

December 2, 2010

VIA ELECTRONIC MAIL

David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions – 75 Fed. Reg. 67642 (Nov. 3, 2010), RIN 3038-AC15

Dear Mr. Stawick:

CME Group Inc. (“CME Group”) appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (“CFTC” or the “Commission”) notice of proposed rulemaking (“NPR”) concerning amendments to Regulation 1.25 regarding the investment of customer segregated funds by futures commission merchants (“FCMs”) and derivative clearing organizations (“DCOs”), and the investment of customer secured funds held in accounts subject to Regulation 30.7. CME Group is the parent of Chicago Mercantile Exchange Inc. (“CME”). CME’s clearing house division (“CME Clearing”) offers clearing and settlement services for exchange-traded contracts, as well as over-the-counter derivatives transactions through CME ClearPort. CME is registered with the CFTC as a DCO, and is one of the largest central counterparty clearing services in the world. As of September 30, 2010, customer-segregated assets on deposit at CME Clearing were in excess of \$57 billion. In light of CME Clearing’s significant role in providing clearing and settlement services for exchange-traded and OTC derivatives and collateral management services for customer funds, CME Group is particularly well-positioned to comment on certain aspects of the CFTC’s rulemaking proposal.

A. Background

As a DCO, CME’s primary concern with respect to the investment of customer collateral is ensuring that collateral can be liquidated quickly and efficiently, without substantial loss of principal. We therefore appreciate and agree with the CFTC’s goals of preserving principal and maintaining liquidity of customer collateral, while also retaining an appropriate degree of investment flexibility and opportunities for FCMs and DCOs to attain capital efficiency.

Recent events in the financial markets, to which the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) is intended to respond, have underscored the need to carefully evaluate the investment of collateral along multiple dimensions. Dodd-Frank’s drive to bring additional clearing services to the OTC marketplace will have impacts of unprecedented scale and scope. For

example, if successful, clearing of OTC derivatives will very substantially increase the amount of customer funds on deposit with FCMs and DCOs.¹ In this burgeoning market environment, it is critical to recognize that successful management of systemic risk will require a broad group of FCMs with the requisite capital resources, skill sets and incentives to provide intermediation services. To achieve these goals, we must have a regulatory system that incorporates appropriate measures to protect the safety of customer funds *and* enables FCMs to earn sufficient returns for the regulatory capital they put at risk by guaranteeing customers' cleared transactions. As further explained below, CME Group believes that this can be best accomplished by: (a) retaining certain forms of permitted investments for customer funds that the current proposal would eliminate; (b) increasing the proposed asset-based concentration limit for money market mutual funds to 50 percent and the proposed issuer-based concentration limit for a family of money market mutual funds to 10 percent.

B. Proposal to Eliminate Certain Permitted Investments

The proposed revisions to Regulation 1.25 would remove a number of currently permitted investments for customer funds.² If the proposal is adopted, the array of permitted investments would no longer include:

- U.S. agency obligations, except those that are fully guaranteed as to principal and interest by the U.S.
- Commercial paper and corporate notes or bonds, with the sole exception of those that are federally guaranteed as to principal and interest under the Temporary Liquidity Guarantee Program ("TLGP"), and that meet certain other prudential standards
- Foreign sovereign debt
- Repurchase and reverse repurchase transactions with affiliate counterparties and in-house transactions

¹ In conjunction with the CFTC's recent amendments to its Part 190 bankruptcy rules creating a new account class for cleared OTC derivatives, CME put into effect its rules setting forth the pre-bankruptcy, substantive requirements for funds of cleared OTC derivatives customers (known as customer *sequestered* funds). Those CME rules generally mirror CFTC regulations for customer segregated funds, and incorporate by reference the terms and conditions of Regulation 1.25. However, in these early stages in the development of collateral management service offerings for the cleared OTC market, CME contemplates the potential for differentiation of collateral standards for firms with the requisite capital and expertise to make broader use of investment offerings, likely in conjunction with prudential capital, haircut, and concentration limits. In the near term, though, CME contemplates that any amendments to Regulation 1.25 will apply under CME rules to investments of customer sequestered funds. We anticipate that the CFTC's forthcoming regulations for customer sequestered funds will adopt a similar approach, particularly in light of the current proposal to harmonize the investment limitations of Regulation 1.25 with those of Regulation 30.7. Additionally, the CFTC recently announced that its proposed rule on protection of collateral of counterparties to uncleared swaps would extend the reach of Regulation 1.25 to segregated initial margin posted in connection with uncleared swaps.

² The CFTC previously issued several interpretive letters regarding customer funds deposited in trust accounts, including but not limited to CME's IEF5 Program (an account at a CME-approved bank that pays a monthly "hard dollar" benefit for member firm cash on the books of that bank's trust ledger). As noted in one such letter, the CFTC "does not need to address the issue of whether the use of such Trust Account constitutes a 'permitted investment' of customer funds under 1.25 since the funds are on deposit in an enumerated good location for purposes of CFTC Rule 1.20, that is, a bank or trust company." (Interpretive Letter No. 03-31.)

With respect to U.S. agency obligations, CME Group supports the CFTC's proposed treatment of fully-guaranteed U.S. agency obligations as deserving of the higher concentration limit referenced below, but we do not agree with the proposal to eliminate all other forms of agency obligations as permitted investments. Rather, CME Group believes that highly liquid U.S. agency obligations, including but not limited to notes issued by the Federal National Mortgage Association ("FNMA") and the Federal Home Loan Mortgage Corporation ("FHLMC"), should remain available as permitted investments. While FNMA and FHLMC do not bear the explicit guarantee of the U.S. government, they remain sound and reliably liquid investment vehicles and generally are more liquid and subject to less principal risk than securities issued by state and municipal governments. We therefore recommend that such non-guaranteed U.S. agency obligations remain as permitted investments, subject to an asset-based concentration limit of 25 percent.

CME Group further suggests that the CFTC retain foreign sovereign debt as a permitted investment category. Our views on this issue are aligned with those expressed in the comment letter submitted by the Futures Industry Association (the "FIA Letter"). As noted in the FIA Letter: (a) current Regulation 1.25(b)(4)(D) limits an FCM's and DCO's ability to invest in the sovereign debt of a foreign country to the extent the FCM or DCO has balances in segregated accounts owed to its customers or clearing members in that country's currency; and (b) FCM and DCO investments in foreign sovereign debt would be limited to those instruments that satisfy the "highly liquid" marketability standard described below. Furthermore, we anticipate that implementation of the Dodd-Frank Act will result in an increased volume of customer funds held by FCMs and an increased number of foreign customers and foreign-domiciled clearing members. We urge the Commission to recognize that the growth of OTC clearing will place an increasing importance on the ability for FCMs and DCOs to use foreign sovereign debt as a means to hedge against the risk of holding the underlying foreign currency.

Finally, with respect to repurchase (or repo) and reverse repo transactions with affiliates and in-house transactions, CME Group concurs with the reasoning in the FIA Letter and the FIA's conclusions that FCMs should continue to be allowed to enter into such transactions as permitted investments under Regulation 1.25. We further agree with the FIA that the proposed counterparty concentration limit of 5 percent of total assets held in segregation for securities subject to reverse repo agreements is unduly restrictive.

C. Money Market Mutual Funds

The NPR raises a host of important issues regarding money market mutual funds ("MMMFs") as permissible investments for customer funds. MMMFs were added to the list of permitted investments under Regulation 1.25 in December 2000. CME Clearing allows certain MMMFs for use as performance bond collateral through its Interest Earning Facility 2 Program (the "IEF2 Program"), which was introduced in 2001. Since their addition to Regulation 1.25 nearly 10 years ago, MMMFs have become a critically important component of the array of permissible investments for customer funds. As the attached chart illustrates, the percentage of customer funds at CME Clearing in the IEF2 Program from July 16, 2001 to October 15, 2010 ranged from a high of 49 percent in March 2003, to lows (following inception of the

Program) of 13 percent in May and November of 2006. The average percentage of customer funds at CME Clearing in the IEF2 Program throughout this period is approximately 28 percent.³

1. *MMMFs as Permissible Investments*

The Commission seeks comment on the concept of eliminating MMMFs as permitted investments, or limiting such permitted investments to Treasury MMMFs or those MMMFs that have portfolios consisting solely of permitted investments under Regulation 1.25. CME Group strongly supports the continued inclusion of all classes of Securities and Exchange Commission (“SEC”) Rule 2a-7 MMMFs as permitted investments for customer funds.

We understand the serious concerns that arose regarding MMMFs after the Reserve Primary Fund “broke the buck” in September 2008. We also understand that, in response to those concerns, the SEC adopted significant amendments to SEC Rule 2a-7, which greatly enhanced the safety and transparency of MMMFs. Rule 2a-7 now includes liquidity provisions that require each MMMF to hold securities that are sufficiently liquid to meet reasonably foreseeable shareholder redemptions, and requires a taxable MMMF to hold at least 10 percent of its total assets in daily liquid assets and at least 30 percent of its total assets in weekly liquid assets. MMMFs also must adopt procedures for monthly stress testing of their ability to maintain a stable net asset value in the event of interest-rate or spread changes, credit changes and shareholder redemptions.

Additionally, Rule 2a-7 now contains: (a) a reduced weighted average maturity for MMMFs of 60 days (decreased from 90 days); and (b) a new “weighted average life” metric of 120 days, which governs the weighted average maturity of a MMMF’s portfolio without regard to interest rate reset dates. The revised Rule further restricts MMMF investments in second-tier securities to no more than 3 percent of total assets and no more than one half of one percent of the entire portfolio in any single issuer, and limits MMMF investments in second-tier securities to those with a final maturity of less than 45 days.

Furthermore, amended Rule 2a-7 subjects MMMFs to new requirements regarding the quality of collateral and the credit-worthiness of repo counterparties. Previously, the Rule only required repo collateral to be “highly rated” and had no express standards with respect to repo counterparties. Under revised Rule 2a-7, in order for money managers to “look through” to repo collateral, the collateral must be cash or government securities and they must be able to determine that the repo counterparty is creditworthy.

In addition to decreasing various forms of risk to which MMMFs are exposed, revised Rule 2a-7 increases transparency into MMMF investments and holdings. MMMFs must disclose information about their portfolio holdings each month on their websites so that customers can monitor their investments. Further, MMMFs must provide the SEC with a monthly electronic filing of more detailed portfolio holdings

³ The percentages described for MMMF investments in CME’s IEF2 Program are based on figures determined as of the fifteenth day of each month, with the 28 percent average calculated as an average of all such mid-month figures across the relevant period.

information, which is made available to the public on a delayed basis. These disclosure requirements provide a level of transparency that did not exist during or prior to the market events of 2008.

Particularly in light of the SEC's commendable revisions to Rule 2a-7, MMMFs are a highly safe, stable and liquid investment vehicle. Throughout 2009 and 2010, MMMFs have been utilized for the investment of approximately 20 to 30 percent of customer funds held at CME, without incident. MMMFs also can provide FCMs with greater flexibility in managing fluctuations in customer fund balances and enhance the overall yield available to FCMs and their customers on the capital they must post as collateral. CME Group strongly urges the CFTC to maintain Rule 2a-7 MMMFs as permitted investments. Risks associated with the investment of customer funds in MMMFs are more appropriately addressed by the CFTC through concentration limits (as discussed below) rather than through overly restrictive constraints on investment choices and diversification options at a point when the amount of customer funds deposited with FCMs and DCOs is likely to substantially increase.

2. Asset-Based and Issuer-Based Concentration Limits

Proposed amendments to Regulation 1.25(b) would add certain asset-based concentration limits for permitted investments, including but not limited to MMMFs. The proposed asset-based limits are intended to correlate to each permitted investment's "level of risk and liquidity relative to other permitted investments."⁴ In that regard, the Commission proposes to adopt the following asset-based concentration limits:

- None (100 percent) for U.S. government securities
- 50 percent for U.S. agency obligations fully guaranteed as to principal and interest by U.S.
- 25 percent for TLGP guaranteed commercial paper and corporate notes or bonds
- 25 percent for non-negotiable CDs
- 10 percent for municipal securities
- 10 percent for interests in MMMFs

CME Group supports the use of appropriate asset-based concentration limits, and believes that the same asset-based limits should apply to FCMs and DCOs. As noted in the NPR, concentration limits "could increase the safety of customer funds by promoting diversification."⁵ Indeed, an important lesson learned in recent years is that risk reduction achieved through diversification of investments is an important goal, particularly in uncertain and volatile times. We are concerned, however, that the proposed asset-based concentration limits – when combined with other provisions in Regulation 1.25 – will have the unintended effect of over-concentrating the investment of customer funds by FCMs and DCOs in a small number of instruments.

⁴ 75 Fed. Reg. 67642, 67648.

⁵ *Id.*

If the proposed amendments were adopted, Regulation 1.25 would, in theory, permit over 50 percent of a customer-funds portfolio to be invested in TGLP securities, municipal securities and non-negotiable CDs. In practice, however, FCMs' use of these investment categories is limited. TGLP securities are associated with a temporary federal program (and liquidity for TGLP securities is limited relative to other permitted categories). Many municipal securities fail to meet the "highly liquid" standard in the revised regulation and, thus, would not qualify as permitted investments.⁶ Non-negotiable CDs cannot be pledged in repo or reverse repo agreements and, consequently, are little used by FCMs for investment of customer funds. Furthermore, Regulation 1.25's mandate that the portfolio (excluding MMMF investments) bear a weighted-average time-to-maturity of 2 years or less, combined with the other proposed limitations, may drive FCMs to concentrate a large portion of customer collateral in government securities that mature in less than 2 years.

While the supply of Treasuries is plentiful, an over-concentration in Treasuries as Regulation 1.25 investments may be deleterious to customers due to the increased costs associated with Treasury security transactions. The structure of MMMFs, on the other hand, enables investments to be converted to cash, at par, on a quick intraday basis, without penalties or material transaction costs. The relatively "frictionless" liquidation of MMMF investments generally makes them preferable to Treasuries and other investment options for FCMs to manage periodic fluctuations in customer fund balances. For this reason – and in order to promote diversification of investments not only in theory but in practice – CME Group urges the CFTC to adopt an asset-based concentration limit for MMMFs of 50 percent.

In considering the proposed asset-based concentration limits, we have analyzed IEF2 Program data and assessed the benefits and uses of MMMFs as compared to other investment options. We have observed that the diverse investments held by MMMFs make them a particularly attractive investment vehicle in a declining interest rate environment. The 28 percent average investment level in the IEF2 Program over the past 9 years may understate the optimal investment level in MMMFs in certain interest rate environments.

Moreover, in light of recent revisions to SEC Rule 2a-7, MMMFs are a highly safe, stable and liquid investment vehicle. MMMFs have remained substantially more liquid and less subject to a risk of principal loss than municipal securities (the other investment category to which the proposed rule assigns a 10 percent asset-based concentration limit), and are more liquid than TGLP securities and non-negotiable CDs (the other investment categories to which the proposed rule assigns a 25 percent asset-based concentration limit). To align with our suggested asset-based concentration limit of 50 percent for MMMFs, we recommend that the CFTC adopt an issuer-based concentration limit for an MMMF family of funds of 10 percent.

⁶ Limited liquidity and price volatility in the markets for many municipal securities will mean that these securities cannot reliably be redeemed within 1 business day without a material discount in value.

3. *Acknowledgement Letters*

With respect to MMMFs, revised Regulation 1.25(c)(3) would require an FCM or DCO to obtain the acknowledgment letter required by Regulation 1.26 from an entity that has substantial control over the fund's assets and has the knowledge and authority to facilitate redemption and payment or transfer of the customer funds. The proposed language specifies that such an entity may include the fund sponsor or investment adviser. Furthermore, the revised Regulation would not contain the current language relating to the issuer of the acknowledgment letter when the shares of the fund are held by the fund's shareholder servicing agent. This revision is designed to eliminate any confusion as to whether the acknowledgment letter requirement is applied differently based on the presence or absence of a shareholder servicing agent. CME Group believes these amendments are appropriate and serve the intended purpose of clarifying the intent of Regulation 1.25(c)(3).

D. Marketability: "Highly Liquid" Standard

Regulation 1.25(b)(1) currently provides that, with the exception of MMMFs, "investments must be 'readily marketable' as defined in Sec. 240.15c3-1 of this title." The current proposal would replace the "readily marketable" requirement with a "highly liquid" standard, a term which would be defined as having the ability to be converted into cash within one business day, without a material discount in value. The Commission seeks comment on "whether the term 'material' might be replaced with a more precise or, perhaps, even calculable standard."⁷ As a potential alternative, the NPR contemplates a definition of "highly liquid" that would require the instrument to have the ability, under stable financial conditions, to be converted into cash within one business day, without greater than a one percent haircut off of its book value.⁸ We believe that the Commission should maintain the current proposed definition of "highly liquid" rather than adopting a more prescriptive or calculable approach. Under an overly prescriptive approach, such as the one-percent alternative set forth in the NPR, even certain Treasuries may fall outside the definition and, thus, not qualify as permitted investments for customer funds.

F. Implementation Period

An important issue not addressed in the NPR is the need for an implementation period for FCMs and DCOs to come into compliance with amended Regulations 1.25 and 30.7, following the effective date of the amendments. CME Group suggests an implementation period of 180 days. In order to avoid undue market disruption, we encourage the Commission to adopt a system of phased implementation over the 180-day period.

⁷ 75 Fed. Reg. at 67647.

⁸ *Id.*

David Stawick
December 2, 2010
Page 8

CME Group thanks the Commission for the opportunity to comment on this matter. We would be happy to discuss any of these issues with Commission staff. If you have any comments or questions, please feel free to contact me at (312) 930-8275 or Craig.Donohue@cmegroup.com; or Lisa Dunsky, Director and Associate General Counsel, at (312) 338-2483 or Lisa.Dunsky@cmegroup.com.

Sincerely,



Craig S. Donohue

cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Bart Chilton
Commissioner Jill Sommers
Commissioner Scott O'Malia
Phyllis Dietz
Jon Debord

Enclosure