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February 15, 2013

Natise Stowe, Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Enhancing Protections Afforded Customers and Customer Funds Held by Futures
Commission Merchants and Derivatives Clearing Organizations (RIN 3038-AD88)

Dear Ms. Stowe:

Franklin Templeton Investments (“Franklin”) appreciates the opportunity to comment on the proposal by the Commodity Futures Trading Commission (“CFTC” or “Commission”) to adopt new rules and rule amendments designed to provide greater protections to customers of futures commission merchants (“FCMs”) and, in particular, to customer assets deposited with the FCMs and derivatives clearing organizations (“DCOs”) (the “Customer Protection Proposal”).¹

Franklin is a leading provider of investment management, retirement planning, and other financial services with approximately \$ 809.8 billion in assets under management as of January 31, 2013. Franklin uses derivatives as a means to pursue the investment objectives of our clients and customers. For this reason, Franklin has a strong interest in ensuring the protection of customer property held by FCMs and DCOs, and applauds the Commission’s acknowledgment of customer protection as a fundamental component of its regulatory mission. We believe the Commission’s efforts in response to recent events, including two FCM failures that have raised questions about customer safety, show a strong commitment to remedying perceived weaknesses in its customer protection regime.

The Customer Protection Proposal would require enhanced customer protections, risk management programs, internal monitoring and controls, capital and liquidity standards, customer disclosure, and auditing and examination programs for FCMs, and would also require self-regulatory organizations (“SROs”) of FCMs to adopt new requirements with respect to the oversight and examination of FCMs. Among other key provisions, the Customer Protection Proposal would require each FCM that carries customer accounts for transacting in futures, options on futures, and swaps to maintain an adequate targeted amount of excess monies in customer accounts, which would assist FCMs in maintaining compliance with the customer funds segregation requirements, protect against fellow

¹ *Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations*, 77 FR 67866 (Nov. 14, 2012), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-26435a.pdf>.

customer risk, and properly re-allocate costs and risk borne by customers with excess margin to under-margined customers.

We support the positions stated in the letter submitted by the Investment Company Institute (“ICI”) on January 14, 2013 in response to the Customer Protection Proposal.² In particular, we support measures in the CFTC’s proposal that would provide greater protection for customers of FCMs and customer funds held by FCMs, require a risk management program designed to monitor and manage the risks associated with FCM activities, improve financial reporting by FCMs, and improve public disclosure of information by FCMs. We also support the ICI’s recommendation that the CFTC strengthen the proposed requirements with respect to the public disclosure by FCMs to ensure that customers are provided with more complete information regarding the FCMs, especially when FCMs are in a difficult financial condition.

Like other asset managers that act in a fiduciary capacity on behalf of customers, we especially support those aspects of the Customer Protection Proposal that seek to reduce exposure of our investors’ property in the hands of FCMs to fellow customer risk, fraud or malfeasance risk, investment risk and operational risk. As the CFTC is aware, exposure to these risks is substantially reduced under collateral arrangements currently used for certain over-the-counter swaps transactions (including those involving mutual funds), where collateral is held under a tri-party custody arrangement.

Mandatory clearing of certain swaps will begin over the next several months. For assets entrusted to FCMs as cleared swaps collateral in connection with this requirement, the Commission’s special segregation requirements (known as “LSOC”), adopted in response to the special statutory requirements applicable to swaps collateral added to the Commodity Exchange Act (“CEA”) by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, as strengthened by the CFTC staff’s interpretive letter dated November 1, 2012,³ help to reduce fellow customer risk. However, LSOC does not provide complete protection against fellow customer risk (among other reasons, because of the current timing requirements for implementing the segregation requirements) and does not protect customer funds held by FCMs against the other types of risk (fraud or malfeasance, investment, and operational risk). Moreover, LSOC does not apply to customer assets held by FCMs in connection with futures transactions.

We support the Customer Protection Proposal because it takes important additional steps to augment the protection of both futures and cleared swaps collateral through the risk management, reporting, and other measures set forth in such proposal. However, we continue to believe that a full segregation model, similar to the arrangements we currently have in place for over-the-counter swaps, provides superior protection for our customers against all of the risks outlined above. We encourage the Commission, after adopting the improvements included in the Customer Protection Proposal, to continue its consideration of measures to implement a full physical segregation model.

We note that the CFTC has received a number of comments, primarily on behalf of DCOs and FCMs, strongly urging that the costs of implementing the Customer Protection Proposal will be prohibitive relative to the benefits, and requesting more time to study and

² Letter from Karrie McMillan, General Counsel, ICI, to Sauntia S. Warfield, Assistant Secretary, CFTC, dated January 14, 2013.

³ CFTC Letter No. 12-31, *Staff Interpretation Regarding Part 22* (Nov. 1, 2012).

substantiate these costs. For this reason, the CFTC extended the initial comment period for another thirty days, until February 15.⁴ In addition, on February 5, 2013, the CFTC held a roundtable discussion, during which these industry participants again urged the CFTC to consider the costs of the Customer Protection Proposal.⁵

In light of these comments, Franklin urges the CFTC to consider as well the potential costs, in terms of lack of confidence in the safety of the markets under its jurisdiction on the part of investors and their fiduciaries, of not adopting additional customer protections in the face of what the CFTC itself has identified as “weaknesses in the customer protection regime prescribed in the Commission’s regulations and through the self-regulatory system” and the resulting “need for enhanced customer protections.”⁶

Thank you for the opportunity to submit our views on this very important proposal. If you have any questions on our comment letter, please feel free to contact me at 916-463-5122.

Sincerely yours,

Wylie Tollette *by JK*

Wylie Tollette
Senior Vice President
Director, Performance Analysis and Investment Risk

⁴ *Extension of Comment Period for the Rulemaking Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations*, 78 FR 4093 (Jan. 18, 2013), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-00820a.pdf>.

⁵ *See CFTC Staff to Host a Public Roundtable to Discuss Proposed Rulemaking Enhancing Protections Afforded Customers and Funds Deposited by Customers* (Feb. 5, 2013), available at http://www.cftc.gov/PressRoom/Events/opaevent_cftcstaff020513.

⁶ 77 FR at 67869, 67871.