chairman  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, D.C. 20581

Re: RIN No. 3038-AD28: Protection of Collateral of Counterparties to  
Uncleared Swaps; Treatment of Securities in a Portfolio Margining  
Account in a Commodity Broker Bankruptcy.

RIN No. 3038-AD99: Protection of Cleared Swaps Customers Before and  
After Commodity Broker Bankruptcies.

Dear Chairman Gensler:

We are writing on behalf of our client, Federated Investors, Inc. and its subsidiaries (“Federated”), to provide comments in response to the Commodity Futures Trading Commission’s (“CFTC’s” or “Commission’s”) Notice of Proposed Rulemaking Regarding Protection of Collateral of Counterparties to Uncleared Swaps,<sup>1</sup> and Advance Notice of Proposed Rulemaking Regarding the Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies.<sup>2</sup> Federated has served since 1974 as an investment adviser to money market mutual funds (“Money Funds”).<sup>3</sup> We appreciate the opportunity to assist the Commission as it considers the potential rulemakings.

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<sup>1</sup> 75 Fed. Reg. 75432 (Dec. 3, 2010).

<sup>2</sup> 75 Fed. Reg. 75162 (Dec. 2, 2010).

<sup>3</sup> Federated has more than thirty-five years in the business of managing Money Funds and, during that period, has participated actively in the money market as it has developed over the years. The registration statement filed with the Securities and Exchange Commission (“SEC”) for Federated’s Money Market Management fund first became effective on January 16, 1974, making it perhaps the longest continuously operating Money Fund to use the Amortized Cost Method. Federated also received one of the initial SEC exemptive orders permitting use of the Amortized Cost Method in 1979.

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In brief, we believe that the proposals to limit investments for customer funds and to extend those proposed limitations to the investment of swaps collateral are unwarranted and counter-productive. As Federated and many other commenters have pointed out, the proposed changes to Rule 1.25 are unduly limiting and economically harmful to Futures Commission Merchants (“FCMs”), Derivatives Clearing Organizations (“DCOs”), customers and markets, and are without support in the administrative record.<sup>4</sup> As discussed in more detail below, they would lead to greater concentration of investments in more risky instruments, reduced profits, higher costs, and further industry consolidation.<sup>5</sup> Imposing these already questionable limitations on investment of swaps collateral (whether for cleared or uncleared transactions) would compound these problems, would be costly and would impose operational burdens on a swaps market among very large sophisticated institutional counterparties that is being regulated for the first time.

*I. The Proposals.*

The proposed rulemaking related to uncleared swap transactions would establish standards as to the treatment of collateral posted by counterparties to swap dealers and major swap participants.<sup>6</sup> The release describing this proposed rulemaking is primarily concerned with the segregation of collateral and custody.<sup>7</sup> However, it also proposes new Rule 22.603, pursuant

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<sup>4</sup> Comment Letters submitted on behalf of Federated on July 10, 2009, August 24, 2009, November 30, 2010 and December 2, 2010, in response to Commission rulemaking proposals on Rule 1.25, *Investment of Customer Funds and Funds Held in and Account for Foreign Futures and Foreign Options Transactions*, 74 Fed. Reg. 23962 (May 22, 2009); and 75 Fed. Reg. 67,642 (Nov. 3, 2010). See also Letters from J. Charles Cardona, President, The Dreyfus Corporation (Dec. 3, 2010); Karrie McMillan, General Counsel, The Investment Company Institute (Dec. 3, 2010); Keith A. Weller, Executive Director & Senior Associate General Counsel, UBS Global Asset Management (Dec. 3, 2010); Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC and Laurie Ferber, Executive Vice President and General Counsel, MF Global, Inc. (Dec. 2, 2010). Prior to the release of the pending proposals, Bank of New York Mellon submitted a comment opposing application of the proposed Rule 1.25 standards to swap transactions on December 6, 2010.

<sup>5</sup> Indeed, the members of the Commission expressed questions regarding the extent to which any such restrictions on investments in Money Funds were warranted. Transcript of Meeting of the CFTC (Oct. 26, 2010)(available at [http://www.cftc.gov/ucm/groups/public/@swaps/documents/dsubmission/dsubmission29\\_102610-transcri.pdf](http://www.cftc.gov/ucm/groups/public/@swaps/documents/dsubmission/dsubmission29_102610-transcri.pdf)); comments of Commissioner O’Malia at 26, 123, 144; Chairman Gensler at 125, 131, 146-147

<sup>6</sup> 75 Fed. Reg. 75432 (Dec. 3, 2010).

<sup>7</sup> See 75 Fed. Reg. at 75433-75435.

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to which, notwithstanding any agreements by the parties, collateral posted to secure swap transactions could only be invested consistent with the requirements of Rule 1.25.<sup>8</sup>

Rule 1.25 is the CFTC's rule governing the investment of customer money deposited with FCMs and DCOs for the purpose of margining transactions in futures and other exchange-traded instruments. The Commission has recently proposed to amend Rule 1.25 by limiting the investment of customer money to no more than 10% of the total "assets held in segregation" (i.e., customer cash held by the FCM or DCO) in interests in Money Funds, and no more than 2% of the total "assets held in segregation" in interests in any one family of Money Funds. The Commission has also requested comment on whether to limit the assets of eligible Money Funds to far more narrowly defined categories of assets than the SEC has seen fit to impose under Rule 2a-7.<sup>9</sup> Thus, the Commission is proposing to apply these same concentration limits through Rule 1.25 to the investment of collateral in uncleared swaps transactions.

In the advance notice of proposed rulemaking related to cleared swap transactions,<sup>10</sup> the Commission also solicits comment on potential methods for the protection of collateral. While this release is also primarily concerned with the segregation of collateral, it is clear that the Commission is considering applying Rule 1.25's limitations on investment to collateral posted in connection with cleared swap transactions.<sup>11</sup>

## *II. Money Funds Are Safe, Liquid Investments for Customer Funds and Swap Collateral.*

The proposals to greatly restrict the use of Money Funds as collateral for swaps or to hold FCM/DCO customer cash are ill-founded. Money Funds have been a regulatory and investment success since they were first offered to investors in 1971. There currently are approximately 650 Money Funds,<sup>12</sup> with almost \$2.8 trillion in assets under management.<sup>13</sup> Money Funds account

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<sup>8</sup> Proposed Rule 22.603; 75 Fed. Reg. at 75434; 75438.

<sup>9</sup> *Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions*, 75 Fed. Reg. 67642, Nov. 3, 2010.

<sup>10</sup> *Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies*, 75 Fed. Reg. 75162, Dec. 2, 2010.

<sup>11</sup> See 75 Fed. Reg. at 75164. It is not clear how the Commission would apply such limitations when collateral for cleared and uncleared transactions is posted in kind. Indeed, Section 724 of the Dodd-Frank Act only appears to contemplate limitations on investment of "money" posted as margin for cleared swap transactions.

<sup>12</sup> Investment Company Institute, *Trends in Mutual Fund Investing*, Sept. 29, 2010, available at [http://www.ici.org/research/stats/trends/trends\\_11\\_10](http://www.ici.org/research/stats/trends/trends_11_10).

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for investments in almost 40% of outstanding commercial paper, approximately two-thirds of short-term state and local government debt, and a substantial amount of outstanding short-term Treasury and federal agency securities.<sup>14</sup> Between 1983, when SEC Rule 2a-7 was adopted, and March 2009, over \$338 trillion flowed into and out of Money Funds.<sup>15</sup> In the history of Money Funds, there have been only two cases where a Money Fund “broke the buck,” and in one case the fund returned 96 cents on the dollar,<sup>16</sup> while the other returned over 99 cents on the dollar.<sup>17</sup> This remarkable history is due to the standards of SEC Rule 2a-7, which imposes strict maturity, liquidity, capital structure, governance and other requirements on Money Funds.

Yet, ignoring this overall record, the current proposals are a reaction to the problems occurring at the Reserve Primary Fund in 2008, when it was forced to liquidate as a result of a run triggered by the bankruptcy of Lehman Brothers, a financial institution that was overly leveraged and overly reliant on short term funding.<sup>18</sup> To conclude that Money Funds therefore proved to be an unsafe investment misses the forest for the trees: just one of about 800 Money Funds in operation at that time – the Reserve Primary Fund – broke the buck and, even then,

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<sup>13</sup> Investment Company Institute, *Money Market Mutual Fund Assets*, Jan. 6, 2011, available at [http://www.ici.org/research/stats/mmf/mm\\_01\\_06\\_11](http://www.ici.org/research/stats/mmf/mm_01_06_11).

<sup>14</sup> See REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, MONEY MARKET FUND REFORM OPTIONS 7, available at <http://www.treasury.gov/press-center/press-releases/Documents/10.21%20PWG%20Report%20Final.pdf>.

<sup>15</sup> See Investment Company Institute, *Report of the Money Market Working Group*, Mar. 17, 2009 (hereinafter “ICI Money Market Working Group Report”), at 38, available at [www.ici.org/pdf/ppr\\_09\\_mmmwg.pdf](http://www.ici.org/pdf/ppr_09_mmmwg.pdf). Money Funds have also been popular for large cash balances because they present less risk than bank deposits in amounts over FDIC insurance limits.

<sup>16</sup> This case involved the Community Bankers U.S. Government Fund in 1994. This fund had only institutional investors, so individual investors were not directly harmed. See ICI Money Market Working Group Report, at 39, available at [www.ici.org/pdf/ppr\\_09\\_mmmwg.pdf](http://www.ici.org/pdf/ppr_09_mmmwg.pdf). See Saul S. Cohen, *The Challenge of Derivatives*, 63 *Fordham L. Rev.* 1993, 1995 n.15 (1995) (internal citations omitted).

<sup>17</sup> This case involved the Reserve Primary Fund in 2008. See Press Release, *Reserve Primary Fund to Distribute \$215 Million* (July 15, 2010), available at [http://www.reservefunds.com/pdfs/Primary%20Distribution\\_71510.pdf](http://www.reservefunds.com/pdfs/Primary%20Distribution_71510.pdf); see also SEC Press Release: *Reserve Primary Fund Distributes Assets to Investors* (Jan. 29, 2010), available at <http://www.sec.gov/news/press/2010/2010-16.htm>.

<sup>18</sup> Many of the factors that led to Lehman Brothers’ demise are now subject to reform under the DFA, thus bolstering the security of the commercial paper issued by firms, the Money Funds that purchase commercial paper and the money markets in general.

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ultimately returned over 99 cents on the dollar.<sup>19</sup> By comparison, in 2007 – 2009 168 banks failed.<sup>20</sup> Quite simply, if one Money Fund did not pay 100 cents on the dollar immediately, it does not mean that others are no longer safe.<sup>21</sup>

In any event, since 2008, the SEC has enhanced Rule 2a-7 and related Rules 17a-9 and 30b1-6T, adopted new Rules 22e-3 and 30b1-7, and created new Form N-MFP for the purpose of risk reduction. Thus, the SEC's system of regulation for Money Funds now requires:

- *Stress testing and reports on results of stress testing to a Money Fund's Board.* Scenarios that must be tested include changes in short-term interest rates, higher redemptions, downgrades and defaults.
- *Monthly disclosure of portfolios on websites.* Money Funds must now report portfolio holdings, including market-based values of securities and "shadow" NAV to the SEC on a monthly basis. This information is to be made publicly available after 60 days.
- *New Weekly Portfolio Restrictions.* Under new weekly requirements, all Money Funds must hold at least 30% of assets in cash, Treasuries, other government securities with remaining maturities of 60 days or less, or securities that convert into cash within five business days.
- *New Daily Portfolio Restrictions.* Under new minimum daily requirements, taxable Money Funds must have at least 10% in cash, direct government obligations, or instruments with overnight maturity.
- *New Liquidity Restrictions.* No more than 5% of a portfolio may be "illiquid." That is, 95% must be able to be sold or disposed of within seven days at carrying value.

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<sup>19</sup> The Investment Company Institute: Statistical Report of Money Funds in 2008 (Jan. 7, 2011) (available on request).

<sup>20</sup> FDIC Failed Bank List (available at <http://www.fdic.gov/bank/individual/failed/banklist.html>).

<sup>21</sup> While other Money Funds experienced significant short-term outflows in the Fall of 2008, and some were kept from "breaking the buck" by sponsor support, we note that the FDIC's Transaction Account Guarantee ("TAG") program, which provided temporary unlimited deposit insurance on low-interest rate transaction deposit accounts, was a significant factor leading investors to move funds from Money Funds to banks. This extraordinary measure expired on December 31, 2010 (and a more limited statutory extension expires at year-end 2012), and was counteracted when regulators instituted a more limited temporary guarantee of existing Money Fund balances.

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- *Quality Restrictions.* Investments must be rated highly and found by a Money Fund's Board to be of high quality.
- *Portfolio Eligibility.* Under revised Rule 2a-7, all of a Money Fund's investments must be "Eligible Securities:" rated securities with a remaining maturity of 397 calendar days or less that have received ratings by two NRSROs in one of the two highest short-term ratings and unrated securities of comparable quality.
  - 97% of a Money Fund's assets must be in "First Tier" securities.
  - 3% may be in "Second Tier" securities. In addition, only 0.5% may be in Second Tier securities of any one issuer, and the maturity of all Second Tier securities may not exceed 45 days.

Finally, Rule 2a-7 minimizes exposure to long-term credit risk by limiting the maturity of a Money Fund's portfolio. Under the revised Rule, the weighted average maturity of a Money Fund's portfolio may not exceed 60 days (it had previously allowed for a weighted average maturity of 90 days), and its weighted average life may not exceed 120 days.

### *III. The Proposals Are Counterproductive and Lack Any Sound Basis.*

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA") requires the CFTC to issue many new rules and rule changes in a very short period of time. However, the DFA does not require contracting the list of investments under Rule 1.25. Nor does the DFA require or suggest that investments for swaps collateral be limited in the same manner as applied to investment of retail futures customers cash. On the contrary, under new Section 4s(e)(3)(C) of the Commodity Exchange Act (as added by Section 731 of the DFA) the Commission "shall permit the use of noncash collateral" in connection with swap transactions. Nothing in Section 713 of the DFA suggests that the Commission should narrowly restrict the forms of noncash collateral that swap counterparties reasonably can agree to use. If swaps counterparties would be permitted to post noncash collateral of whatever kind they may mutually agree, limiting the investment of cash collateral as proposed makes little sense. Moreover, it may actually create a perverse incentive for traders to post other types of noncash collateral that involve far more risks than Money Funds so that cash can be invested in higher yielding assets.<sup>22</sup>

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<sup>22</sup> We also note that there are both legal and operational impediments to transferring shares of mutual funds including Money Funds, *see United States v. National Association of Securities Dealers, Inc.*, 422 U.S. 694 (1975) (describing history of regulatory restrictions on transfers of mutual fund shares and the share issuance/redemption process used by mutual funds under the Investment Company Act), that could have the practical effect of limiting

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By our count, since October 2010, the Commission has issued 31 releases announcing new rules, proposed rule changes and advance notices of proposed rulemakings. The rulemakings that are mandated by the DFA already stretch staff resources and consume much of the Commission's time. Additional rulemakings inevitably reduce the time available to gather data and analyze the impact of proposed rules, and increase the risk of unanticipated consequences. If the DFA does not require the Commission to address an area now, it should wait until there is time for adequate review so that the rulemakings do not cause more harm than good.

As Federated has stated in its prior comments, the proposed changes to Rule 1.25 will increase overall risks and costs. Like FCMs and DCOs, swap market participants invest collateral in Money Funds not only for higher returns, but also because a portfolio with Money Funds is more diversified and subject to lower risk in several respects. Money Funds involve significantly less concentration, credit and operational risk than other investments permitted by Rule 1.25, even as that Rule is proposed to be amended. The proposed changes would reduce profits for market participants by restricting investment options. Lower profitability of investment, in turn, would likely result in increased charges for services, and a contraction of the number of entities providing services.

Moreover, the proposals will increase risk associated with the collateral, rather than decrease risk as intended. By imposing limits on investment of collateral in Money Funds, the proposal would force more collateral to be invested in the other categories of permitted investments. Those other categories of permitted investments under Rule 1.25 as proposed to be amended have more risk than do Money Funds.

- For example, the proposed revised Rule 1.25 allows investments in deposits at banks of up to 25% of assets held in segregation. Banks fail at rates far above Money Funds, which poses a particular credit risk for deposits above the \$250,000 deposit insurance limit, and may also pose a liquidity risk even on the amounts below the insurance limit. We note that in the 40-year history of Money Funds, some 2,808

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in-kind transfer of a counterparty's existing Money Fund shares as swaps collateral. Thus, restricting investment of swaps collateral posted as cash, without a parallel restriction of collateral posted in kind, would have the perverse impact of increasing the use of far more risky assets that are readily transferrable as in-kind collateral in swaps transactions, while uniquely restricting the use of highly liquid and low risk Money Funds as swaps collateral.

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banks have failed and 592 have received government-injected capital.<sup>23</sup> Yet, the proposed concentration limit for investment of swap collateral in bank-issued certificates of deposit is 2 1/2 times the amount that is permitted to be held in Money Funds.

- Likewise, the Commission proposes to apply the same 10% aggregate concentration limit that it would apply to Money Funds to investments in municipal bonds, which pose far greater credit risk (and which are becoming riskier in the current economic environment), are far less liquid, far less transparent, and have greater interest rate risk.<sup>24</sup> Indeed, the municipal auction rate securities markets froze and became illiquid in February 2008, in a foreshadowing of the broader economic crisis. Yet, the per-issuer limit for municipal bonds in Rule 1.25 as proposed to be amended is 5%, as compared to 2% for individual Money Funds.
- Finally, U.S. government securities and instruments guaranteed by the United States, which are proposed to have no concentration limits, also pose greater interest rate risk than Money Funds.<sup>25</sup> When interest rates rise – and they have nowhere to go but up in the current environment – the value of U.S. government bonds drops. The longer the maturity of the bond, the greater the volatility. Due to significant interest rate risk

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<sup>23</sup> FDIC Failures and Assistance Transactions (available at <http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30>).

<sup>24</sup> Municipal credit quality is rapidly eroding, largely as a result of unfunded (and undisclosed) pension obligations. In the first six months of 2010, 35 municipal bond issues totaling \$1.5 billion defaulted. *Municipal Bond Defaults at Triple the Typical Rate, Lehmann Says*, Bloomberg Businessweek (Jul. 16, 2010) (available at <http://www.businessweek.com/news/2010-07-16/municipal-bond-defaults-at-triple-the-typical-rate-lehmann-says.html>). There are estimates that there will be another 50 to 100 municipal defaults in 2011. 60 Minutes, *State Budgets: Day of Reckoning* (available at <http://www.cbsnews.com/video/watch/?id=7166293n&tag=contentBody;housing>); *Wave of Muni Defaults to Spur Layoffs, Social Unrest: Whitney*, CNBC.com (Dec. 21, 2010) ([http://www.cnbc.com/id/40769692/Wave\\_of\\_Muni\\_Defaults\\_to\\_Spur\\_Layoffs\\_Social\\_Unrest\\_Whitney](http://www.cnbc.com/id/40769692/Wave_of_Muni_Defaults_to_Spur_Layoffs_Social_Unrest_Whitney)). Meanwhile, municipal bond funds reported market losses of \$2.03 billion during the week of January 3, 2011, and investors have withdrawn \$23.3 billion from municipal bond mutual funds in eight weeks before January 10. Dan Seymour, *Mutual Fund Cash Exodus Continues*, The Bond Buyer (Jan. 10, 2011). Even so, Federal Reserve Chairman Bernanke has testified that the central bank will not lend to states or municipalities or otherwise intervene in municipal credit markets. Jon Hilsenrath and Neil King Jr., *Bernanke Rejects Bailouts, Fed Chief Says State and Local Governments Shouldn't Expect Federal Loans*, The Wall Street Journal (Jan. 8, 2011).

<sup>25</sup> Present low interest on short term Treasuries will tempt investors to chase yield by moving out the maturity curve. This increases interest rate risk, and cannot be controlled by the rule in any way.



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in government bonds with even modest increases in market rates of interest, the ability to promptly liquidate collateral in the form of government bonds and receive the entire principal balance back is by no means assured. Money Funds, due to their very short portfolio maturity requirements under SEC Rule 2a-7 are not exposed to material interest rate risk. Moreover, even as regards credit risk, the assumption that sovereign debt, including U.S. government debt, is risk-free and inherently lower in risk than all other debt, is coming under increasing scrutiny as budget deficits and expanding Federal debt remain unaddressed.

Federated has expressed these concerns in the context of the proposed amendments to Rule 1.25. But the potential effects of applying Rule 1.25's proposed new limits to the investment of collateral in swaps markets expands the mistake into an entirely new area and will have a decidedly negative impact on the swaps markets. Swaps are moving from a largely unregulated, individually-negotiated market framework, to a framework where participants will be regulated and standardized trades will be centrally cleared. At present, Money Funds are used as investment vehicles for swap collateral because they are easy to use, present fewer operational risks than other instruments (such as bonds), are liquid, and are readily available in large volumes. In addition, in the swaps market, investors (as opposed to swap dealers or major swap participants) can negotiate to select investments for the collateral that they post. One commenter has noted that ninety-two percent of its customers elect to invest in Money Funds.<sup>26</sup> Imposing new limitations on the use of Money Funds poses significant costs and economic risks that have not been adequately considered.

Likewise, FCMs and swap counterparties rely heavily on income from investment of collateral and customer funds – many execution services are actually priced at non-profitable levels. Limiting the use of Money Funds would reduce income to such entities and increase costs to counterparties and customers. This will fundamentally change the economics of transactions and the structure of the markets, even to the extent of increasing consolidation and concentrating risk in the resulting lower number of firms.

It is therefore surprising that the Commission's rulemaking releases do not analyze or attempt to project how the suggested changes will affect investment returns. Nor do they discuss how swap collateral is generally invested in the markets at present. Thus, the releases provide no estimates of lost income to swap market participants and do not discuss potential consolidation

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<sup>26</sup> See Letter from Jonathan Spigel, Executive Vice President, Bank of New York Mellon (Dec. 6, 2010).

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or potential movement of trading and markets overseas, where restrictions on investment of cash would not apply.

Under the Administrative Procedure Act and other laws, federal rulemakings, especially such significant ones, need data and documented analysis in order to support decisions and the premises behind them. Similarly, before adopting such rules, the Commission must undertake a Cost-Benefit Analysis and prepare a Small Business Impact Assessment (as required by the Regulatory Flexibility Act) and a Competitive Impact Assessment (as required by Section 15(b) of CEA).<sup>27</sup> Yet, the releases do not include any such analyses as to the potential effects of the proposed limitations on investment of swap collateral. Of course, reducing risk is a legitimate goal, but federal law requires economic analysis, not undocumented and untested assumptions or anecdotes, to support an agency's conclusion that proposed rules will do so.

#### *IV. Federated Proposal.*

There appears to be no pressing need to restrict investments of collateral in this fashion. Swaps (whether cleared or uncleared) are between large, highly sophisticated entities that can find counterparties and impose terms for preservation of collateral that most futures traders cannot. In the setting of bilateral, over-the-counter transactions between sophisticated firms, permitted investments of swap collateral can be broader than those for customer funds used to secure exchange-traded futures and options transactions.

Nonetheless, if the Commission remains concerned about a situation such as that involving the Reserve Primary Fund, we submit that it would be best to pursue changes that would serve to minimize the impact of the failure of any Money Fund or family of Money Funds. Thus, the Commission could set concentration limits on investments with any one fund or fund family for the investment of customer funds under Rule 1.25. For example, the rule could set a 20% concentration limit on investment with any fund family, and a 10% limit per fund within a family.

We believe there should be no limits on investment of collateral for uncleared or cleared swaps. Rather, for such funds, the CFTC should require swap dealers, FCMs and DCOs to adopt written investment policies that emphasize safety of principal, diversification, yield maturity,

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<sup>27</sup> Finally, we note that the annual impact of the proposed rule changes on the U.S. economy will exceed \$100 million. Thus, these proposals may be deemed a "Major Rulemaking," and subject to Congressional review under the Congressional Review Act. The Congressional Review Act was enacted as Section 251 of the Contract With America Advancement Act, Pub.L. No. 104-121 (1996), and is codified at 5 U.S.C. §§ 801 *et seq.*

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quality, and liquidity. Such standards could also be applied to the investment of funds under Rule 1.25.

This approach would be similar to that employed by the Financial Services Authority. The FSA's Client Money Rules do not establish any concentration limits on the use of money funds. Rather, under Chapter 7 of the FSA's Client Money Rules, a firm that receives client money must promptly place it into an account (or accounts) with any of certain types of banking entities or a "qualifying money market fund."<sup>28</sup> The firm must exercise due skill, care and diligence in the selection, appointment and periodic review of the banking entity or money market fund and must make a record of the grounds upon which it has satisfied itself of the appropriateness of its selection.<sup>29</sup> Such a standard, especially if required to be exercised on a continuous and ongoing basis, would serve to address a situation where a given Money Fund approaches "breaking the buck." In this regard, we note that such review and monitoring would be facilitated by the SEC's enhanced disclosure requirements for Money Funds, described above.

### *Conclusion*

The pending proposal to amend Rule 1.25 to limit FCMs' and DCOs' use of Money Funds to hold customer cash is an overreaction to the unfortunate situation at the Reserve Primary Fund in 2008. If the proposal is adopted for the futures markets, it will increase risk and illiquidity rather than reducing them, and will result in competitive harms to FCMs and the marketplace. Applying such restrictions on the use of Money Funds as collateral in the swaps markets compounds the overreaction and will cause significant harm to participants and the swaps markets, while increasing the overall risks – operational, credit and interest rate – in the investment of swaps collateral. These restrictions are not required by the DFA, are not supported by any data or analysis, and are not a prudent first step for the Commission to take in the regulation of the institutional swaps markets.

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<sup>28</sup> CASS 7.4.1.

<sup>29</sup> CASS 7.4.7. Factors that should be considered include limits on the volume of redemption of customer funds that a money fund may impose in any period. CASS 7.4.9.

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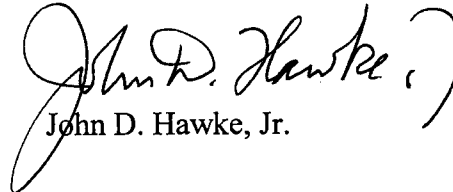
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We thank you again for the opportunity to comment on these important matters, and we look forward to working with you as you move forward.

Sincerely,



John D. Hawke, Jr.

cc: Hon. Michael Dunn  
Hon. Jill E. Summers  
Hon. Bart Chilton  
Hon. Scott D. O'Malia

Mr. David A. Stawick  
Secretary