By Electronic Mail – comments.cftc.gov

January 17, 2024

Mr. Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
1155 21st Street NW
Washington DC 20581

Re: Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations – 88 Fed. Reg. 81236 (Nov. 21, 2023)

Dear Mr. Kirkpatrick:

Managed Funds Association[1] ("**MFA**") welcomes the opportunity to comment on the Commodity Futures Trading Commission's ("**CFTC**" or "**Commission**") proposed rulemaking regarding "Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations" (the "**Proposed Rules**").[2] MFA supports the Commission's consideration of the joint petition with the Futures Industry Association and the CME Group Inc. (the "**Joint Petition**") in requesting an order under Section 4(c) of the Commodity Exchange Act (the "**Act**") to expand investments ("**Permitted Investments**") that futures commission merchants ("**FCMs**") and derivatives clearing organizations ("**DCOs**") may enter into with Customer Funds (as defined in the Proposed Rules). We also support the petition from Invesco Capital Management LLC (the "**Invesco Petition,**" and with the Joint Petition, the "**Petitions**") as the Petitions argued that US Treasury exchange-traded fund securities ("**ETFs**") should be added to the list of Permitted Investments.[3]

MFA supports the Commission's Proposed Rules, which would expand the ability of FCMs and DCOs to better manage risks relating to their holding of Customer Funds, mitigate foreign currency risks (which the current rules create from requiring FCMs and DCOs to invest foreign currencies in US dollar-

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[1] Managed Funds Association ("**MFA**"), based in Washington, DC, New York, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 175 member firms, including traditional hedge funds, credit funds, and crossover funds, that collectively manage over $3.2 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time.

[2] 88 Fed. Reg. 81236 (Nov. 21, 2023).

[3] *See* Proposed Rules, 88 Fed. Reg. at 81239 (at n. 45) (referencing the Joint Petition) and 81240 (at n. 56) (referencing the Invesco Petition) (internal citations omitted).

denominated investments), and reduce concentration risk by allowing FCMs and DCOs to more greatly diversify their margin investments.

I. Executive Summary

A. MFA supports expansion of the list of Permitted Investments to include sovereign debt of Canada, France, Germany, Japan, and the United Kingdom ("**Specified Foreign Sovereign Debt**").

B. Including Specified Foreign Sovereign Debt as Permitted Investments facilitates stronger risk management practices of FCMs and DCOs.

C. The proposed conditions on Permitted Investments in Specified Foreign Sovereign Debt provide useful guardrails to help ensure the appropriateness of the investment.

D. MFA Recommends that the scope of permitted exchange-traded funds be clarified to better align with industry practices.

E. MFA supports Permitted Investments in affiliated eligible money market funds ("**MMFs**") or ETFs as proposed.

F. MFA supports replacing references to LIBOR with SOFR and recommends including non-US reference rates of Specified Foreign Sovereign Debt.

II. Specific Comments

A. MFA Supports the Proposed Expansion of the List of Permitted Investments to include Specified Foreign Sovereign Debt

The Commission notes that it has preliminarily determined that the two-year debt instruments in the Specified Foreign Sovereign Debt have credit, liquidity and volatility characteristics that are consistent with two-year US Treasury securities.[4] MFA's view is that such a determination entirely consistent with the "overall objectives of Regulation 1.25 of preserving principal and maintaining liquidity of Customer Funds"[5] as well as the Commission's broader responsibility to protect customer funds and avoid systemic risk and mission to "ensure that its regulations are robust and responsive to our evolving market structure."[6]

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4 *Id.* at 81258.

5 *Id.* at 81244.

6 *Id.* at 81287 (App. 3—Statement of Cmr. Kristin N. Johnson).

The Commission notes that the Specified Foreign Sovereign Debt instruments "may also be less liquid than US government securities."[7] We however note that liquidity, as measured by bid-ask spread (*i.e.*, highest bid minus lowest ask) for short-term Specified Foreign Sovereign Debt referenced in the Proposed Rules are all highly liquid and of comparable liquidity with US government securities for the same duration.[8] Volatility of Specified Foreign Sovereign Debt in the past several quarters has largely mirrored volatility in US government securities.[9]

B. Including Specified Foreign Sovereign Debt Facilitates as Permitted Investments Stronger Risk Management Processes of FCMs and DCOs

Including Specified Foreign Sovereign Debt as a Permitted Investments for FCMs and DCOs improves their ability to manage the risks associated with holding Customer Funds denominated in the applicable foreign currencies. The Commission notes that "holding high-quality foreign sovereign debt may pose less risk to Customer Funds than the credit risk of commercial banks through unsecured bank demand deposit accounts" located outside the US (typically the only alternative available).[10] CFTC rules currently require an FCM's risk management policies and procedures to include evaluation and diligence processes for assessing any depository of Customer Funds for adequate capitalization, creditworthiness, operational reliability, and access to liquidity. The FCM's assessment must also consider concentration risks if Customer Funds are overly concentrated with any depository or group of depositories.[11] FCMs and their customers can mitigate risk when FCMs can diversify non-USD exposures by leveraging both permitted non-US depositories as well as Permitted Investments in Specified Foreign Sovereign Debt instruments.[12]

Investments of Customer Funds denominated in foreign currencies in foreign sovereign debt are an important component of foreign currency risk management for FCMs and DCOs.[13] The current rules, however, would require an FCM that holds non-USD Customer Funds in excess of what it is required must

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7 Proposed Rules, 88 Fed. Reg. at 81247.

8 *See* Joint Petition, at Appendix 1.

9 *See* Proposed Rules, 88 Fed. Reg. at 81244 ("The Commission also analyzed the volatility of the Specified Foreign Sovereign Debt and observed, based on the available data, that the price risk of the relevant foreign sovereign debt is comparable to that of US Treasury securities.").

10 Proposed Rules, 88 Fed. Reg. at 81244 (at n. 113); *see also* 2018 Order, 83 Fed. Reg. at 35242, *infra* at n. 16.

11 CFTC Regulation 1.11(e)(3)(i).

12 *See* ICE Clearing House Application for an Exemptive Order Under Section 4(c) of the Commodity Exchange Act: Investment in Foreign Sovereign Debt Under Regulation 1.25 (Jun. 22, 2017), at 7; *see also* 2018 Order, 83 Fed. Reg. at 32542 (at n. 10).

13 Proposed Rules, 88 Fed. Reg. at 81244 (n. 114); *see also* Rules Relating to Intermediaries of Commodity Interest Transactions, 65 Fed. Reg. 77993, 78003 (Dec.13, 2000) ("**2000 Permitted Investments Amendment**"); Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions, 76 Fed. Reg. 78776, 78780 (Dec. 19, 2011) ("**2011 Permitted Investments Amendment")**.

first convert such non-USD Customer Fund balances into USD – thus incurring foreign currency risk,[14] when a more risk-prudent approach would be to invest such Customer Funds in a Permitted Investment. MFA believes the FCM should be permitted to invest in a Permitted Investment without having first to convert the excess funds to USD.

It is worth noting that the level of Customer Funds held in denominations of the Specified Foreign Sovereign Debt has increased significantly. The CFTC noted that "FCMs collectively held an aggregate of a US dollar equivalent of $51 billion of Customer Funds denominated in Canadian dollars, ("**CAD**"), euros ("**EUR**"), Japanese yen ("**JPY**"), and British pounds ("**GBP**") on August 15, 2023, representing in total approximately 10 percent of the total $490 billion of Customer Funds held by FCMs in segregated accounts on August 15, 2023."[15]

Prudent risk management obligations strongly support expanding the list of Permitted Investments to include Specified Foreign Sovereign Debt. Customer Funds in denominations of Specified Foreign Sovereign Debt have increased, we understand, with the growth of the cleared swaps market since the Dodd-Frank Act. FCMs should not be incentivized to refuse margin deposits not denominated in USD (to the extent that such deposits cannot be transferred to DCOs) or to require customers depositing such balances to assume the foreign currency risk.

C. The Proposed Conditions on Permitted Investments in Specified Foreign Sovereign Debt Provide Useful Guardrails to Help Ensure the Appropriateness of the Investment

MFA does not oppose the CFTC proposal to permit to permit FCM/DCO investment in Specified Foreign Sovereign Debt subject to conditions consistent with the criteria specified in the CFTC's 2018 order regarding Permitted Investments ("**2018 Order**").[16] The Proposed Rules permit investments only if (i) balances owed to customers (or clearing members, as applicable) denominated in the applicable currency, and provided that the two-year credit default spread of the issuing sovereign is 45 bps or less;[17] (ii) the dollar-weighted average time-to-maturity of investment portfolios in Specified Foreign Sovereign Debt[18] must not exceed 60 calendar days; and (iii) direct investments in a Specified Foreign Sovereign Debt instrument must not have a remaining maturity greater than 180 calendar days.

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14 Proposed Rules, 88 Fed. Reg. at 81267.

15 *See* Proposed Rules 88 Fed. Reg at 81243-44 (sourced from the Segregation Investment Detail Reports filed by FCMs as of Aug. 15, 2023 (*Id.* at 81244 (at n. 118))).

16 *Id.* at 81243. *See* Order Granting Exemption from Certain Provisions of the Commodity Exchange Act Regarding Investment of Customer Funds and from Certain Related Commission Regulations, 83 Fed. Reg. 35241, 35244 (Jul. 25, 2018) ("**2018 Order**").

17 Proposed Rules, 88 Fed. Reg. at 81244-45.

18 As computed under Rule 2a-7 under the Investment Company Act of 1940, on a country-by-country basis; securities acquired under reverse repurchase transactions (or sold under repurchase transactions) would count toward this computation.

The proposed conditions appear appropriately tailored to the proposed inclusion of Specified Foreign Sovereign Debt instruments as Permitted Investments, and to the overall objectives of Regulation 1.25 that such Permitted Investments preserve principal and maintain liquidity of Customer Funds.

D. MFA Recommends that the Scope of Permitted Exchange-Traded Funds be Clarified to Better Align with Industry Practices

MFA supports the CFTC's proposal to include interests in certain exchange-traded funds as Permitted Investments. The proposed definition of "Qualified ETF" should be clarified, however, to better align that definition with the definition of "government money market fund" (drawn from Rule 2a-7, as defined below), with the CFTC's proposed guidance on capital charges applicable to investments in US Treasury ETFs, and with market practice among the managers of eligible MMFs and ETFs.[19]

The proposed condition on holdings of a Qualified ETF is unduly restrictive, as it would be limited to "short-term US Treasury securities that 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 US Department of the Treasury."[20] Such a definition would appear to exclude short-term securities issued by US government agencies that are guaranteed as to principal and interest by the US government.

The definition of "Qualified ETF" in the Proposal similarly should be revised to allow ETFs that invest at least 80% (vs. the 95% as proposed) of its total assets in securities with a maximum remaining maturity of less than 12 months issued or guaranteed by the US Treasury ("short-term securities"), including short-term securities issued by US government agencies that are backed by the full faith and credit of the US government, government MMFs (as defined in Rule 2a-7 of the Investment Company Act of 1940 ("**1940 Act**")), and/or repurchase and reverse repurchase agreements with a remaining term to final maturity of 12 months or less collateralized by US Treasury securities or other government securities (as defined under Rule 2a-7 and section 2(a)(16) of the 1940 Act) with a remaining term to final maturity of 12 months or less.[21] Adopting an 80% requirement, as opposed to a 95% requirement, would better align with current mutual fund portfolio management practices.

MFA does not support the requirement that a Qualified ETF be limited to a fund that provides cash only redemptions. ETFs are permitted under the 1940 Act to issue securities (*e.g.*, in a "vertical slice" of the portfolio) to redeeming shareholders rather than cash, as the US Treasuries themselves are highly liquid. Limiting FCMs and DCOs to investing in ETFs that provide cash redemptions only also could result in an unfair "first-mover advantage" among redeeming and non-redeeming shareholders. Absent amendment,

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19 Proposed Rules, 88 Fed. Reg. at 81260 n. 262.

20 *Id.*, 88 Fed. Reg. at 81249.

21 This condition (ii) is intended to amend Proposed Rules 1.25(c)(8)(ii) and (iii). *See* Letter from Michael A. Macchiaroli, Associate Director, Division of Trading and Markets, to Kris Dailey, Vice President, Risk Oversight & Operational Regulation, Financial Industry Regulatory Authority ("**FINRA**"), dated Jun. 2, 2022 (cited in the Proposed Rules, at n. 262).

the Proposed Rules also would unduly limit the investment options for the FCM/DCO. MFA therefore recommends allowing FCMs to invest in ETFs that provide redemptions in cash or securities, consistent with the 1940 Act.

E. MFA Supports Permitted Investments in Affiliated Eligible MMFs or ETFs as Proposed

MFA notes that Regulation 1.25(b)(5)(ii) currently permits an FCM or a DCO to invest Customer Funds in a fund affiliated with that FCM or DCO. No change to this provision appears warranted, and the CFTC should not move to prohibit such investments. "Risks posed by affiliates" are a component of the Risk Management Program that FCMs are required to adopt under Regulation 1.11.[22] The Commission previously recognized that "many FCMs are part of a larger holding company structure that may include affiliates that are engaged in a wide array of business activities," and that the "top level company" in such a structure "is in the best position to evaluate the risks that an affiliate of an FCM may pose to the enterprise, as it has the benefit of an organization-wide view and because an affiliate's business may be wholly unrelated to an FCM's activities."[23]

MFA agrees with the Commission's assessment that, "to the extent an FCM is part of a holding company with an integrated risk management program, the Commission would allow an FCM to address affiliate risks and comply with [Regulation] 1.11(e)(1)(ii) through its participation in a consolidated entity risk management program."[24] Permitted Investments involving FCM affiliates are already subject to the policies, procedures, and controls of such consolidated risk management programs,[25] and subject to compliance examinations and audits.[26]

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22 *See* CFTC Regulation 1.11(e)(1)(ii).

23 Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 Fed. Reg. 68506, 68519 (Nov. 14, 2013).

24 *Id.*

25 *Id.* at 68520 (FCM's risk management policies and procedures "must take into consideration the market, credit, counterparty, operational, and liquidity risks associated with the investments.")

26 Notably, FCMs are expressly permitted to deposit Customer Funds with affiliated banks or brokers, provided that they disclose such arrangements, and of course, subject to their obligations to monitor and control the risks related to such arrangements, pursuant to CFTC Regulation 1.11. *See* paragraph (7) of the Risk Disclosure Statement required under CFTC Regulation 1.55(a) ("Futures commission merchants are permitted to deposit customer funds with affiliated entities, such as affiliated banks, securities brokers or dealers, or foreign brokers. You should inquire as to whether your futures commission merchant deposits funds with affiliates and assess whether such deposits by the futures commission merchant with its affiliates increases the risks to your funds.").

F. MFA Supports Replacing References to LIBOR with SOFR and Recommends Including Non-US Reference Rates as Permitted Investments

For the reasons set forth in the Proposed Rules,[27] MFA supports the Commission's proposal to amend CFTC Regulation 1.25(b)(2)(iv)(A) by replacing LIBOR with SOFR as a permitted benchmark for Permitted Investments that contain an adjustable rate of interest and to remove commercial paper, corporate notes, and corporate bonds from the list of Permitted Investments. MFA notes, however, that non-US jurisdictions have adopted their own floating-rate replacement for LIBOR. In the UK, for example, the Sterling Overnight Index Average ("**SONIA**") has been designated as the replacement for LIBOR.[28] MFA recommends that the Proposed Rules be revised to incorporate the LIBOR replacement rates adopted by each of the Specified Foreign Sovereign Debt jurisdictions.

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[27] 88 Fed. Reg. at 81253-54.

[28] *See, e.g.*, Bank of England, *Preparing for 2022: What You Need to Know About LIBOR Transition* (Nov. 2018), avail. at https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/what-you-need-to-know-about-libor-transition.

MFA supports the Commission's stated goal of expanding the universe of permitted investments, with appropriate risk mitigants and controls, for collateral investment by FCMs and DCOs. MFA appreciates the opportunity to comment on the Proposed Rules and thanks the Commission for its consideration of our comments. If you have any questions about these comments, or if we can provide additional information, please do not hesitate to contact Jeff Himstreet, Vice President and Senior Counsel (jhimstreet@managedfunds.org), or the undersigned (jhan@managedfunds.org).

Respectfully submitted,

/s/ Jennifer W. Han

Jennifer W. Han
Executive Vice President
Chief Counsel & Head of Regulatory Affairs

cc: The Honorable Rostin Behnam, Chairman
The Honorable Kristin N. Johnson, Commissioner
The Honorable Christy Goldsmith Romero, Commissioner
The Honorable Summer K. Mersinger, Commissioner
The Honorable Caroline D. Pham, Commissioner