January 17, 2024

VIA ELECTRONIC SUBMISSION ([Link](#))
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
USA

Re: Commodity Futures Trading Commission's Notice of Proposed Rulemaking on *Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations*

The Global Association of Central Counterparties ("CCP Global")[1] is the international association for central counterparties ("CCPs"), representing 41 members who operate over 60 individual CCPs across the Americas, EMEA, and the Asia-Pacific region.

CCP Global appreciates the opportunity to respond to the Notice of Proposed Rulemaking on *Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations*[2] ("the Proposal" or "NPR") proposed by the Commodity Futures Trading Commission (the "CFTC" or the "Commission").

Introductory remarks

We generally commend the CFTC for the proposals contained in the NPR, especially those related to making general obligations of Canada, France, Germany, Japan, and the United Kingdom permissible for futures commission merchants ("FCMs") and derivatives clearing organizations ("DCOs") for investing balances in segregated accounts owed to, respectively, their customers or clearing members denominated in those countries' currencies. As noted in the Petition for Order under Section 4(c) of the Commodity Exchange Act[3], the ability of DCOs and FCMs to invest customer cash in Designated Foreign Sovereign Debt effectively eliminates the credit risk of commercial banks DCOs and FCMs are exposed to while holding cash in unsecured deposit accounts at commercial banks. This is a very important factor from a risk management perspective, not only for DCOs and FCMs, but also taking into account the objective of ensuring customer protection and the financial system stability more broadly.

[1] Previously known as CCP12.
[2] Federal Register, CFTC, Notice of Proposed Rulemaking, *Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations* (November 2023), available at Link.
[3] CME Group, FIA, Petition for Order under Section 4(c) of the Commodity Exchange Act (May 2023), available at Link

DCO access to Federal Reserve deposit accounts

As the Commission is seeking to strengthen DCO safeguards for the investment of customer funds via rules designed to minimize credit risk, market risk, and liquidity risk, it should be also noted that permitting all DCOs to deposit customer funds at the Federal Reserve Banks, where they are subject to a comparable level of regulatory requirements and supervisory oversight as those DCOs that have deposit accounts today, would also effectively and efficiently mitigate these risks. As the Commission stated in another recently proposed rulemaking, "central banks are often the safest place to deposit customer funds".[4] Accordingly, the Commission should continue to advocate for Federal Reserve deposit access for all DCOs holding customer funds, where they are subject to a comparable level of regulatory requirements and supervisory oversight as those DCOs that have deposit accounts today, so those funds are held in the safest place.

Specified Foreign Sovereign Debt

The Commission is also "proposing to permit FCMs and DCOs to invest in Specified Foreign Sovereign Debt provided that the two-year credit default spread of the issuing sovereign is 45 BPS or less."[5] Further, according to the Proposal, "if the credit default spread of a subject country were to exceed the 45 BPS cap, FCMs and DCOs would not be permitted to make new investments in the country's Specified Foreign Sovereign Debt. In addition, if the credit default spread exceeded the 45 BPS cap, FCMs and DCOs would be required to discontinue investing Customer Funds in that sovereign's debt through Repurchase Transactions as soon as practicable."[6] In this context, the Commission is requesting comments on whether the proposed credit default spread is appropriate and how the breach threshold should be operationalized (e.g., should there be a minimum number of breaches before investments are limited or should there be a "cooling-off" period for further investments in foreign sovereign debt following a breach).

While we agree that there should be a mechanism to exclude a sovereign's debt in the event of increased credit risk, we would strongly suggest a phased "cooling-off" period and flexibility provided in terms of number of breaches before investments are limited, as the use of hard limits without a level of flexibility in the event of a breach may lead to unintended consequences such as 'cliff-edge' effects when the credit default spread approaches/breaches the limit. This would aggravate volatility in the underlying bond market, increasing uncertainty and potentially creating procyclical effects. We also note that investment of customer funds in reverse repo is limited to overnight maturity or must be capable of reversal on demand.[7] Therefore, an immediate limitation on new investments will have the effect of requiring a large proportion of all FCM and DCO investments in reverse repo collateralised by the relevant debt to be re-allocated within one business day.

One approach could be for the regulations to require FCMs and DCOs to have appropriate policies and procedures in place to manage credit risk on investments more generally, and to have regard to the relevant threshold in doing so. Another alternative, if the cap were to remain, would be to

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[4] Federal Register, CFTC, Notice of Proposed Rulemaking, *Protection of Clearing Member Funds Held by Derivatives Clearing Organizations* (January 2024), available at Link, at p. 289.
[5] CFTC, NPR, *Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations, op.cit.*, at p. 81245.
[6] *Ibid.*
[7] 17 CFR 1.25(d)(6)

supplement with reference to an appropriate level of flexibility regarding the number of observed breaches / prolonged period in excess of the cap, and allowing a period of time for orderly divestment into other debt. Both approaches would align with CFTC Core Principle D and Rule 39.13, thereunder, which provides that each DCO ensure it possesses the ability to manage the risks associated with discharging its responsibilities through the use of appropriate tools and procedures, and Core Principle F and Rule 39.15(e), thereunder, which provides that funds and assets invested by a DCO be held in instruments with minimal credit, market, and liquidity risks.

U.S. Treasury Exchange-Traded Funds

CCP Global also supports the Proposal's inclusion of Short-Term U.S. Treasury exchange-traded funds ("ETFs") as a permitted investment, as they provide an additional option for FCMs and DCOs to reinvest customer funds in safe and highly liquid securities backed by U.S. Treasuries. These ETFs provide efficiencies that would allow FCMs and DCOs to diversify their investment portfolios while further limiting credit risk. To provide for these benefits, certain modifications should be made to the Proposal to ensure that ETFs are a viable option as a permitted investment for all FCMs and DCOs.

First, requiring permitted ETFs to invest 95% of their assets in only U.S. Treasuries with less than 1 year time to maturity is unnecessarily punitive. These ETFs are already subject to the SEC Names Rule which requires funds invest at least 80% their assets in investments consistent with their name. This rule also allows for additional investments, including repo collateralized in U.S. Treasuries, cash, and cash equivalents, including money market funds ("MMFs"). Therefore, the Proposal should be amended by lowering the investment threshold from 95% to 80% and allowing for the investment in U.S. Treasuries, cash, repo collateralized in U.S. Treasuries, and U.S. Treasury MMFs, which would better align with current market conventions.

An FCM or DCO that invests customer funds in the shares of an eligible ETF should not need to be an authorized participant themselves, as is contemplated in the Proposal. Notably, it is not common practice for FCMs and DCOs to be an authorized participant, thus, this condition would prohibit them from investing in ETFs. As described below, maintaining status as an authorized participant is merely one of multiple ways in which an FCM or DCO can effectively manage its investment in ETFs. Namely, an FCM or DCO can invest in or liquidate ETFs either by way of 1) issuance or redemption of ETF shares in the primary market through an authorized participant as proposed or 2) purchase or sale in the secondary market, which is efficient and timely enough as described below. Thus, an FCM or DCO should not be restricted only to redemptions of ETFs in the capacity of an authorized participant, which is unrealistic to DCOs and unreasonably inflexible when FCMs consider reinvestment. Instead, the CFTC should amend the Proposal to state that FCMs and DCOs investing in these ETFs are required to follow the established rules and regulations regarding maintenance of customer funds.

Additionally, the secondary market for these ETFs has grown substantially over the past several years. With increased trading volumes, there is ample liquidity to allow FCMs and DCOs to buy and sell shares of eligible ETFs with minimal price impact on the secondary market. Furthermore, T+1 short settlement, which is conducted using DVP on the secondary market, is available. This aligns with the T+1 primary market settlement requirement and standard settlement for U.S. Treasuries.

Finally, the requirement that eligible ETFs must be acceptable collateral by a DCO as margin is unprecedented and could cause confusion. DCOs and FCMs have their own risk management policies in consideration of their specific risk management needs and roles for determining appropriate investments and those policies also differ institution to institution. Additionally, DCOs, which include foreign CCPs, are subject to different regulatory requirements for collateral acceptability for margin as compared to the regulations for permitted investments, such as CFTC regulation 39.33(c)(3), which further suggests there should not be a linkage between FCM investments and DCO collateral acceptability.

Conclusion

CCP Global's proposed changes herein would result in requirements for permitted investments that are a clear and reasonable set of eligibility criteria that offers sufficient protections, limited risk, and appropriate flexibility.

About CCP Global

CCP Global is the international association for CCPs, representing 41 members who operate over 60 individual central counterparties (CCPs) across the Americas, EMEA, and the Asia-Pacific region.

CCP Global promotes effective, practical, and appropriate risk management and operational standards for CCPs to ensure the safety and efficiency of the financial markets it represents. CCP Global leads and assesses global regulatory and industry initiatives that concern CCPs to form consensus views, while also actively engaging with regulatory agencies and industry constituents through consultation responses, forum discussions, and position papers.

For more information, please contact the office by e-mail at office@ccp-global.org or through our website by visiting www.ccp-global.org.

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