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CFTC Adopts Final Rule on Investment of Customer Funds

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The Commodity Futures Trading Commission has adopted amendments to CFTC Rules 1.25 and 30.7 that would narrow the scope of permissible investments for customer funds held by futures commission merchants (FCMs) and derivatives clearing organizations (DCOs) in the customer segregated account maintained under section 4d(a)(2) of the Commodity Exchange Act or the foreign futures and foreign options secured amount account maintained in accordance with CFTC Rule 30.7. Among the key investment categories that will no longer be permitted under the amended rule are (i) foreign sovereign debt obligations, (ii) commercial paper and corporate notes or bonds (other than certain instruments that are fully guaranteed by the U.S. government pursuant to the Temporary Liquidity Guarantee Program (TLGP)), and (iii) inter-affiliate resale and repurchase transactions and certain internal transactions (i.e., "internal repos").

The prohibition on internal transactions does not affect all such transactions. The CFTC confirms in the Federal Register release that an FCM that is also registered as a broker-dealer may purchase permitted securities from its securities arm. Such transactions "are acceptable and are unaffected by elimination of in-house transactions." Moreover, a dually-registered FCM/broker-dealer receiving collateral from a customer that is not an acceptable margin deposit at a DCO or foreign board of trade may exchange that collateral for acceptable collateral held by the FCM/broker-dealer to the extent necessary to meet margin requirements.

Under the revised rules (and subject to the concentration limits set out therein, as further described below), FCMs and DCOs may continue to invest customer funds and Part 30 "secured amount funds" in (i) U.S. government securities, (ii) state and municipal securities, (iii) obligations of any U.S. government corporation or enterprise sponsored by the U.S. government (including debt issued by Fannie Mae and/or Freddie Mac, but only so long as the applicable entity is operating under the conservatorship or receivership of the Federal Housing Finance Authority with capital support from the U.S.), (iv) certificates of deposit, (v) commercial paper and corporate notes or bonds fully guaranteed as to principal and interest by the U.S. under the TLGP,

and (vi) interests in money market mutual funds (MMMFs), as well as (vii) purchase and repurchase transactions with non-affiliated banks, broker-dealers, or government securities brokers or dealers that involve assets of the type described in (i) through (vi) above.

The amended rules also revise both certain issuer- and asset-based concentration limits on certain of the permitted instruments described above, as well as counterparty concentration limits for reverse repurchase transactions. These include asset-based concentration limits (as a percentage of the total assets held in segregation by the FCM or DCO) of:

- 50% for U.S. agency obligations;
- 25% each for (i) commercial paper, (ii) permitted corporate notes and bonds and (iii) certificates of deposit; and
- 10% for state and municipal securities.

With respect to MMMFs, (A) investments in MMMFs that have less than $1 billion in assets and/or which are managed by a management company with less than $25 billion in MMMF assets under management are subject to a 10% asset-based concentration limit, and (B) aggregate investments in all MMMFs in excess of these standards are subject to an asset-based concentration limit of 50%. MMMFs that invest exclusively in U.S. government securities, however, are not subject to a concentration limit.

The amended rule also imposes issuer-based concentration limits on MMMF investments of 25% in a single family of MMMFs and 10% in an individual MMMF (again excluding MMMFs that invest exclusively in U.S. government securities, which are not subject to these concentration limits and are excluded for purposes of calculating these limits). Finally, reverse repurchase transactions (i.e., transactions where the FCM or DCO purchases securities, subject to an agreement to resell) with a single counterparty cannot exceed 25% of the FCM or DCO's total assets held in segregation.

The final rules become effective 60 days after publication in the Federal Register. FCMs and DCOs will have 180 days after the effective date to come into compliance, however. A copy of the final rules is available here.

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