valid OMB Control Number. The OMB Control Number for this information collection is 2120–0056. Public reporting for this collection of information is estimated to be approximately 5 minutes per response, including the time for reviewing instructions, completing and reviewing the collection of information. All responses to this collection of information are mandatory. Comments concerning the accuracy of this burden and suggestions for reducing the burden should be directed to the FAA at: 800 Independence Ave., SW., Washington, DC 20591, Attn: Information Collection Clearance Officer, AES–200.

Related Information

(h) Refer to Piaggio Aero Industries S.p.A. Service Bulletin (Mandatory) N.: SB 80–0275, Rev. N. 0, dated June 15, 2009, and Piaggio Aero Industries P180–Service Letter No. SL–80–0202, dated January 30, 2009, for related information. For service information related to this AD, contact Piaggio Aero Industries S.p.A., Via Cibrario, 4–16154 Genoa, Italy; phone: +39 010 6481 353; fax: +39 010 6481 881; email: *airworthiness@piaggioaero.it;* Internet: *http://www.piaggioaero.com.* You may review copies of the referenced service information at the FAA, Small Airplane Directorate, 901 Locust, Kansas City, Missouri 64106. For information on the availability of this material at the FAA, call 816–329–4148.

Issued in Kansas City, Missouri, on October 28, 2010.

John Colomy,

Acting Manager, Small Airplane Directorate, Aircraft Certification Service.

[FR Doc. 2010–27723 Filed 11–2–10; 8:45 am]

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1 and 30

RIN 3038–AC15

Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed rule.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is proposing to amend its regulations regarding the investment of customer segregated funds and funds held in an account subject to Commission Regulation 30.7 (30.7 funds). Certain amendments reflect the implementation of new statutory provisions enacted under Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposed rules address: Certain changes to the list of permitted investments, a clarification of the liquidity requirement, the removal of rating requirements, an expansion of concentration limits including asset-based, issuer-based, and counterparty concentration restrictions. It also addresses revisions to the acknowledgment letter requirement for investment in a money market mutual fund (MMMF), revisions to the list of exceptions to the next-day redemption requirement for MMMFs, the application of customer segregated funds investment limitations to 30.7 funds, the removal of ratings requirements for depositories of 30.7 funds, and the elimination of the option to designate a depository for 30.7 funds.

DATES: Comments must be received on or before December 3, 2010.

ADDRESSES: You may submit comments, identified by RIN number, by any of the following methods:

- *Agency Web site, via its Comments Online process: http://comments.cftc.gov.* Follow the instructions for submitting comments through the Web site.
- *Mail:* David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.
- *Hand Delivery/Courier:* Same as mail above.
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *http://www.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that may be exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the established procedures in CFTC Regulation 145.9.[1]

FOR FURTHER INFORMATION CONTACT: Phyllis P. Dietz, Associate Director, 202–418–5449, *pdietz@cftc.gov,* or Jon DeBord, Attorney-Advisor, 202–418–5478, *jdebord@cftc.gov,* or Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1151 21st Street, NW., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Background
A. Regulation 1.25
B. Regulation 30.7
C. Advance Notice of Proposed Rulemaking
D. The Dodd-Frank Act
II. Discussion of the Proposed Rules
A. Permitted Investments
1. Government Sponsored Enterprise Securities
2. Commercial Paper and Corporate Notes or Bonds
3. Foreign Sovereign Debt
4. In-House Transactions
B. General Terms and Conditions
1. Marketability
2. Ratings
3. Restrictions on Instrument Features
4. Concentration Limits
(a) Asset-Based Concentration Limits
(b) Issuer-Based Concentration Limits
(c) Counterparty Concentration Limits
C. Money Market Mutual Funds
1. Acknowledgment Letters
2. Next-Day Redemption Requirement
D. Repurchase and Reverse Repurchase Agreements
E. Regulation 30.7
1. Harmonization
2. Ratings
3. Designation as a Depository for 30.7 Funds
III. Related Matters
A. Regulatory Flexibility Act
B. Paperwork Reduction Act
C. Costs and Benefits of the Proposed Rules
Text of Rules

I. Background

A. Regulation 1.25

Under Section 4d(a)(2) of the Commodity Exchange Act (Act),[2] the investment of customer segregated funds is limited to obligations of the United States and obligations fully guaranteed as to principal and interest by the United States (U.S. government securities), and general obligations of any State or of any political subdivision thereof (municipal securities). Pursuant to authority under Section 4(c) of the Act,[3] the Commission substantially expanded the list of permitted investments by amending Commission Regulation 1.25[4] in December 2000 to permit investments in general obligations issued by any enterprise sponsored by the United States (government sponsored enterprise securities or GSE securities), bank certificates of deposit (CDs), commercial paper, corporate notes,[5] general obligations of a sovereign nation, and interests in MMMFs.[6] In connection

[1] Commission regulations referred to herein are found at 17 CFR Ch. 1.

[2] 7 U.S.C. 6d(a)(2).

[3] 7 U.S.C. 6(c).

[4] 17 CFR 1.25.

[5] This category of permitted investment was later amended to read "corporate notes or bonds." *See* 70 FR 28190, 28197 (May 17, 2005).

[6] *See* 65 FR 77993 (Dec. 13, 2000) (publishing final rules); and 65 FR 82270 (Dec. 28, 2000) (making technical corrections and accelerating

with that expansion, the Commission included several provisions intended to control exposure to credit, liquidity, and market risks associated with the additional investments, *e.g.,* requirements that the investments satisfy specified rating standards and concentration limits, and be readily marketable and subject to prompt liquidation.[7]

The Commission further modified Regulation 1.25 in 2004 and 2005. In February 2004, the Commission adopted amendments regarding repurchase agreements using customer-deposited securities and time-to-maturity requirements for securities deposited in connection with certain collateral management programs of derivatives clearing organizations (DCOs).[8] In May 2005, the Commission adopted amendments related to standards for investing in instruments with embedded derivatives, requirements for adjustable rate securities, concentration limits on reverse repurchase agreements, transactions by futures commission merchants (FCMs) that are also registered as securities brokers or dealers (in-house transactions), rating standards and registration requirements for MMMFs, an auditability standard for investment records, and certain technical changes.[9]

The Commission has been, and continues to be, mindful that customer segregated funds must be invested in a manner that minimizes their exposure to credit, liquidity, and market risks both to preserve their availability to customers and DCOs and to enable investments to be quickly converted to cash at a predictable value in order to avoid systemic risk. Toward these ends, Regulation 1.25 establishes a general prudential standard by requiring that all permitted investments be "consistent with the objectives of preserving principal and maintaining liquidity." [10]

In 2007, the Commission's Division of Clearing and Intermediary Oversight (Division) launched a review of the nature and extent of investments of customer segregated funds and 30.7 funds (2007 Review) in order to further its understanding of investment strategies and practices and to assess whether any changes to the Commission's regulations would be appropriate. As part of this review, all registered DCOs and FCMs carrying customer accounts provided responses to a series of questions. As the Division was conducting follow-up interviews with respondents, the market events of September 2008 occurred and changed the financial landscape such that much of the data previously gathered no longer reflected current market conditions. However, much of that data remains useful as an indication of how Regulation 1.25 was implemented in a more stable financial environment, and recent events in the economy have underscored the importance of conducting periodic reassessments and, as necessary, revising regulatory policies to strengthen safeguards designed to minimize risk.

B. Regulation 30.7

Regulation 30.7 [11] governs an FCM's treatment of customer money, securities, and property associated with positions in foreign futures and foreign options. Regulation 30.7 was issued pursuant to the Commission's plenary authority under Section 4(b) of the Act.[12] Because Congress did not expressly apply the limitations of Section 4d of the Act to 30.7 funds, the Commission historically has not subjected those funds to the investment limitations applicable to customer segregated funds.

The investment guidelines for 30.7 funds are general in nature.[13] Although Regulation 1.25 investments offer a safe harbor, the Commission does not currently limit investments of 30.7 funds to permitted investments under Regulation 1.25. Appropriate depositories for 30.7 funds currently include certain financial institutions in the United States, financial institutions in a foreign jurisdiction meeting certain capital and credit rating requirements, and any institution not otherwise meeting the foregoing criteria, but which is designated as a depository upon the request of a customer and the approval of the Commission.

C. Advance Notice of Proposed Rulemaking

In May 2009, the Commission issued an advance notice of proposed rulemaking (ANPR) [14] to solicit public comment prior to proposing amendments to Regulations 1.25 and 30.7. The Commission stated that it was considering significantly revising the scope and character of permitted investments for customer segregated funds and 30.7 funds. In this regard, the Commission sought comments, information, research, and data regarding regulatory requirements that might better safeguard customer segregated funds. It also sought comments, information, research, and data regarding the impact of applying the requirements of Regulation 1.25 to investments of 30.7 funds.

The Commission received twelve comment letters in response to the ANPR, and it has considered those comments in formulating its proposal.[15] Eleven of the 12 letters supported maintaining the current list of permitted investments and/or specifically ensuring that MMMFs remain a permitted investment. Five of the letters were dedicated solely to the topic of MMMFs, providing detailed discussions of their usefulness to FCMs. Several letters addressed issues regarding ratings, liquidity, concentration, and portfolio weighted average time to maturity. The alignment of Regulation 30.7 with Regulation 1.25 was viewed as non-controversial.

The FIA's comment letter expressed its view that "all of the permitted investments described in Rule 1.25(a) are compatible with the Commission's objectives of preserving principal and maintaining liquidity." This opinion was echoed by MF Global, Newedge and FC Stone. CME asserted that only "a small subset of the complete list of Regulation 1.25 permitted investments are actually used by the industry. * * *" NFA also wrote that investments in instruments other than U.S. government securities and MMMFs are "negligible" and recommended that the Commission eliminate asset classes not "utilized to any material extent."

D. The Dodd-Frank Act

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[16] Title IX of the

effective date of final rules from February 12, 2001 to December 28, 2000).

[7] *Id.*

[8] 69 FR 6140 (Feb. 10, 2004).

[9] 70 FR 28190.

[10] 17 CFR 1.25(b).

[11] 17 CFR 30.7.

[12] 7 U.S.C. 6(b).

[13] *See* Commission Form 1–FR–FCM Instructions at 12–9 (Mar. 2010) ("In investing funds required to be maintained in separate section 30.7 account(s), FCMs are bound by their fiduciary obligations to customers and the requirement that the secured amount required to be set aside be at all times liquid and sufficient to cover all obligations to such customers. Regulation 1.25 investments would be appropriate, as would investments in any other readily marketable securities.").

[14] 74 FR 23962 (May 22, 2009).

[15] The Commission received comment letters from CME Group Inc. (CME), Crane Data LLC (Crane), The Dreyfus Corporation (Dreyfus), FCStone Group Inc. (FCStone), Federated Investors, Inc. (Federated), Futures Industry Association (FIA), Investment Company Institute (ICI), MF Global Inc. (MF Global), National Futures Association (NFA), Newedge USA, LLC (Newedge), and Treasury Strategies, Inc. (TSI). Two letters were received from Federated: A July 10, 2009 letter (Federated letter I) and an August 24, 2009 letter.

[16] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act

Continued

Dodd-Frank Act[17] was promulgated in order to increase investor protection, promote transparency and improve disclosure.

Section 939A of the Dodd-Frank Act obligates federal agencies to review their respective regulations and make appropriate amendments in order to decrease reliance on credit ratings. The Dodd-Frank Act requires the Commission to conduct this review within one year after the date of enactment.[18] The Commission is proposing amendments to Regulations 1.25 and 30.7 that include removal of provisions setting forth credit rating requirements. Separate rulemakings proposed today address the elimination of credit ratings from Regulations 1.49 and 4.24 and the removal of Appendix A to Part 40 (which contains a reference to credit ratings).

The Commission is now proposing amendments to Regulations 1.25 and 30.7 and requests comment on all aspects of the proposed rules, as well as comment on the specific provisions and issues highlighted in the discussion below. In addition, commenters are welcome to offer their views regarding any other related matters that are raised by the proposed amendments.

II. Discussion of the Proposed Rules

A. Permitted Investments

In proposing amendments to Regulation 1.25, the Commission seeks to simplify the regulation and impose requirements that can better ensure the preservation of principal and maintenance of liquidity. The Commission has endeavored to tailor its proposal to achieve these goals while retaining an appropriate degree of investment flexibility and opportunities for attaining capital efficiency for DCOs and FCMs investing customer segregated funds.

The Commission seeks to simplify Regulation 1.25 by narrowing the scope of investment choices in order to eliminate the potential use of instruments that may pose an unacceptable level of risk. In their July 2009 comment letters, both NFA and CME suggested contracting the scope of permitted investments by eliminating asset classes used negligibly as investment vehicles.

The Commission seeks to increase the safety of Regulation 1.25 investments by promoting diversification. For example, issuer-specific concentration limits control how much exposure an FCM or DCO has to the credit risk of any one investment. The Commission believes that greater diversification can be achieved through instituting two additional types of concentration limits. First, asset-based concentration limits, suggested by the FIA, MF Global and Newedge in their comment letters, reduce market risk by limiting how much of any one class of instrument an FCM or DCO can have in its portfolio at any one time. Second, repurchase agreement counterparty concentration limits serve to cap an FCM or DCO's exposure to the credit risk of a counterparty.

Below, the Commission details its proposal to remove government sponsored enterprise (GSE) securities that are not backed by the full faith and credit of the United States, corporate debt obligations not guaranteed by the United States, general obligations of a sovereign nation (foreign sovereign debt), and in-house transactions from the list of permitted investments. These proposed changes reflect the position of the Commission that the safety of a particular instrument or transaction must be viewed through the lens of its likely performance during a period of market volatility and financial instability.

1. Government Sponsored Enterprise Securities

The Commission proposes to amend paragraph (a)(1)(iii) to expressly add U.S. government corporation obligations[19] to GSE securities (together, U.S. agency obligations) and to add the requirement that the U.S. agency obligations must be fully guaranteed as to principal and interest by the United States. GSEs are chartered by Congress but are privately owned and operated. Securities issued by GSEs do not have an explicit federal guarantee although they are considered by some to have an "implicit" guarantee due to their federal affiliation.[20] Obligations of U.S. government corporations, such as the Government National Mortgage Association (known as Ginnie Mae), are explicitly backed by the full faith and credit of the United States. Although the Commission is not aware of any GSE securities that have an explicit federal guarantee, it believes that GSE securities should remain on the list of permitted investments in the event this status changes in the future.

The failure of two GSEs during the financial crisis has moved the Commission to view the securities of such GSEs as inappropriate for investments of customer funds. In 2008, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) failed due to problems in the subprime mortgage market. While Fannie Mae and Freddie Mac were bailed out in 2008, the U.S. government had no obligation to do so and investors cannot rely on another bailout should a GSE fail in the future.

In consideration of the above, the Commission proposes to amend paragraph (a)(1)(iii) of Regulation 1.25 by permitting investments in only those U.S. agency obligations that are fully guaranteed as to principal and interest by the United States.[21] The Commission requests comment on whether GSE securities should remain as permitted investments under Regulation 1.25, either subject to a Federal guarantee requirement or not.

2. Commercial Paper and Corporate Notes or Bonds

In order to simplify the regulation by eliminating rarely-used instruments, and in light of the credit, liquidity, and market risks posed by corporate debt securities, the Commission proposes to limit investments in "commercial paper"[22] and "corporate notes or bonds"[23] to commercial paper and corporate notes or bonds that are federally guaranteed as to principal and interest under the Temporary Liquidity Guarantee Program (TLGP) and meet certain other prudential standards.[24]

may be accessed at *http://www.cftc.gov./LawRegulation/OTCDERIVATIVES/index.htm.*

[17] Pursuant to Section 901 of the Dodd-Frank Act, Title IX may be cited as the "Investor Protection and Securities Reform Act of 2010."

[18] *See* Section 939A(a) of the Dodd-Frank Act.

[19] *See* 31 U.S.C. 9101 (defining "government corporation").

[20] Frank J. Fabozzi with Steven V. Mann, The Handbook of Fixed Income Securities, 242–245 (McGraw Hill 7th ed. 2005).

[21] Although U.S. Government corporation obligations backed by the full faith and credit of the United States could also be categorized as U.S. Government securities under Regulation 1.25(a)(1)(i), the Commission is distinguishing them from other government securities, such as Treasury securities, because they cannot be expected to have the same liquidity even if they satisfy the "highly liquid" requirement under proposed. Regulation 1.25(b)(1). *See also* discussion of concentration limits in Section II.B.4. of this notice.

[22] Regulation 1.25(a)(1)(v).

[23] Regulation 1.25(a)(1)(vi).

[24] Commercial paper would remain available as a direct investment for MMMFs and corporate notes or bonds would remain available as indirect investments for MMMFs by means of a repurchase agreement. Additionally, it should be noted that two commenters suggested expanding the list of permitted investments to include commercial paper and corporate notes or bonds guaranteed by foreign sovereign governments. However, as the Commission has determined that foreign sovereign debt is itself unsuitable as a permitted investment, going forward (explained in more detail below), it follows that corporate debt guaranteed by a foreign sovereign government would also not be permissible.

Information obtained during the 2007 Review indicated that commercial paper and corporate notes or bonds were not widely used by FCMs or DCOs.[25] Consistent with this, the NFA states in its comment letter that most firms invest about 33 percent of their customer funds in government securities, 10 percent in MMMFs, and the balance maintained in bank accounts or on deposit with a carrying broker.

In the fall of 2008, the Federal Deposit Insurance Corporation (FDIC) created the TLGP, which guarantees principal and interest on certain types of corporate debt. Although the TLGP debt securities are backed by the full faith and credit of the U.S. Government and therefore pose minimal credit risk to the buyer for the period during which the guarantee is effective, initially there was concern as to whether the securities were readily marketable and sufficiently liquid so that the holders of such securities would be able to liquidate them quickly and easily without having to incur a substantial discount.

In February 2010, having evaluated the growing market for TLGP debt securities, the Division issued an interpretative letter concluding that TLGP debt securities are sufficiently liquid, and might therefore qualify as permitted investments under Regulation 1.25 if they meet the following criteria in addition to satisfying the pre-existing requirements imposed by Regulation 1.25: (1) The size of the issuance is greater than $1 billion; (2) the debt security is denominated in U.S. dollars; and (3) the debt security is guaranteed for its entire term.[26]

Although the TLGP expires in 2012, the Commission believes it is useful to include commercial paper and corporate notes or bonds that are fully guaranteed as to principal and interest by the United States as permitted investments because this would permit continuing investment in TLGP debt securities, even though the Commission has proposed to otherwise eliminate commercial paper and corporate notes or bonds. Therefore, the Commission proposes to limit the commercial paper and corporate notes or bonds that can qualify as permitted investments to only those guaranteed as to principal and interest under the TLGP and that meet the criteria set forth in the Division's interpretation. As a result of this limitation, paragraph (b)(3)(iv), which relates to adjustable rate securities, is no longer necessary.[27] The Commission proposes to delete current paragraph (b)(3)(iv) and replace it with language codifying the criteria for federally backed commercial paper and corporate notes or bonds. Accordingly, the Commission proposes to delete paragraph (b)(3)(i)(B) and amend paragraph (b)(3)(iii) to remove references to paragraph (b)(3)(iv). The Commission requests comment on the proscription of commercial paper and corporate notes or bonds that are not federally guaranteed under the TLGP, the liquidity of TLGP debt, and whether the removal of the requirements for adjustable rate securities will have any unintended or detrimental effects on Regulation 1.25 investments.

3. Foreign Sovereign Debt

The Commission proposes to remove foreign sovereign debt as a permitted investment in the interests of both simplifying the regulation and safeguarding customer funds. The 2007 Review revealed negligible investment in foreign sovereign debt[28] and that fact, in combination with recent events undermining confidence in the solvency of a number of foreign countries, supports the Commission's proposed action. Removal of foreign sovereign debt from the list of permitted investments is not expected to significantly impact FCM and DCO investment strategies for customer funds. The Commission notes that, aside from general appeals to maintain the current list of permitted investments, only one commenter specifically addressed foreign sovereign debt.[29]

Currently, an FCM or DCO can invest customer funds in foreign sovereign debt subject to two limitations: (1) The debt must be rated in the highest category by at least one nationally recognized statistical rating organization (NRSRO) and (2) the FCM or DCO may invest in such debt only to the extent it has balances in segregated accounts owed to its customers or its clearing member FCMs, respectively, denominated in that country's currency. The purpose of permitting investments in foreign sovereign debt is to facilitate investments of customer funds in the form of foreign currency without the need to convert that foreign currency to a U.S. dollar denominated asset, which would increase the FCM or DCO's exposure to currency risk. An investment in the sovereign debt of the same country that issues the foreign currency would limit the FCM or DCO's exposure to sovereign risk, *i.e.,* the risk of the sovereign's default.

Both the lack of investment in foreign sovereign debt and the recent global financial volatility have caused the Commission to reevaluate this provision. First, as noted above, it appears that foreign sovereign debt is rarely used as an investment tool by FCMs. Second, the financial crisis has highlighted the fact that certain countries' debt can exceed an acceptable level of risk.

In consideration of the above, the Commission proposes to remove foreign sovereign debt as a permitted investment under Regulation 1.25 and renumber paragraph (a)(1) accordingly. The Commission requests comment on whether foreign sovereign debt should remain, to any extent, as a permitted investment and, if so, what requirements or limitations might be imposed in order to minimize sovereign risk.

4. In-House Transactions

The Commission proposes to eliminate in-house transactions permitted under paragraph (a)(3) and subject to the requirements of paragraph (e) of Regulation 1.25. This proposal is consistent with the Commission's proposed prohibition on an FCM or DCO entering into a repurchase or reverse repurchase agreement with a counterparty that is an affiliate of the FCM or DCO.[30]

In 2005, two commenters recommended that the Commission permit FCMs that are dually registered as securities brokers or dealers to engage

[25] The 2007 Review indicated that out of 87 FCM respondents, only nine held commercial paper and seven held corporate notes/bonds as direct investments during the November 30, 2006–December 1, 2007 period. Further, 26 FCM respondents engaged in reverse repurchase agreements as of December 1, 2007 and none received commercial paper or corporate notes or bonds in those transactions.

[26] Letter from Ananda Radhakrishnan, Director, Division of Clearing and Intermediary Oversight, CFTC, to Debra Kokal, Chairman of the Joint Audit Committee (Jan. 15, 2010) (TLGP Letter).

[27] The original purpose of this paragraph was to set parameters for adjustable rate securities issued by corporations and, to a lesser extent, GSEs. As proposed, Regulation 1.25 would only permit corporate and GSE securities that had explicit U.S. Government guarantees. Therefore, the mechanics of an adjustable rate component for these instruments would no longer require oversight for Regulation 1.25 purposes.

[28] The 2007 Review indicated that out of 87 FCM respondents, only three held an investment in foreign sovereign debt at any time during that year. It should also be noted that only one FCM invested in such debt under Regulation 30.7.

[29] FIA, in its comment letter, recommended expanding investment in foreign sovereign debt beyond the current rule, which limits an FCM's investment in foreign sovereign debt to the amount of its liabilities to its clients in that foreign country's currency (FIA letter at 5). As the Commission is prepared to remove foreign sovereign debt entirely, a more detailed analysis of this recommendation is unnecessary.

[30] *See* discussion *infra* at Section II.D, regarding proposed Regulation 1.25(d)(3).

in in-house transactions.[31] At the time, the Commission concluded that in-house transactions would allow FCMs to realize "greater capital efficiency" and further reasoned that "the substitution of one permitted investment for another in an in-house transaction [would] not present an unacceptable level of risk to the customer segregated account."[32] The Commission therefore amended Regulation 1.25 to allow an FCM/broker-dealer to enter into transactions that are the economic equivalent of a repurchase or reverse repurchase agreement, subject to certain requirements.[33] More specifically, an FCM may exchange customer money for permitted investments held in its capacity as a broker-dealer, it may exchange customer securities for permitted investments held in its capacity as a broker-dealer, and it may exchange customer securities for cash held in its capacity as a broker-dealer.[34]

Recent market events have, however, increased concerns about the concentration of credit risk within the FCM/broker-dealer corporate entity in connection with in-house transactions. Therefore, consistent with the Commission's proposal to prohibit FCMs from entering into repurchase and reverse repurchase agreements with affiliates, the Commission is proposing to eliminate in-house transactions as permitted investments for customer funds under paragraph (a)(3) of Regulation 1.25 and rescind paragraph (e), which sets forth the requirements for in-house transactions. Accordingly, paragraph (f) will be redesignated as new paragraph (e).

The Commission requests comment on the impact of this proposal on the business practices of FCMs and DCOs. Specifically, the Commission requests that commenters present scenarios in which a repurchase or reverse repurchase agreement with a third party could not be satisfactorily substituted for an in-house transaction.

The Commission requests comment on any other aspect of the proposed changes to paragraph (a) of Regulation 1.25. In particular, the Commission solicits comment on whether MMMFs should be eliminated as a permitted investment.[35] In discussing whether MMMF investments satisfy the overall objective of preserving principal and maintaining liquidity, the Commission specifically requests comment on whether changes in the settlement mechanisms for the tri-party repo market might impact a MMMF's ability to meet the requirements of Regulation 1.25.[36]

B. General Terms and Conditions

FCMs and DCOs may invest customer funds only in enumerated permitted investments "consistent with the objectives of preserving principal and maintaining liquidity * * *."[37] In furtherance of this general standard, paragraph (b) of Regulation 1.25 establishes various specific requirements designed to minimize credit, market, and liquidity risk. Among them are a requirement that the investment be "readily marketable," that it meet specified rating requirements, and that it not exceed specified issuer concentration limits. The Commission is proposing to amend these standards to facilitate the preservation of principal and maintenance of liquidity by establishing clear, prudential standards that further investment quality and portfolio diversification. The Commission notes that an investment that meets the technical requirements of Regulation 1.25 but does not meet the overarching prudential standard cannot qualify as a permitted investment.

1. Marketability

Regulation 1.25(b)(1) states that "[e]xcept for interests in money market mutual funds, investments must be 'readily marketable' as defined in § 240.15c3–1 of this title."[38] The Commission proposes to remove the "readily marketable" requirement from paragraph (b)(1) and substitute in its place a "highly liquid" standard.[39] The Commission did not receive any comment letters specifically discussing the meaning and application of the "readily marketable" requirement.[40]

The term "ready market" is borrowed from the Securities and Exchange Commission (SEC) capital rules and is interpreted by the SEC.[41] That standard is used in setting appropriate haircuts for the purpose of calculating capital. Although its inclusion in Regulation 1.25 was intended to be a proxy for the concept of liquidity, it is not a concept that is otherwise easily applied as a prudential standard in determining the appropriateness of a debt instrument for investment of customer funds.

It is the Commission's view that the "readily marketable" language should be eliminated as it creates an overlapping and confusing standard when applied in the context of the express objective of "maintaining liquidity." While "liquidity" and "ready market" appear to be interchangeable concepts, they have distinctly different origins and uses: The objective of "maintaining liquidity" is to ensure that investments can be promptly liquidated in order to meet a margin call, pay variation settlement, or return funds to the customer upon demand. As noted above, the SEC's "ready market" standard is intended for a different purpose and is easier to apply to exchange traded equity securities than debt securities.

Although Regulation 1.25 requires that investments be consistent with the objective of maintaining liquidity, the Commission has not articulated an explanation or a definition of the concept of "liquidity." The Commission therefore proposes to define "highly liquid" functionally, as having the ability to be converted into cash within one business day, without a material discount in value. This approach focuses on outcome rather than process, and the Commission believes it will be easier to apply to debt securities than the current "readily marketable" standard.

An alternative to using a materiality standard in the definition of highly liquid is to employ a more formulaic and measurable approach. An example of a calculable standard would be one that provides that an instrument is

[31] *See* 70 FR at 28193 (FIA and Lehman Brothers supporting in-house transactions).

[32] 70 FR 5577, 5581 (Feb. 3, 2005).

[33] *See* Regulation 1.25(a)(3) and (e).

[34] Regulation 1.25(a)(3)(i)–(iii).

[35] MMMFs are discussed in greater detail *infra,* in Sections II.B.4 and II.C of this notice.

[36] An industry task force recently concluded an extensive review of the tri-party repo market to identify ways in which it could be improved. *See* Payments Risk Committee, Task Force on Tri-Party Repo Infrastructure, *http://www.newyorkfed.org/tripartyrepo/task_force_report.html* (May 17, 2010). In contrast to current practice, under which funds from maturing repos are available early in the day, modifications to the settlement arrangements for tri-party repo transactions may result in payments occurring later in the day. To the extent that MMMFs invest in tri-party repos, this change could impact their ability to pay out large amounts of cash early in the day.

[37] Regulation 1.25(b).

[38] *See* 17 CFR 240.15c3–1(c)(11)(i) (SEC regulation defining "ready market").

[39] Related to this proposed new standard, the provision in paragraph (a)(2)(ii)(A) that requires securities subject to repurchase agreements to be "'readily marketable' as defined in § 240.15c–1 of this title" also would be amended to provide that securities subject to repurchase agreements must be "'highly liquid' as defined in paragraph (b)(2) of this section."

[40] FIA, MF Global and Newedge mentioned marketability in their letters but no significant changes were recommended.

[41] The term "ready market" is defined, in relevant part, to "include a recognized established securities market in which there exists independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined for a particular security almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time conforming to trade custom." 17 CFR 240.15c3–1(c)(11)(i).

highly liquid if there is a reasonable basis to conclude that, under stable financial conditions, the instrument has the ability to be converted into cash within one business day, without greater than a 1 percent haircut off of its book value.

The Commission proposes to amend paragraph (b)(1) to eliminate the marketability standard and in its place establish a requirement that permitted investments be highly liquid. The Commission requests comment on whether the proposed definition of "highly liquid" accurately reflects the industry's understanding of that term, and whether the term "material" might be replaced with a more precise or, perhaps, even calculable standard. The Commission welcomes comment on the ease or difficulty in applying the proposed or alternative "highly liquid" standards.

2. Ratings

The Commission proposes to remove all rating requirements from Regulation 1.25. This proposal is mandated by Section 939A of the Dodd-Frank Act. Further, the proposal reflects the Commission's views that ratings are not sufficiently reliable as currently administered, that there is reduced need for a measure of credit risk given the proposed elimination of certain permitted investments, and that FCMs and DCOs should bear greater responsibility for understanding and evaluating their investments.[42]

The original purpose of imposing rating requirements was to mitigate credit risk associated with permitted investments which included commercial paper and corporate notes. Recent events in the financial markets, however, revealed significant weaknesses in the ratings industry.

Eliminating or restricting rating requirements has been considered by Congress and regulators with some frequency during the past two years. This has been motivated, at least in part, by public sentiment that credit rating agencies did not accurately rate debt in the months and years leading up to the financial crisis, worsening the financial crisis and increasing investors' losses. The SEC, in September 2009, adopted rule amendments that removed references to NRSROs from a variety of SEC rules and forms promulgated under the Securities Exchange Act of 1934 and from certain rules promulgated under the Investment Company Act of 1940 (Investment Company Act).[43] In November 2009, the SEC adopted rules imposing enhanced disclosure and conflict of interest requirements for NRSROs.[44] The SEC also has opened comment periods on other proposed amendments, including one that would remove references to NRSROs from its net capital rule.[45]

The Dodd-Frank Act contains several measures that focus both on decreasing reliance on NRSROs and improving the performance of NRSROs when they must be relied upon. Section 939 of the Dodd-Frank Act mandates the removal of certain references to NRSROs in several statutes,[46] and Section 939A requires all Federal agencies to review references to NRSROs in their regulations, to remove reliance on credit ratings and, if appropriate, to replace such reliance with other standards of credit-worthiness.

The Commission, therefore, intends to remove credit rating requirements from Regulation 1.25.[47] Alternative standards of credit-worthiness are not being proposed. Evidence that rating agencies have not reliably gauged the safety of debt instruments in the past and the fact that other Regulation 1.25 proposed amendments published in this notice obviate much of the need for credit ratings, have helped to shape the Commission's decision.

While some might argue that imperfect information is better than none at all, several factors outweigh the possible risks associated with removing rating requirements. First, eliminating commercial paper and corporate notes or bonds as permitted investments would take away a large class of potentially risky investments for which ratings would be relevant. Second, the issuer concentration limits and proposed asset-based concentration limits should reduce the likelihood that one problem investment would destabilize an entire investment portfolio. Finally, removing rating requirements would not absolve FCMs and DCOs from investing in safe, highly liquid investments; rather it would shift to FCMs and DCOs more of the responsibility to diligently research their investments.

In light of the above analysis, the Commission proposes to eliminate paragraph (b)(2) of Regulation 1.25 and renumber the subsequent provisions of paragraph (b) accordingly.

3. Restrictions on Instrument Features

Currently, both non-negotiable and negotiable CDs are permitted under Regulation 1.25. Paragraph (b)(3)(v) details the required redemption features of both types of CDs.

Non-negotiable CDs represent a direct obligation of the issuing bank to the purchaser. The CD is wholly owned by the purchaser until early redemption or the final maturity of the CD. To be permitted under Regulation 1.25, the terms of the CD must allow the purchaser to redeem the CD at the issuing bank within one business day, with any penalty for early withdrawal limited to any accrued interest earned. Therefore, other than in the event of a bank default, an investor is assured of the return of its principal.

Negotiable CDs are considerably different than non-negotiable CDs in that they are typically purchased by a broker on behalf of a large number of investors. The large size of the purchase by the broker results in a more favorable interest rate for the purchasers, who essentially own shares of the negotiable CD. Unlike a non-negotiable CD, the purchaser of a negotiable CD cannot redeem its interest from the issuing bank. Rather, an investor seeking redemption prior to a CD's maturity date must liquidate the CD in the secondary market. Depending on the negotiated CD terms (interest rate and duration) and the current economic conditions, the market for a given CD can be illiquid and can result in the inability to redeem within one business day and/or a significant loss of principal.

Therefore, the Commission proposes to amend paragraph (b)(3)(v) by restricting CDs to only those instruments which can be redeemed at the issuing bank within one business day, with any penalty for early withdrawal limited to accrued interest earned according to its written terms.[48]

[42] The Commission received three letters regarding rating requirements, but none focused on the question of whether or not to retain ratings.

[43] *See* 74 FR 52358 (Oct. 9, 2009) (publishing final rules and proposing additional rule amendments).

[44] *See* 74 FR 63832 (Dec. 4, 2009) (publishing final rules and proposing additional rule amendments).

[45] 74 FR at 52377–78 (proposing removal of certain references to NRSROs in the SEC's net capital rules for broker-dealers).

[46] Sections 7(b)(1)(E)(i), 28(d) and 28(e) of the Federal Deposit Insurance Act (12 U.S.C. 1811 *et seq.*), Section 1319 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4519), Section 6(a)(5)(A)(iv)(I) of the Investment Company Act of 1940 (15 U.S.C. 80a–6(a)(5)(A)(iv)(I)), Section 5136A of title LXII of the Revised Statutes of the United States (12 U.S.C. 24a), and Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78a(3)(a)).

[47] *See infra* Section II.E.2 regarding the corresponding change in Regulation 30.7.

[48] While it proposes to eliminate negotiable CDs as an interest bearing vehicle for purposes of Regulation 1.25, the Commission notes that Section 627 of the Dodd-Frank Act removes the prohibition on payments of interest on demand deposits. Demand deposits which meet Regulation 1.25 standards of liquidity may, therefore, be a source of interest income to DCOs and FCMs.

4. Concentration Limits

Paragraph (b)(4) of Regulation 1.25 currently sets forth issuer-based concentration limits for direct investments, securities subject to repurchase or reverse repurchase agreements, and in-house transactions. The Commission proposes to adopt asset-based concentration limits for direct investments and a counterparty concentration limit for reverse repurchase agreements in addition to amending its issuer-based concentration limits and rescinding concentration limits applied to in-house transactions.[49]

(a) Asset-based concentration limits. Asset-based concentration limits would dictate the amount of funds an FCM or DCO could hold in any one class of investments, expressed as a percentage of total assets held in segregation. In their comment letters, the FIA, MF Global and Newedge specifically suggested the incorporation of asset-based concentration limits. The Commission agrees that such limits could increase the safety of customer funds by promoting diversification.

Specifically, the Commission proposes the following asset-based limits in light of its evaluation of credit, liquidity, and market risk:

- No concentration limit (100 percent) for U.S. government securities;
- A 50 percent concentration limit for U.S. agency obligations fully guaranteed as to principal and interest by the United States;
- A 25 percent concentration limit for TLGP guaranteed commercial paper and corporate notes or bonds;
- A 25 percent concentration limit for non-negotiable CDs;
- A 10 percent concentration limit for municipal securities; and
- A 10 percent concentration limit for interests in MMMFs.

Asset-based concentration limits are consistent with the Commission's historical view that not all permitted investments have identical risk profiles.[50] In its efforts to increase the safety of permitted investments on a portfolio basis, the Commission has decided to assign to each permitted investment an asset-based concentration limit that correlates to its level of risk and liquidity relative to other permitted investments.[51]

U.S. government securities are backed by the full faith and credit of the U.S. government, are highly liquid, and are the safest of the permitted investments. As such, the Commission proposes a 100 percent concentration limit, allowing an FCM or DCO to invest all of its segregated funds in U.S. government securities.[52]

U.S. agency obligations, as proposed, must be fully guaranteed as to principal and interest by the United States. The Commission views these as sufficiently safe but potentially not as liquid as a Treasury security. Because of this concern, and in the interest of promoting diversification, the Commission proposes a 50 percent concentration limit.[53]

The Commission categorizes TLGP debt securities as corporate securities,[54] which are riskier than U.S. government securities. While TLGP debt securities have an explicit FDIC guarantee, which provides confidence for TLGP debt investors that they will receive the full amount of principal and interest in the event of an issuer default, the timing of such a payment is uncertain. Additionally, while TLGP debt securities that meet the Commission's requirements have a liquid secondary market, that might not always be the case. The Commission therefore proposes to apply a 25 percent concentration limit for TLGP debt securities as well.

CDs are safe for relatively small amounts, but the risk increases for larger sums. The rise in bank failures since 2008 is a cause for concern with regard to CDs because they are FDIC insured to a maximum of only $250,000. As a result, the Commission proposes to apply a 25 percent concentration limit to CDs.

In evaluating possible asset-based concentration limits for TLGP debt securities and CDs, the Commission determined that the same concentration limit should apply to both, even though the risk profiles of the asset classes are different. The Commission recognizes that TLGP debt securities pose no risk to principal, unlike bank CDs which are subject to the possible default of the issuing bank. However, a CD which must be redeemable within one business day under Regulation 1.25(b)(3)(v) could prove to be more liquid than TLGP debt securities during a time of market stress. The Commission requests comment on whether there should be differentiation between asset-based concentration limits for TLGP debt securities and CDs and, if so, what those different concentration limits should be.

Municipal securities are backed by the state or local government that issues them, and they have traditionally been viewed as a safe investment. However, municipal securities have been volatile and, in some cases, increasingly illiquid over the past two years. Therefore, the Commission proposes to apply a 10 percent concentration limit to municipal securities.[55]

MMMFs have been widely used as an investment for customer segregated funds.[56] As discussed in the next section, their portfolio diversification, administrative ease, and heightened prudential standards recently imposed by the SEC, continue to make MMMFs an attractive investment option. However, their volatility during the 2008 financial crisis, which culminated in one fund "breaking the buck" and many more funds requiring infusions of capital, underscores the fact that investments in MMMFs are not without risk.[57] To mitigate these risks, the Commission proposes to assign a 10 percent concentration limit for MMMFs.[58] The Commission believes that this concentration limit is commensurate with the risks posed by MMMFs. The Commission solicits comment regarding whether 10 percent is an appropriate asset-based concentration limit for MMMFs. The Commission welcomes opinions on what alternative asset-based concentration limit might be appropriate for MMMFs and, if such

[49] The Commission is aware that other diversification methods exist or could be devised (such as the diversification requirements for MMMF investments in CME's IEF2 collateral management program) and believes that such methods can coexist with the proposed concentration limits.

[50] *See* 70 FR at 5581 (discussing the relative risk profiles of permitted investments in the context of repurchase agreements).

[51] The Commission notes that paragraphs (b)(4)(ii)–(iii) of Regulation 1.25 would apply to both asset-based and issuer-based concentration limits. Therefore, for the purpose of calculating asset-based concentration limits, instruments purchased by an FCM or DCO as a result of a reverse repurchase agreement under paragraph (b)(4)(iii) would be combined with instruments held by the FCM or DCO as direct investments.

[52] FIA, MF Global and Newedge each assigned a 100 percent concentration limit to U.S. government securities. *See* FIA letter at 3, MF Global letter at 2, and Newedge letter at 5.

[53] FIA, MF Global and Newedge each assigned a 75 percent concentration limit to GSE securities. *See* FIA letter at 3, MF Global letter at 2, and Newedge letter at 5.

[54] *See* TLGP Letter.

[55] FIA, MF Global and Newedge each assigned a 25 percent concentration limit to all assets that were not U.S. government securities, GSE securities or MMMFs. *See* FIA letter at 3, MF Global letter at 2, and Newedge letter at 5.

[56] The 2007 Review indicated that out of 87 FCM respondents, 46 had invested customer funds in MMMFs at some point during the November 30, 2006–December 1, 2007 period.

[57] *See* 75 FR 10060, 10078 n.234 (Mar. 4, 2010).

[58] FIA recommended a 100 percent concentration limit, Newedge recommended a 50 percent concentration limit, and MF Global recommended a 25 percent concentration limit for MMMFs. *See* FIA letter at 3, Newedge letter at 5, and MF Global letter at 2.

asset-based concentration limit is higher than 10 percent, what corresponding issuer-based concentration limit should be adopted.

(b) Issuer-based concentration limits. The Commission has considered the current concentration limits and proposes to amend its issuer-based limits for direct investments to include a 2 percent limit for an MMMF family of funds, expressed as a percentage of total assets held in segregation. Currently, there is no concentration limit applied to MMMFs and the Commission believes that it is prudent to require FCMs and DCOs to diversify their MMMF portfolios. The 25 percent issuer-based limitation for GSEs (now U.S. agency obligations) and the 5 percent issuer-based limitation for municipal securities, commercial paper, corporate notes or bonds, and CDs will remain in place.

(c) Counterparty concentration limits. Finally, the Commission proposes a counterparty concentration limit of 5 percent of total assets held in segregation for securities subject to reverse repurchase agreements. Under Regulation 1.25(b)(4)(iii), concentration limits for reverse repurchase agreements are derived from the concentration limits that would have been assigned to the underlying securities had the FCM or DCO made a direct investment. Therefore, under current rules, an FCM or DCO could have 100 percent of its segregated funds subject to one reverse repurchase agreement. The obvious concern in such a scenario is the credit risk of the counterparty. This credit risk, while concentrated, is significantly mitigated by the fact that in exchange for cash, the FCM or DCO is holding Regulation 1.25-permissible securities of equivalent or greater value. However, a default by the counterparty would put pressure on the FCM or DCO to convert such securities into cash immediately and would exacerbate the market risk to the FCM or DCO, given that a decrease in the value of the security or an increase in interest rates could result in the FCM or DCO realizing a loss. Even though the market risk would be mitigated by asset-based and issuer-based concentration limits, a situation of this type could seriously jeopardize an FCM or DCO's overall ability to preserve principal and maintain liquidity with respect to customer funds.

In accordance with the above discussion, the Commission proposes to amend paragraph (b)(4) to add a new paragraph (i) setting forth asset-based concentration limits for direct investments; amend and renumber as new paragraph (ii) issuer-based concentration limits for direct investments; amend and renumber as new paragraph (iii) concentration limits for reverse repurchase agreements; delete the existing paragraph (iv) due to the Commission's proposed elimination of in-house transactions; renumber as a new paragraph (iv) the provision regarding treatment of customer-owned securities; and add a new paragraph (v) setting forth counterparty concentration limits for reverse repurchase agreements.

The Commission requests comment on any and all aspects of the proposed concentration limits, including whether asset-based concentration limits are an effective means for facilitating investment portfolio diversification and whether there are other methods that should be considered. In addition, the Commission requests comment on whether the proposed concentration levels are appropriate for the categories of investments to which they are assigned and whether there should be different standards for FCMs and DCOs.

C. Money Market Mutual Funds

The continued use of MMMFs was the sole focus of five comment letters,[59] a substantial focus of one,[60] and referenced positively by an additional four.[61] Taken together, the letters conveyed a consensus that MMMFs are both safe and administratively efficient. In their respective comment letters, Federated noted that MMMFs are subject to the overlapping regulatory regimes overseen by the SEC, and ICI highlighted the quality, liquidity and diversity of an MMMF's holdings. Further, TSI noted that out of 700–800 MMMFs, only one failed during the September 2008 financial turmoil, a crisis which Dreyfus likened to a "1,000 year flood."

While the Commission appreciates the benefits of MMMFs, it also is cognizant of their risks. Reserve Primary Fund, the September 2008 failure referenced by TSI, was an MMMF that satisfied the enumerated requirements of Regulation 1.25 and at one point was a $63 billion fund. The Reserve Primary Fund's breaking the buck called attention to the risk to principal and potential lack of sufficient liquidity of any MMMF investment. In the wake of the Reserve Primary Fund problem, the Commission has been forced to consider the possibility that any number of MMMFs that meet the technical requirements of Regulation 1.25(c) might not meet the Regulation 1.25 objective of preserving principal and maintaining liquidity, particularly during volatile market conditions.[62] Lending credence to such concerns, the SEC has estimated that, in order to avoid breaking the buck, nearly 20 percent of all MMMFs received financial support from their money managers or affiliates from mid-2007 through the end of 2008.[63]

In response to the potential risks posed by investments in MMMFs, the Commission is proposing to institute the concentration limits discussed above. However, the Commission has decided to refrain from further restricting investments in MMMFs at this time. The Commission is hopeful that the combination of its asset-based limitations, issuer-based limitations applied to a single family of funds, and the SEC's recent MMMF reforms will adequately address the risks associated with MMMFs.[64]

The Commission requests comment on whether MMMF investments should be limited to Treasury MMMFs,[65] or to those MMMFs that have portfolios consisting only of permitted investments under Regulation 1.25.

The Commission is proposing two technical amendments to paragraph (c) of Regulation 1.25. First, the Commission is proposing to clarify the acknowledgment letter requirement under paragraph (c)(3); and second, the Commission is proposing to revise and clarify the exceptions to the next-day redemption requirement under paragraph (c)(5)(ii).

1. Acknowledgment Letters

The Commission is proposing to amend Regulation 1.25(c)(3) to clarify

[59] *See* Crane letter, Dreyfus letter, Federated letter I, ICI letter, and TSI letter.

[60] *See* CME letter at 5–6.

[61] *See* FCStone letter at 2, MF Global letter at 2, Newedge letter at 5, and NFA letter at 1.

[62] *See* 75 FR at 10078 n.234 (SEC final rulemaking adopting amendments to regulations governing MMMFs, describing the September 2008 run on MMMFs: "On September 17, 2008, approximately 25% of prime institutional money market funds experienced outflows greater than 5% of total assets; on September 18, 2008, approximately 30% of prime institutional money market funds experienced outflows greater than 5%; and on September 19, 2008, approximately 22% of prime institutional money market funds experienced outflows greater than 5%").

[63] *See* 74 FR 32688, 32693 (July 8, 2009).

[64] *See* 75 FR 10060 (SEC final rulemaking decreasing the percentage of second tier securities (which are securities that do not receive the highest rating from an NRSRO or, if unrated, securities that are comparable in quality to securities that do not receive the highest rating from an NRSRO) from 5 percent to 3 percent, reducing the dollar-weighted average portfolio maturity from 90 days to 60 days, introducing a dollar-weighted average life to maturity of 120 days, and imposing new daily and weekly liquidity requirements, among others).

[65] A "Treasuries fund" must have at least 80 percent of its assets invested in U.S. treasuries at all times, as required by 17 CFR 270.35d–1.

the appropriate party to provide an acknowledgment letter where customer funds are invested in MMMFs. Regulation 1.26 requires an FCM or DCO which invests customer funds in instruments permitted under Regulation 1.25 to create a segregated account at a depository for such instruments and to obtain an acknowledgment letter from the depository. Because interests in MMMFs generally are not held at a depository in the first instance, like other permitted investments, Regulation 1.25(c)(3) currently provides an exception to the Regulation 1.26 requirement that an acknowledgment letter be provided by a depository. Regulation 1.25(c)(3) requires the "sponsor of the fund and the fund itself" to provide an acknowledgment letter when the MMMF shares are held by a fund's shareholder servicing agent.

The Commission has received a number of inquiries regarding the meaning of this provision and the definition of "sponsor," a term that is not defined in the Investment Company Act. While the term is not defined, it is nonetheless used throughout the Investment Company Act and is generally understood to refer to the entity that organizes the fund. Such an entity typically provides seed capital to the investment company and may be an affiliated investment adviser or underwriter to the investment company.

The Commission seeks to clarify that the intent of Regulation 1.25(c)(3) is to require an acknowledgment letter from a party 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 segregated funds invested in shares of an MMMF. The Commission has concluded that in many circumstances, the fund sponsor, the investment adviser, or fund manager would satisfy this requirement. To the extent there are circumstances where an entity such as the Administrator would be in this position, proposed Regulation 1.25(c)(3) encompasses such an entity. The Commission requests comment on whether the proposed standard is appropriate and whether there are other entities that could serve as examples.

The Commission is also proposing to remove the current language in Regulation 1.25(c)(3) 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. The Commission requests comment on whether removal of this language helps clarify the intent of Regulation 1.25(c)(3).

The Commission is accordingly proposing to amend Regulation 1.25(c)(3) to set forth a functional definition accompanied by specific examples. The proposed amendment would require an FCM or DCO to obtain the acknowledgment letter required by Regulation 1.26 [66] 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 segregated funds. The proposed language would specify that such an entity may include the fund sponsor or investment adviser.[67]

2. Next-Day Redemption Requirement

Regulation 1.25(c) requires that "[a] fund shall be legally obligated to redeem an interest and to make payment in satisfaction thereof by the business day following a redemption request." [68] This "next-day redemption" requirement is a significant feature of Regulation 1.25 and is meant to ensure adequate liquidity.[69] Regulation 1.25(c)(5)(ii) lists four exceptions to the next-day redemption requirement, and incorporates by reference the emergency conditions listed in Section 22(e) of the Investment Company Act (Section 22(e)).[70] The Commission has received questions from FCMs regarding Regulation 1.25(c)(5), particularly because the exceptions listed in paragraph (c)(5)(ii) overlap with some of those appearing in Section 22(e).

Recently, as part of its MMMF reform initiative, the SEC adopted a rule that provides the basis for another exception to the next-day redemption requirement.[71] Promulgated under Section 22(e), Rule 22e–3 [72] permits MMMFs to suspend redemptions and postpone payment of redemption proceeds in order to facilitate an orderly liquidation of the fund.[73] Before Rule 22e–3 may be invoked, the fund's board, including a majority of its disinterested directors, must determine that the extent of the deviation between the fund's amortized cost per share and its current net asset value per share may result in material dilution or other unfair results,[74] and the board, including a majority of its disinterested directors, must irrevocably approve the liquidation of the fund.[75] In addition, prior to suspending redemption, the fund must notify the SEC of its decision.[76]

In order to expressly incorporate Rule 22e–3 into the permitted exceptions for purposes of clarity, and to otherwise clarify the existing exceptions to the next-day redemption requirement, the Commission has decided to amend paragraph (c)(5)(ii) of Regulation 1.25 by more closely aligning the language of that paragraph with the language in Section 22(e) and specifically including Rule 22e–3. Section 22(e) will, however, continue to be incorporated by reference so as to provide for any future amendment or regulatory actions by the SEC.

The Commission will include, as Appendix A to the rule text, safe harbor language that can be used by MMMFs to ensure that their prospectuses comply with Regulation 1.25(c)(5). The proposed language tracks the proposed paragraph (c)(5).

The Commission requests comment on all aspects of its proposed amendments to paragraph (c). The Commission seeks comment specifically on any proposed regulatory language that commenters believe requires further clarification. In addition, commenters are invited to submit views on the usefulness and substance of the proposed safe harbor language contained in proposed Appendix A.

D. Repurchase and Reverse Repurchase Agreements

The Commission proposes to eliminate repurchase and reverse repurchase transactions with affiliate counterparties. This amendment forwards the interests of both protecting

[66] In a related proposed rulemaking, the Commission has proposed to add a new paragraph (c) to Regulation 1.26 which would specifically govern acknowledgment letters for MMMFs. The Commission also has proposed a mandatory form of acknowledgment letter in proposed Appendix A to Regulation 1.26. *See* 75 FR 47738 (Aug. 9, 2010).

[67] A fund sponsor or investment adviser would be identified as appropriate entities to provide an acknowledgment letter, because they would typically be expected to satisfy the proposed standard. However, in any circumstance where the fund sponsor or investment adviser does not meet that standard, the acknowledgment letter would have to be obtained from another entity that can meet the regulatory requirement.

[68] Regulation 1.25(c)(5)(i).

[69] *See* 70 FR 5585 (noting that "[t]he Commission believes the one-day liquidity requirement for investments in MMMFs is necessary to ensure that the funding requirements of FCMs will not be impeded by a long liquidity time frame.").

[70] 15 U.S.C. 80a–22(e).

[71] *See* Letter from Ananda Radhakrishnan, Director, Division of Clearing and Intermediary Oversight, CFTC, to Debra Kokal, Chairman of the Joint Audit Committee (June 3, 2010) (stating that Rule 22e–3 falls within the exceptions to the next-day redemption requirement under Regulation 1.25).

[72] 17 CFR 270.22e–3.

[73] *See* 75 FR at 10088.

[74] 17 CFR 270.22e–3(a)(1).

[75] 17 CFR 270.22e–3(a)(2).

[76] 17 CFT 270.22e–3(a)(3).

customer funds as well as establishing consistency within the regulation, which would no longer permit in-house transactions and currently prohibits investments in instruments issued by affiliates.

Repurchase and reverse repurchase transactions were originally included as permitted investments to increase the liquidity in the portfolio of segregated funds.[77] By entering into repurchase agreements with unaffiliated counterparties, FCMs can convert securities holdings into cash or alternatively supply cash to market participants in exchange for liquid securities. In the event that a counterparty receiving cash defaults, the other party is protected due to its holding of the counterparty's securities. Reverse repurchase and repurchase agreements contribute generally to increased market liquidity and are not inconsistent with the required safety of customer funds.

The benefits of such an arrangement are diminished, however, when repurchase agreements are between affiliates. In particular, the concentration of credit risk increases the likelihood that the default of one party could exacerbate financial strains and lead to the default of its affiliate. While such a scenario would be unexpected in calm markets, during periods of financial turbulence such problems are considerably more likely to occur. It should be noted that the actions of market participants suggest that even possession and control of liquid securities may be insufficient to alleviate concerns relating to transactions with financially troubled counterparties.[78]

Further, the interests of consistency of the regulation weigh in favor of disallowing repurchase agreements between affiliates. Currently, a repurchase agreement between affiliates is allowed under Regulation 1.25(d), while investments in debt instruments issued by an affiliate—effectively a collateralized loan between affiliates—is prohibited by paragraph (b)(6). A repurchase agreement is functionally equivalent to a short-term collateralized loan. In both transactions, one party provides cash to another party, secured by assets owned by the other party, and, in return, the other party repays the cash, plus interest, and its assets are returned. The similarity of the two transactions would seem to require similar treatment under Regulation 1.25.

Therefore, the Commission proposes to amend paragraph (d) by adding new paragraph (3) prohibiting repurchase and reverse repurchase agreements with affiliates. Current paragraphs (3) through (12) will be renumbered as (4) through (13), accordingly. The Commission seeks comment on its proposal to eliminate repurchase and reverse repurchase transactions with affiliate counterparties.

E. Regulation 30.7

1. Harmonization

The Commission proposes to harmonize Regulation 30.7 with the investment limitations of Regulation 1.25. As noted above, the Commission has not previously restricted investments of 30.7 funds to the permitted investments under Regulation 1.25, although Regulation 1.25 limitations can be used as a safe harbor for such investments.[79] The Commission now believes that it is appropriate to align the investment standards of Regulation 30.7 with those of Regulation 1.25 because many of the same prudential concerns arise with respect to both segregated customer funds and 30.7 funds. Such a limitation should increase the safety of 30.7 funds and provide clarity for the FCMs, DCOs, and designated self-regulatory organizations.

The Commission anticipates that the impact of this amendment will be slight, as it appears that using Regulation 1.25 standards in 30.7 investments is a common industry practice. For example, Newedge commented that the harmonization of Regulations 1.25 and 30.7 "would reflect current market practice * * *" since, in its opinion, "* * * many if not most FCMs currently invest Part 30.7 funds in the same products and transactions in which they invest Rule 1.25 funds."[80] FIA also noted that its "member firms generally follow the Rule 1.25 investment guidelines" when investing 30.7 funds.[81] In addition to adding new paragraph (g) to Regulation 30.7 to reflect this amendment, the Form 1–FR–FCM instruction manual would be revised accordingly.[82]

The Commission solicits comment on applying the requirements of Regulation 1.25 to 30.7 funds. In this regard, the Commission seeks comment on any differences between customer segregated funds and 30.7 funds that would warrant the continuing application of different standards.

2. Ratings

The Commission proposes to remove all rating requirements from Regulation 30.7. This proposal is required by Section 939A of the Dodd-Frank Act and further reflects the Commission's views on the unreliability of ratings as currently administered and its interest in aligning Regulation 30.7 with Regulation 1.25.[83]

The only reference to credit ratings in Regulation 30.7 is in paragraph (c)(1)(ii)(B). Paragraph (c)(1)(ii) permits 30.7 funds to be kept in an account with a depository outside the United States if the depository meets any of three alternative standards: (1) The depository has in excess of $1 billion of regulatory capital, (2) the depository or its parent's "commercial paper or long-term debt instrument * * * is rated in one of the two highest rating categories by at least one" NRSRO, or (3) if it does not meet either of the first two criteria, the depository has been permitted to hold 30.7 funds upon the request of a customer.

The use of the credit rating of the commercial paper or long-term debt of the depository institution is comparable to the standard used to gauge the safety of an issuer of a CD.[84] The Commission has viewed credit ratings as unreliable to gauge the safety of an issuer of a CD and proposed, in Section II.B.2 of this notice, to remove this requirement from Regulation 1.25. The Commission now proposes to remove paragraph (c)(1)(ii)(B) in Regulation 30.7 as it views an NRSRO rating as similarly unreliable to gauge the safety of a depository institution for 30.7 funds. This proposal also serves to align

[77] 65 FR 39008, 39015 (June 22, 2000).

[78] *See* SEC Press Release No. 2008–46, "Answers to Frequently Asked Investor Questions Regarding the Bear Stearns Companies, Inc." (Mar. 18, 2008), *available at http://www.sec.gov/news/press/2008/2008-46.htm* (noting that rumors of liquidity problems at Bear Stearns caused their counterparties to become concerned, creating a "crisis of confidence" which led to the counterparties' "unwilling[ness] to make secured funding available to Bear Stearns on customary terms.").

[79] *See* Commission Form 1–FR–FCM Instructions at 12–9 (Mar. 2010) ("In investing funds required to be maintained in separate section 30.7 account(s), FCMs are bound by their fiduciary obligations to customers and the requirement that the secured amount required to be set aside be at all times liquid and sufficient to cover all obligations to such customers. Regulation 1.25 investments would be appropriate, as would investments in any other readily marketable securities.").

[80] Newedge letter at 4.

[81] FIA letter at 5.

[82] Pending adoption of final amendments to Regulation 30.7, the Commission will revise the section headed "Permissible Investments of Part 30 Set-Aside Funds" on page 12–9 to align with, and refer back to, the discussion of Regulation 1.25 investments on pages 10–7 and 10–8.

[83] *See* discussion *supra* Section II.B.2 regarding the Commission's policy decision to remove references to credit ratings from Regulation 1.25 and other regulations.

[84] *See* Regulation 1.25(b)(2)(i)(E).

Regulation 30.7 with Regulation 1.25 on the topic of NRSROs.

The Commission requests comment on whether there is a standard or measure of solvency and credit-worthiness that can be used as an additional test of a bank's safety. Specifically, the Commission seeks comment on whether a leverage ratio or a capital adequacy ratio requirement consistent with or similar to those in the Basel III accords [85] would be an appropriate additional safeguard for a bank or trust company located outside the United States.

3. Designation as a Depository for 30.7 Funds

Under Regulation 30.7(c)(1)(ii)(C), a bank or trust company that does not otherwise meet the requirements of paragraph (c)(1)(ii) may still be designated as an acceptable depository by request of its customer and with the approval of the Commission. The Commission proposes to no longer allow a customer to request that a bank or trust company located outside the United States be designated as a depository for 30.7 funds. The Commission has never allowed a bank or trust company located outside the United States to be a depository through these means, and believes that it is appropriate to require that all depositories meet the regulatory capital requirement under paragraph (c)(1)(ii)(A).

Therefore, the Commission proposes to amend Regulation 30.7 by deleting paragraph (c)(1)(ii)(C). The Commission requests comment on whether an exception of any kind to Regulation 30.7(c)(1)(ii) is appropriate.

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) [86] requires federal agencies, in promulgating rules, to consider the impact of those rules on small businesses. The rule amendments proposed herein will affect FCMs and DCOs. The Commission has previously established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its rules on small entities in accordance with the RFA.[87] The Commission has previously determined that registered FCMs [88] and DCOs [89] are not small entities for the purpose of the RFA. Accordingly, pursuant to 5 U.S.C. 605(b), the Chairman, on behalf of the Commission, certifies that the proposed rules will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) imposes certain requirements on federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. The proposed rule amendments do not require a new collection of information on the part of any entities subject to the proposed rule amendments. Accordingly, for purposes of the PRA, the Commission certifies that these proposed rule amendments, if promulgated in final form, would not impose any new reporting or recordkeeping requirements.

C. Costs and Benefits of the Proposed Rules

Section 15(a) of the CEA [90] requires the Commission to consider the costs and benefits of its actions before issuing a rulemaking under the Act. By its terms, section 15(a) does not require the Commission to quantify the costs and benefits of a rule or to determine whether the benefits of the rulemaking outweigh its costs; rather, it requires that the Commission "consider" the costs and benefits of its actions. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest or to effectuate any of the provisions or accomplish any of the purposes of the Act.

Summary of proposed requirements. The proposed rules would facilitate greater protection of customer funds and 30.7 funds and reduction of systemic risk by establishing stricter prudential standards for investment of such funds. The proposed amendments restrict the scope of permitted investments to reflect the current economic environment. During the prior ten-year period, starting with the December 2000 rulemaking, Regulation 1.25 was substantially revised and expanded. The more restrictive proposals contained herein are based on the Commission's experience over the course of the past decade and, in particular, since September 2008, during which certain permitted investments under Regulation 1.25 were shown to present potentially unacceptable levels of risk. In narrowing the scope of Regulation 1.25 (as to both type and characteristics of permitted investments), the Commission's primary purpose is to safeguard the funds of customers and, in so doing, to help ease the chain reaction of negative effects that can come about during a financial crisis in the broader financial marketplace.

Costs. With respect to costs, the Commission has determined that any costs associated with the proposal are outweighed by its benefits. The Commission recognizes that scaling back on the type and form of permitted investments could result in certain FCMs and DCOs earning less income from their investments of customer funds. This, in turn, could reduce an FCM or DCO's overall profits and create an incentive for them to charge higher fees to customers. The Commission believes, however, that the potential loss of income for those FCMs and DCOs whose investment strategies will be materially affected by the proposed amendments will be outweighed by the reduction in potential risk associated with the current regulatory standards for permitted investments. To the extent that customers may bear the cost of the proposed changes, the customers will nonetheless benefit from greater protection of their funds. Eliminating the option of a customer to designate, with the Commission's permission, a foreign depository for 30.7 funds would potentially limit the choices of suitable depositories. However, the presence of alternative depositories would mitigate any adverse impact. The proposed amendments would not affect the efficiency or competitiveness of futures markets, and the proposed amendments will not affect price discovery.

Benefits. With respect to benefits, the Commission has determined that the proposal will result in several benefits. First, the risk-reducing nature of the proposed amendments would facilitate greater financial integrity of FCMs and DCOs and, as a result, futures markets more generally. Essential to the proper functioning of futures markets is the financial integrity of the clearing

[85] *See* Press Release, Basel Committee on Banking Supervision, Group of Governors and Heads of Supervision Announces Higher Global Minimum Capital Standards (Sept. 12, 2010), *http://bis.org/press/p100912.pdf.*

[86] 5 U.S.C. 601 *et seq.*

[87] 47 FR 18618 (Apr. 30, 1982).

[88] *Id.* at 18619.

[89] 66 FR 45604, 45609 (Aug. 29, 2001).

[90] 7 U.S.C. 19(a).

process, which is dependent upon the immediate availability of sufficient funds for daily pays and collects and default management.

The proposed amendments would also raise the standards for risk management practices of FCMs and DCOs that invest customer funds. They balance the need for investment flexibility and capital efficiency with the need to preserve principal and maintain liquidity. In particular, the proposal both narrows the scope of permitted investments to only those that the Commission considers the safest, and mandates diversification well beyond previous requirements. The Commission believes that these structural safeguards will decrease the credit, market, and liquidity risk exposures of FCMs and DCOs. Moreover, the revised requirements will more closely align with the investment restrictions contained in Section 4d of the Act.

Also, the Commission recognizes that many, if not most, FCMs and DCOs are already engaging in sound risk management practices and are pursuing responsible investment strategies under the existing regulatory regime. However, the Commission believes that in an environment where many of its previous economic assumptions are called into question, it becomes necessary to establish new bright line requirements to better ensure proper risk management in connection with the investment of customer segregated and 30.7 funds.

The proposed amendments retain an appropriate degree of flexibility in making investments with customer segregated and 30.7 funds, while significantly strengthening the rules that protect the safety of such funds. In addition, eliminating the option of a customer to designate, with the Commission's permission, a foreign depository for 30.7 funds that otherwise would not meet the requirements of Regulation 30.7 both closes a loophole that might have allowed for a less financially sound depository to hold 30.7 funds and eliminates the need for the Commission to individually review the safety and soundness of foreign depositories.

Public Comment. The Commission invites public comment on its cost-benefit considerations. Commenters are also are invited to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the Proposal with their comment letters.

Lists of Subjects

17 CFR Part 1

Brokers, Commodity futures, Consumer protection, Reporting and recordkeeping requirements.

17 CFR Part 30

Commodity futures, Consumer protection, Currency, Reporting and recordkeeping requirements.

In consideration of the foregoing and pursuant to the authority contained in the Commodity Exchange Act, in particular, Sections 4d, 4(c), and 8a(5) thereof, 7 U.S.C. 6d, 6(c) and 12a(5), respectively, the Commission hereby proposes to amend Chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for Part 1 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

2. Revise § 1.25 to read as follows:

§ 1.25 Investment of customer funds.

(a) *Permitted investments.* (1) Subject to the terms and conditions set forth in this section, a futures commission merchant or a derivatives clearing organization may invest customer money in the following instruments (permitted investments):

(i) Obligations of the United States and obligations fully guaranteed as to principal and interest by the United States (U.S. government securities);

(ii) General obligations of any State or of any political subdivision thereof (municipal securities);

(iii) Obligations of any United States government corporation or enterprise sponsored by the United States government and fully guaranteed as to principal and interest by the United States (U.S. agency obligations);

(iv) Certificates of deposit issued by a bank (certificates of deposit) as defined in section 3(a)(6) of the Securities Exchange Act of 1934, or a domestic branch of a foreign bank that carries deposits insured by the Federal Deposit Insurance Corporation;

(v) Commercial paper fully guaranteed as to principal and interest by the United States under the Temporary Liquidity Guarantee Program as administered by the Federal Deposit Insurance Corporation (commercial paper);

(vi) Corporate notes or bonds fully guaranteed as to principal and interest by the United States under the Temporary Liquidity Guarantee Program as administered by the Federal Deposit Insurance Corporation (corporate notes or bonds); and

(vii) Interests in money market mutual funds.

(2)(i) In addition, a futures commission merchant or derivatives clearing organization may buy and sell the permitted investments listed in paragraphs (a)(1)(i) through (vii) of this section pursuant to agreements for resale or repurchase of the instruments, in accordance with the provisions of paragraph (d) of this section.

(ii) A futures commission merchant or a derivatives clearing organization may sell securities deposited by customers as margin pursuant to agreements to repurchase subject to the following:

(A) Securities subject to such repurchase agreements must be "highly liquid" as defined in paragraph (b)(1) of this section.

(B) Securities subject to such repurchase agreements must not be "specifically identifiable property" as defined in § 190.01(kk) of this chapter.

(C) The terms and conditions of such an agreement to repurchase must be in accordance with the provisions of paragraph (d) of this section.

(D) Upon the default by a counterparty to a repurchase agreement, the futures commission merchant or derivatives clearing organization shall act promptly to ensure that the default does not result in any direct or indirect cost or expense to the customer.

(b) *General terms and conditions.* A futures commission merchant or a derivatives clearing organization is required to manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity and according to the following specific requirements:

(1) *Liquidity.* Investments must be "highly liquid" such that they have the ability to be converted into cash within one business day without material discount in value.

(2) *Restrictions on instrument features.* (i) With the exception of money market mutual funds, no permitted investment may contain an embedded derivative of any kind, except that the issuer of an instrument otherwise permitted by this section may have an option to call, in whole or in part, at par, the principal amount of the instrument before its stated maturity date; *provided, however,* that the terms of such instrument obligate the issuer to

repay the principal amount of the instrument at not less than par value upon maturity.

(ii) No instrument may contain interest-only payment features.

(iii) No instrument may provide payments linked to a commodity, currency, reference instrument, index, or benchmark, and it may not otherwise constitute a derivative instrument.

(iv) Commercial paper and corporate notes or bonds must meet the following criteria:

(A) The size of the issuance must be greater than $1 billion;

(B) The instrument must be denominated in U.S. dollars; and

(C) The instrument must be fully guaranteed as to principal and interest by the United States for its entire term.

(v) Certificates of deposit must be redeemable at the issuing bank within one business day, with any penalty for early withdrawal limited to any accrued interest earned according to its written terms.

(3) *Concentration.* (i) *Asset-based concentration limits for direct investments.* (A) Investments in U.S. government securities shall not be subject to a concentration limit.

(B) Investments in U.S. agency obligations may not exceed 50 percent of the total assets held in segregation by the futures commission merchant or derivatives clearing organization.

(C) Investments in each of commercial paper, corporate notes or bonds and certificates of deposit may not exceed 25 percent of the total assets held in segregation by the futures commission merchant or derivatives clearing organization.

(D) Investments in each of municipal securities and money market mutual funds may not exceed 10 percent of the total assets held in segregation by the futures commission merchant or derivatives clearing organization.

(ii) *Issuer-based concentration limits for direct investments.* (A) Securities of any single issuer of U.S. agency obligations held by a futures commission merchant of derivatives clearing organization may not exceed 25 percent of total assets held in segregation by the futures commission merchant or derivatives clearing organization.

(B) Securities of any single issuer of municipal securities, certificates of deposit, commercial paper, or corporate notes or bonds held by a futures commission merchant or derivatives clearing organization may not exceed 5 percent of total assets held in segregation by the futures commission merchant or derivatives clearing organization.

(C) Interests in any single family of money market mutual funds may not exceed 2 percent of total assets held in segregation by the futures commission merchant or derivatives clearing organization.

(D) For purposes of determining compliance with the issuer-based concentration limits set forth in this section, securities issued by entities that are affiliated, as defined in paragraph (b)(5) of this section, shall be aggregated and deemed the securities of a single issuer. An interest in a permitted money market mutual fund is not deemed to be a security issued by its sponsoring entity.

(iii) *Concentration limits for agreements to repurchase.* (A) *Repurchase agreements.* For purposes of determining compliance with the asset-based and issuer-based concentration limits set forth in this section, securities sold by a futures commission merchant or derivatives clearing organization subject to agreements to repurchase shall be combined with securities held by the futures commission merchant or derivatives clearing organization as direct investments.

(B) *Reverse repurchase agreements.* For purposes of determining compliance with the asset-based and issuer-based concentration limits set forth in this section, securities purchased by a futures commission merchant or derivatives clearing organization subject to agreements to resell shall be combined with securities held by the futures commission merchant or derivatives clearing organization as direct investments.

(iv) *Treatment of customer-owned securities.* For purposes of determining compliance with the asset-based and issuer-based concentration limits set forth in this section, securities owned by the customers of a futures commission merchant and posted as margin collateral are not included in total assets held in segregation by the futures commission merchant, and securities posted by a futures commission merchant with a derivatives clearing organization are not included in total assets held in segregation by the derivatives clearing organization.

(v) *Counterparty concentration limits.* Securities purchased by a futures commission merchant or derivatives clearing organization from a single counterparty, subject to an agreement to resell to that counterparty, shall not exceed 5 percent of total assets held in segregation by the futures commission merchant or derivatives clearing organization.

(4) *Time-to-maturity.* (i) Except for investments in money market mutual funds, the dollar-weighted average of the time-to-maturity of the portfolio, as that average is computed pursuant to § 270.2a–7 of this title, may not exceed 24 months.

(ii) For purposes of determining the time-to-maturity of the portfolio, an instrument that is set forth in paragraphs (a)(1)(i) through (vii) of this section may be treated as having a one-day time-to-maturity if the following terms and conditions are satisfied:

(A) The instrument is deposited solely on an overnight basis with a derivatives clearing organization pursuant to the terms and conditions of a collateral management program that has become effective in accordance with § 39.4 of this chapter;

(B) The instrument is one that the futures commission merchant owns or has an unqualified right to pledge, is not subject to any lien, and is deposited by the futures commission merchant into a segregated account at a derivatives clearing organization;

(C) The derivatives clearing organization prices the instrument each day based on the current mark-to-market value; and

(D) The derivatives clearing organization reduces the assigned value of the instrument each day by a haircut of at least 2 percent.

(5) *Investments in instruments issued by affiliates.* (i) A futures commission merchant shall not invest customer funds in obligations of an entity affiliated with the futures commission merchant, and a derivatives clearing organization shall not invest customer funds in obligations of an entity affiliated with the derivatives clearing organization. An affiliate includes parent companies, including all entities through the ultimate holding company, subsidiaries to the lowest level, and companies under common ownership of such parent company or affiliates.

(ii) A futures commission merchant or derivatives clearing organization may invest customer funds in a fund affiliated with that futures commission merchant or derivatives clearing organization.

(6) *Recordkeeping.* A futures commission merchant and a derivatives clearing organization shall prepare and maintain a record that will show for each business day with respect to each type of investment made pursuant to this section, the following information:

(i) The type of instruments in which customer funds have been invested;

(ii) The original cost of the instruments; and

(iii) The current market value of the instruments.

(c) *Money market mutual funds.* The following provisions will apply to the investment of customer funds in money market mutual funds (the fund).

(1) The fund must be an investment company that is registered under the Investment Company Act of 1940 with the Securities and Exchange Commission and that holds itself out to investors as a money market fund, in accordance with § 270.2a–7 of this title.

(2) The fund must be sponsored by a federally-regulated financial institution, a bank as defined in section 3(a)(6) of the Securities Exchange Act of 1934, an investment adviser registered under the Investment Advisers Act of 1940, or a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation.

(3) A futures commission merchant or derivatives clearing organization shall maintain the confirmation relating to the purchase in its records in accordance with § 1.31 and note the ownership of fund shares (by book-entry or otherwise) in a custody account of the futures commission merchant or derivatives clearing organization in accordance with § 1.26(c). The futures commission merchant or the derivatives clearing organization shall obtain the acknowledgment letter required by § 1.26(c) 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 segregated funds. Such entity may include the fund sponsor or investment adviser.

(4) The net asset value of the fund must be computed by 9 a.m. of the business day following each business day and made available to the futures commission merchant or derivatives clearing organization by that time.

(5)(i) General requirement for redemption of interests. A fund shall be legally obligated to redeem an interest and to make payment in satisfaction thereof by the business day following a redemption request, and the futures commission merchant or derivatives clearing organization shall retain documentation demonstrating compliance with this requirement.

(ii) Exception. A fund may provide for the postponement of redemption and payment due to any of the following circumstances:

(A) For any period during which there is a non-routine closure of the Fedwire or applicable Federal Reserve Banks;

(B) For any period:

(1) During which the New York Stock Exchange is closed other than customary week-end and holiday closings; or

(2) During which trading on the New York Stock Exchange is restricted;

(C) For any period during which an emergency exists as a result of which:

(1) Disposal by the company of securities owned by it is not reasonably practicable; or

(2) It is not reasonably practicable for such company fairly to determine the value of its net assets;

(D) For any period as the Securities and Exchange Commission may by order permit for the protection of security holders of the company;

(E) For any period during which the Securities and Exchange Commission has, by rule or regulation, deemed that:

(1) Trading shall be restricted; or

(2) An emergency exists; or

(F) For any period during which each of the conditions of § 270.22e–3(a)(1) through (3) of this title are met.

(6) The agreement pursuant to which the futures commission merchant or derivatives clearing organization has acquired and is holding its interest in a fund must contain no provision that would prevent the pledging or transferring of shares.

(7) Appendix A to this section sets forth language that will satisfy the requirements of paragraph (c)(5) of this section.

(d) *Repurchase and reverse repurchase agreements.* A futures commission merchant or derivatives clearing organization may buy and sell the permitted investments listed in paragraphs (a)(1)(i) through (vii) of this section pursuant to agreements for resale or repurchase of the securities (agreements to repurchase or resell), provided the agreements to repurchase or resell conform to the following requirements:

(1) The securities are specifically identified by coupon rate, par amount, market value, maturity date, and CUSIP or ISIN number.

(2) Permitted counterparties are limited to a bank as defined in section 3(a)(6) of the Securities Exchange Act of 1934, a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation, a securities broker or dealer, or a government securities broker or government securities dealer registered with the Securities and Exchange Commission or which has filed notice pursuant to section 15C(a) of the Government Securities Act of 1986.

(3) A futures commission merchant or derivatives clearing organization shall not enter into an agreement to repurchase or resell with a counterparty that is an affiliate of the futures commission merchant or derivatives clearing organization, respectively. An affiliate includes parent companies, including all entities through the ultimate holding company, subsidiaries to the lowest level, and companies under common ownership of such parent company or affiliates.

(4) The transaction is executed in compliance with the concentration limit requirements applicable to the securities transferred to the customer segregated custodial account in connection with the agreements to repurchase referred to in paragraphs (b)(3)(iii)(A) and (B) of this section.

(5) The transaction is made pursuant to a written agreement signed by the parties to the agreement, which is consistent with the conditions set forth in paragraphs (d)(1) through (13) of this section and which states that the parties thereto intend the transaction to be treated as a purchase and sale of securities.

(6) The term of the agreement is no more than one business day, or reversal of the transaction is possible on demand.

(7) Securities transferred to the futures commission merchant or derivatives clearing organization under the agreement are held in a safekeeping account with a bank as referred to in paragraph (d)(2) of this section, a derivatives clearing organization, or the Depository Trust Company in an account that complies with the requirements of § 1.26.

(8) The futures commission merchant or the derivatives clearing organization may not use securities received under the agreement in another similar transaction and may not otherwise hypothecate or pledge such securities, except securities may be pledged on behalf of customers at another futures commission merchant or derivatives clearing organization. Substitution of securities is allowed, *provided, however,* that:

(i) The qualifying securities being substituted and original securities are specifically identified by date of substitution, market values substituted, coupon rates, par amounts, maturity dates and CUSIP or ISIN numbers;

(ii) Substitution is made on a "delivery versus delivery" basis; and

(iii) The market value of the substituted securities is at least equal to that of the original securities.

(9) The transfer of securities to the customer segregated custodial account is made on a delivery versus payment basis in immediately available funds. The transfer of funds to the customer segregated cash account is made on a payment versus delivery basis. The transfer is not recognized as accomplished until the funds and/or

securities are actually received by the custodian of the futures commission merchant's or derivatives clearing organization's customer funds or securities purchased on behalf of customers. The transfer or credit of securities covered by the agreement to the futures commission merchant's or derivatives clearing organization's customer segregated custodial account is made simultaneously with the disbursement of funds from the futures commission merchant's or derivatives clearing organization's customer segregated cash account at the custodian bank. On the sale or resale of securities, the futures commission merchant's or derivatives clearing organization's customer segregated cash account at the custodian bank must receive same-day funds credited to such segregated account simultaneously with the delivery or transfer of securities from the customer segregated custodial account.

(10) A written confirmation to the futures commission merchant or derivatives clearing organization specifying the terms of the agreement and a safekeeping receipt are issued immediately upon entering into the transaction and a confirmation to the futures commission merchant or derivatives clearing organization is issued once the transaction is reversed.

(11) The transactions effecting the agreement are recorded in the record required to be maintained under § 1.27 of investments of customer funds, and the securities subject to such transactions are specifically identified in such record as described in paragraph (d)(1) of this section and further identified in such record as being subject to repurchase and reverse repurchase agreements.

(12) An actual transfer of securities to the customer segregated custodial account by book entry is made consistent with Federal or State commercial law, as applicable. At all times, securities received subject to an agreement are reflected as "customer property."

(13) The agreement makes clear that, in the event of the bankruptcy of the futures commission merchant or derivatives clearing organization, any securities purchased with customer funds that are subject to an agreement may be immediately transferred. The agreement also makes clear that, in the event of a futures commission merchant or derivatives clearing organization bankruptcy, the counterparty has no right to compel liquidation of securities subject to an agreement or to make a priority claim for the difference between current market value of the securities and the price agreed upon for resale of the securities to the counterparty, if the former exceeds the latter.

(e) *Deposit of firm-owned securities into segregation.* A futures commission merchant shall not be prohibited from directly depositing unencumbered securities of the type specified in this section, which it owns for its own account, into a segregated safekeeping account or from transferring any such securities from a segregated account to its own account, up to the extent of its residual financial interest in customers' segregated funds; *provided, however,* that such investments, transfers of securities, and disposition of proceeds from the sale or maturity of such securities are recorded in the record of investments required to be maintained by § 1.27. All such securities may be segregated in safekeeping only with a bank, trust company, derivatives clearing organization, or other registered futures commission merchant. Furthermore, for purposes of §§ 1.25, 1.26, 1.27, 1.28 and 1.29, investments permitted by § 1.25 that are owned by the futures commission merchant and deposited into such a segregated account shall be considered customer funds until such investments are withdrawn from segregation.

Appendix to § 1.25—Money Market Mutual Fund Prospectus Provisions Acceptable for Compliance With Paragraph (c)(5)

Upon receipt of a proper redemption request submitted in a timely manner and otherwise in accordance with the redemption procedures set forth in this prospectus, the [Name of Fund] will redeem the requested shares and make a payment to you in satisfaction thereof no later than the business day following the redemption request. The [Name of Fund] may postpone and/or suspend redemption and payment beyond one business day only as follows:

a. For any period during which there is a non-routine closure of the Fedwire or applicable Federal Reserve Banks;

b. For any period (1) during which the New York Stock Exchange is closed other than customary week-end and holiday closings or (2) during which trading on the New York Stock Exchange is restricted;

c. For any period during which an emergency exists as a result of which (1) disposal of securities owned by the [Name of Fund] is not reasonably practicable or (2) it is not reasonably practicable for the [Name of Fund] to fairly determine the net asset value of shares of the [Name of Fund];

d. For any period during which the Securities and Exchange Commission has, by rule or regulation, deemed that (1) trading shall be restricted or (2) an emergency exists;

e. For any period that the Securities and Exchange Commission, may by order permit for your protection; or

f. For any period during which the [Name of Fund,] as part of a necessary liquidation of the fund, has properly postponed and/or suspended redemption of shares and payment in accordance with federal securities laws.

PART 30—FOREIGN FUTURES AND FOREIGN OPTIONS TRANSACTIONS

3. The authority citation for part 30 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6c, and 12a, unless otherwise noted.

4. In § 30.7, revise paragraph (c) and add paragraph (g) to read as follows:

§ 30.7 Treatment of foreign futures or foreign options secured amount.

* * * * *

(c)(1) The separate account or accounts referred to in paragraph (a) of this section must be maintained under an account name that clearly identifies them as such, with any of the following depositories:

(i) A bank or trust company located in the United States;

(ii) A bank or trust company located outside the United States that has in excess of $1 billion of regulatory capital;

(iii) A futures commission merchant registered as such with the Commission;

(iv) A derivates clearing organization;

(v) A member of any foreign board of trade; or

(vi) Such member or clearing organization's designated depositories.

(2) Each futures commission merchant must obtain and retain in its files for the period provided in § 1.31 of this chapter an acknowledgment from such depository that it was informed that such money, securities or property are held for or on behalf of foreign futures and foreign options customers and are being held in accordance with the provisions of these regulations.

* * * * *

(g) Each futures commission merchant that invests customer funds held in the account or accounts referred to in paragraph (a) of this section must invest such funds pursuant to the requirements of § 1.25 of this chapter.

Issued in Washington, DC, on October 26, 2010, by the Commission.

David A. Stawick,

Secretary of the Commission.

Note: The following statement will not appear in the Code of Federal Regulations.

Statement of Chairman Gary Gensler

Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions

October 26, 2010

I support today's Commission vote on the proposed rulemaking regarding the investment of customer segregated and secured amount funds. This rulemaking fulfills part of the Dodd-Frank Act's requirement that the Commission remove all reliance on credit ratings from its regulations. In addition, the rule enhances protections regarding where derivatives clearing organizations (DCOs) and futures commission merchants (FCMs) can invest customer funds. The market events of the last two years have underscored the importance of prudent investment standards to ensure the financial integrity of DCOs and FCMs and of maximizing protection of customer funds.

[FR Doc. 2010–27657 Filed 11–2–10; 8:45 am]

BILLING CODE P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 180

RIN Number 3038–AD27

Prohibition of Market Manipulation

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission is proposing rules to implement new anti-manipulation authority in section 753 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposed rules expand and codify the Commission's authority to prohibit manipulation.

DATES: Comments must be received on or before January 3, 2011.

ADDRESSES: You may submit comments, identified by RIN number AD27, by any of the following methods:

- *Agency Web Site, via its Comments Online process:* Comments may be submitted to: *http://comments.cftc.gov.* Follow the instructions for submitting comments on the Web site.
- *Mail:* David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.
- *Hand Delivery/Courier:* Same as mail above.
- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *http://www.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the established procedures in CFTC Regulation 145.9.[1]

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from *www.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

FOR FURTHER INFORMATION CONTACT: Robert Pease, Counsel to the Director of Enforcement, 202–418–5863, *rpease@cftc.gov* or Mark D. Higgins, Counsel to the Director of Enforcement, 202–418–5864, *mhiggins@cftc.gov,* Division of Enforcement, Commodity Futures Trading Commission, Three Lafayette Centre, 1151 21st Street, NW., Washington, DC 20581.

I. Background

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[2] Title VII of the Dodd-Frank Act[3] amended the Commodity Exchange Act ("CEA")[4] to establish a comprehensive new regulatory framework for swaps and security-based swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating robust recordkeeping and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission's oversight.

In addition, Title VII of the Dodd-Frank Act contains expanded and clarified authority to prohibit manipulative behavior.

Section 753 of the Dodd-Frank Act amends section 6(c) of the CEA to expand the authority of the Commission to prohibit fraudulent and manipulative behavior. New CEA section 6(c)(1), which prohibits the use or employment of any manipulative or deceptive device or contrivance, requires the Commission to promulgate implementing rules within one year of enactment of the Dodd-Frank Act. The Commission also proposes to implement regulations pursuant to section 6(c)(3) of the CEA under its general rulemaking authority in section 8(a)(5) of the CEA.[5]

Accordingly, the Commission is proposing rules to address manipulative behavior. The Commission requests comment on all aspects of the proposed rules, as well as comment on the specific provisions and issues highlighted in the discussion below.

II. Manipulation Under Section 753

A. Section 753's Amendments to the CEA

Section 753 of the Dodd-Frank Act gives the Commission enhanced "anti-manipulation authority" as part of its expanded enforcement powers. It does so by amending section 6(c) of the CEA in a number of respects.

First, section 753 adds a new subsection (c)(1). Subsection (c)(1) broadly prohibits fraud-based manipulative schemes as follows:

> It shall be unlawful for any person, directly or indirectly, to use or employ, or attempt to use or employ, in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Commission shall promulgate by not later than 1 year after the date of enactment of the Dodd-Frank Act, provided no rule or regulation promulgated by the Commission shall require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect.

[1] 17 CFR 145.9.

[2] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at *http://www.cftc.gov./LawRegulation/OTCDERIVATIVES/index.htm.*

[3] Pursuant to Section 701 of the Dodd-Frank Act, Title VII may be cited as the "Wall Street Transparency and Accountability Act of 2010."

[4] 7 U.S.C. 1 *et seq.* (2006).

[5] 7 U.S.C. 12a(5).