Futures Industry Association
2001 Pennsylvania Ave. NW
Suite 600
Washington, DC 20006-1823

202.466.5460
202.296.3184 fax
www.futuresindustry.org

International Swaps and Derivatives Association, Inc.
360 Madison Avenue, 16th Floor
New York, NY 10017
United States of America
Telephone:1 (212) 901-6000
Facsimile:1 (212) 901-6001
email: isda@isda.org
website: www.isda.org

By Electronic Mail

December 2, 2010

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington DC 20581

Re: Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions, 75 Fed.Reg. 67642 (November 3, 2010)

Dear Mr. Stawick:

The Futures Industry Association ("FIA")[1] and International Swaps and Derivatives Association, Inc. ("ISDA" and, collectively with, the "Associations)[2] are pleased to submit this letter in response to the Commodity Futures Trading Commission's ("Commission's") request for comment on the proposed amendments to Commission Rule 1.25, Investment of

[1] FIA is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 30 of the largest futures commission merchants ("FCMs") in the United States. Among FIA's associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States contract markets.

[2] ISDA is the largest global financial trade association, by number of member firms. ISDA was chartered in 1985, and today has over 830 member institutions from 57 countries on six continents. These members include most of the word's most institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities.

Customer Funds, and Rule 30.7, Treatment of Foreign Futures or Foreign Options Secured Amount (the "Proposed Amendments").[3] The Associations agree with the Commission that the rules governing the investment of customer assets must be "consistent with the objectives of preserving principal and maintaining liquidity."[4] To that end, assets should 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."[5]

In its July 2009 letter to the Commission's advanced notice of proposed rulemaking on Rule 1.25, FIA affirmed its view that all of the permitted investments currently set out in the rule are compatible with preserving principal and maintaining liquidity and noted, in particular, that FIA member firms had experienced ample liquidity in US Treasury securities and the general obligations of government sponsored entities during the financial turmoil of the preceding year. Nonetheless, to further reduce the exposure of customer funds to potential credit, liquidity and market risks, FIA suggested revisions to the general terms and conditions governing such investments relating to (i) rating requirements for certain securities, (ii) liquidity, (iii) concentration limits for certain assets, and (iv) the weighted average maturity of the portfolio.[6]

Although the Associations support and share the Commission's goals, we are unable to support the Proposed Amendments in their entirety. For the reasons described below, we are concerned that several of the proposed revisions are inconsistent with the Commission's goals, may increase systemic risk or may have significant unintended consequences. We are particularly troubled by the proposals to (i) prohibit entirely investments in the securities of government sponsored enterprises ("GSEs") and corporate obligations (unless such securities are guaranteed as to principal and interest by the United States) and all foreign sovereign debt, (ii) limit the investment in money market mutual funds to 10 percent of investible assets held in segregation and (iii) prohibit repurchase and reverse repurchase transactions with affiliated banks and registered broker-dealers (as well as so-called "in-house" transactions).

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3 Our comments herein are limited to the appropriate standards that should govern the investment of customer funds held by an FCM in connection with transactions executed on designated contract markets and foreign boards of trade. We express no opinion on the scope of the rules, if any, that should govern the investment of funds held by an FCM or other Commission registrant in connection with other transactions that are subject to the Commission's jurisdiction. In this regard, the Associations understand that the Commission has approved for publication in the Federal Register proposed rules governing the treatment of collateral posted with swap dealers and major swap participants to margin uncleared swaps and, in connection therewith, has proposed to restrict the investment of such funds to those investments permitted under Rule 1.25. the Associations reserve the right to submit comments on this latter proposal within the prescribed comment period.

4 75 Fed.Reg. 76742, 67643 (November 3, 2010).

5 Id.

6 Letter from John M. Damgard, President, Futures Industry Association, to David A. Stawick, Secretary to the Commission, dated July 20, 2009.

Liquidity

As discussed immediately below, the Associations support the Commission's proposal to require that customer funds be invested only in investments that are "highly liquid." The revisions to the Proposed Amendments that we are recommending herein, therefore, should not result in "the potential use of instruments that may pose an unacceptable level of risk."[7] Nonetheless, in order to further enhance the liquidity of an FCM's customer funds investment portfolio, the Associations also recommend that the Commission amend Rule 1.25 to require that at least 25 percent of total assets held in segregation be in the form of immediately available cash or US Treasury securities.[8]

Marketability

The Associations generally support the Commission's proposal to delete the requirement in Rule 1.25(b)(1) that investments must be "readily marketable" as defined in Securities and Exchange Commission ("SEC") Rule 15c3-1 and require instead that investments must be "highly liquid" such that, under stable market conditions, FCMs are able to convert such investments into cash within one business day without material discount in value. In this regard, however, we note that even the most liquid securities do not necessarily trade every day. Therefore, we ask the Commission to confirm that, in determining whether a security is highly liquid, an FCM may make reference to securities that are directly comparable, particularly for those issuers with many classes of securities outstanding. Further, we ask the Commission to confirm that FCMs may rely on publicly-available prices as well as third-party pricing vendors such as Bloomberg, TradeWeb, TRACE, IDCG and MSRB (for municipal securities). Our comments below recommending revisions to the investment restrictions set out in the Proposed Amendments are subject at all times to the condition that the specific investments in which an FCM invests customer funds are "highly liquid."

Permitted Investments

The Commission proposes to restrict the permitted investment of customer assets to (i) obligations of the United States and obligations guaranteed as to principal and interest by the United States,[9] (ii) general obligations of any State or any political subdivision thereof (municipal securities), and (iii) non-negotiable certificates of deposit that are redeemable by the issuing bank within one business day. Securities issued by government sponsored enterprises (agency securities), foreign sovereign debt, corporate notes and bonds, commercial

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[7] 75 Fed.Reg. 67642, 67644 (November 3, 2010).

[8] In accordance with Commission Rule 1.25(b)(3)(iv), customer-owned securities posted as collateral are not included in computing total assets held in segregation for purposes of this rule.

[9] Such securities include corporate notes and bonds that are guaranteed pursuant to the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program ("TLGP"). As the Commission noted, this program expires in 2012.

paper, and negotiable certificates of deposit would no longer be permitted investments under the Proposed Amendments.[10]

Government Sponsored Enterprises. We appreciate the Commission's concern with respect to securities issued by GSEs. Certainly, the failure of the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") justify the Commission's decision to evaluate whether such agency securities should remain a permitted investment. However, we cannot support a complete prohibition on the investment of customer assets in agency securities.

Although they are clearly the largest and most well-known, it must be remembered that Fannie Mae and Freddie Mac are not the only GSEs in whose securities FCMs are currently permitted to invest. Other GSEs include the Federal Home Loan Banks, the Federal Farm Credit Banks, the Federal Agricultural Mortgage Corporation, and the Tennessee Valley Authority.[11] Each of these entities has been found by Congress to perform activities critical to the public interest. To fund these activities, these GSEs rely on investments from both foreign and domestic investors. We are concerned that the Proposed Amendments may result in a loss of investor confidence in the securities of these entities and a concomitant rise in the cost of borrowing.[12]

More important, each of these enterprises weathered the financial crisis without the need for a federal bailout. Trading in the securities of these entities, including the securities of Fannie Mae and Freddie Mac, have remained highly liquid, as the Commission proposes to define that term.[13] Moreover, the Associations note that, in the exercise of its authority under the Housing and Economic Recovery Act of 2008, the Department of the Treasury has initiated separate Senior Preferred Stock Purchase Agreements with Fannie Mae and Freddie Mac.

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[10] The proposed restrictions on investments permitted under Rule 1.25 may have an impact on the weighted average maturity of an FCM's portfolio. The Commission has not proposed any revisions to this subsection of the rule. However, the Proposed Amendments provide an opportunity to include within the rule a definition of the term "weighted average maturity," which would facilitate consistent application of the weighted average maturity calculation. We would appreciate the opportunity to discuss this issue with the Commission in the near future.

[11] In contrast to Fannie Mae and Freddie Mac, these GSEs are not publicly-traded entities.

[12] As the Federal Housing Finance Agency observed in a January 20, 2010 Mortgage Market Note ("Market Note"): "Investor confidence is essential to liquid and well-functioning mortgage markets, which in turn benefit homeowners and qualified mortgage borrowers by lowering borrowing costs and supporting home prices."

[13] In its July 2009 comment letter responding to the Commission's advance notice of proposed rulemaking, FIA enclosed Excel spreadsheets prepared from publicly available data, demonstrating that, from December 2007 through May 2009, firms experienced ample liquidity in the secondary markets for US Treasury securities and general obligations of government sponsored agencies. Although the markets experienced higher volatility levels in the fall of 2008, bid to offer spreads were always available. As demonstrated in the attached PowerPoint presentation, "Liquidity in the Agency Markets", the general obligations of government sponsored agency securities remain highly liquid.

The Senior Preferred Stock Purchase Agreements "effectively provide a very long-term federal guarantee to existing and future debt holders."[14] If either Fannie Mae's or Freddie Mac's liabilities exceed its assets under generally accepted accounting principles, "the Treasury must provide sufficient cash capital to eliminate that deficit in exchange for senior preferred stock."[15]

In light of the foregoing and the fact that each of these government sponsored enterprises serves an important public purpose, it would not be appropriate to prohibit entirely investments in these securities. A determination by the Commission that investments in these securities are not suitable for customer funds could send a signal to institutional and foreign investors that such investments are not safe, which could result in these agencies having to face an unjustifiable increase in funding costs.

The Associations, therefore, recommend that the Commission permit investments in agency securities, subject to the conditions that (i) with the exception of Agency Discount Notes, the size of the issuance is at least $1 billion, (ii) trading in the securities of such agency remains highly liquid, (iii) the prices at which the securities may be traded are publicly available, *e.g.*, through Bloomberg or TRACE, and (iv) investments in any single issuer of government sponsored enterprise securities do not exceed 15 percent and investments in government sponsored enterprise securities, in the aggregate, do not exceed 50 percent of total assets held in segregation.

Corporate notes and bonds, commercial paper and negotiable certificates of deposit. Section 939A of the Dodd-Frank Act requires the Commission to review its rules and make changes necessary to decrease reliance on credit ratings. To this end, the Commission has proposed to amend Rule 1.25 to delete paragraph (b)(2) thereof, which prescribes the ratings issued by nationally recognized statistical rating organizations ("NRSROs") that all permitted investments except US government obligations and money market mutual funds are required to maintain. Although we believe credit ratings can continue to provide a valuable function, we recognize that the Dodd-Frank Act offers the Commission no clear alternative to removing reference to credit ratings in Rule 1.25.

We do not agree, however, that the inability to rely on credit ratings supports the Commission's proposal to remove corporate notes and bonds, commercial paper, and negotiable certificates of deposit from the list of permitted investments entirely. In the limited time available to analyze the impact of the Proposed Amendments and to prepare this comment letter, we have not had an opportunity to develop standards on which our members could agree. Nonetheless, provided trading in the relevant security remains highly liquid, we believe these securities should continue to be eligible investments under Rule 1.25. The Associations would welcome the opportunity to work with the Commission in developing

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14 Market Note, p. 1.

15 Id., p. 3.

criteria to identify the types of corporate notes and bonds, commercial paper and negotiable certificates of deposit in which customer funds may be invested and set appropriate concentration and other limits.

Foreign sovereign debt. We cannot support the proposed prohibition on investing in foreign sovereign debt. FCMs offer, and many clients prefer, a single currency margining arrangement, most often denominated in US dollars. In the event a clearing organization requires that margin be deposited in a foreign currency, the FCM faces a foreign currency exposure when meeting that margin requirement. The FCM is able to mitigate the risk of its (and its customer's) foreign currency exposure by investing customer funds in securities denominated in the relevant currency.

For this reason, we urge the Commission to allow an FCM somewhat greater latitude than currently permitted under Rule 1.25 in investing customer funds in relevant sovereign debt to the extent of the FCM's liabilities to its clients, or its clients' obligations to a clearing organization, in that country's currency.[16] Under current Rule 1.25(b)(4)(D), an FCM "may invest in the sovereign debt of a country to the extent it has balances in segregated accounts owed to its customers denominated in that country's currency; a derivatives clearing organization may invest in the sovereign debt of a country to the extent it has balances in segregated accounts owed to its clearing member futures commission merchants denominated in that country's currency."

The Associations appreciate the Commission's concern that "certain countries' debt can exceed an acceptable level of risk."[17] However, we note that, unless otherwise specifically authorized by the customer, segregated funds held outside of the US may be held only in the currency's country of origin or a money center bank or G-7 country, *i.e.*, Canada, France, Italy, Germany, Japan, and the United Kingdom.[18] We submit that the Commission's concern should not apply to the debt of the money center countries.[19] Separately, we suggest that an FCM that accepts foreign currency from customers located outside of the United States or from customers that trade on foreign markets should not be denied the opportunity to invest in foreign sovereign debt to the limited extent described above, because "it appears that foreign sovereign debt is rarely used as an investment tool by FCMs."[20]

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16 As with other investments, however, an FCM not invest in particular foreign sovereign debt unless trading in the instrument is highly liquid.

17 75 Fed.Reg. 67642, 67645 (November 3, 2010).

18 Commission Rule 1.49.

19 The Commission should also consider whether prohibiting FCMs from investing in foreign sovereign debt might invite retaliation from foreign jurisdictions.

20 Id. Elsewhere in the Federal Register release, the Commission cites its 2007 review of the nature and extent of investments of customer segregated funds, which indicated that FCMs did not invest in certain securities in any significant degree, as apparent support for removing such securities from the list of permitted investments. We disagree. Securities should be removed from the list of permitted investments only if the

Money Market Mutual Funds

In response to the problems experienced by the Reserve Primary Fund in 2008, the Commission has proposed to prohibit an FCM from investing more than 10 percent of the total assets held in segregation in money market mutual funds, in the aggregate, and no more than 2 percent of total assets held in segregation in any one family of money market mutual funds. Under the current rule, money market mutual funds are not subject to any concentration limits.

In its July 2009 comment letter, FIA recommended that Rule 1.25 be amended to provide (i) that an FCM's investment in any one money market mutual fund may not exceed 5 percent of assets under management in that fund, and (ii) that no more than 25 percent of invested customer funds may be invested in any one money market mutual fund. FIA did not, however, recommend a concentration limit on the amount of segregated assets that could be invested in money market mutual funds overall.

We have reconsidered our earlier recommendation in light of the Proposed Amendments and have concluded that some changes are appropriate. In this regard, we suggest that Rule 1.25 be amended to provide (i) that an FCM's investment in any one money market mutual fund may not exceed 5 percent of assets under management in that fund (unchanged from our earlier recommendation), and (ii) that no more than 15 percent of the total assets held in segregation may be invested in any one family of money market mutual funds. In addition, investments in money market mutual funds would not be permitted to exceed 50 percent of the total assets held in segregation.

We submit that the concentration limits the Commission has proposed are too strict and unnecessary to mitigate the potential risks of investing in money market mutual funds. The Associations believe the SEC's recent revisions to Rule 2a-7 significantly enhance the safety and transparency of money market mutual funds. The Associations understand that the Investment Company Institute and several registered investment companies intend to file comment letters with the Commission that, among other things, will describe these amendments in detail. However, we note that the amendments are designed to further assure the liquidity of money market mutual funds.

In this connection, the revised rule: (i) reduces the weighted average maturity of a money market fund's portfolio from 90 days to 60 days; (ii) provides that the average weighted life of a money market fund's portfolio may not exceed 120 days; (iii) provides that second tier securities may not exceed 3 percent of a money market fund's portfolio or more than 0.5 percent of any single issuer; (iv) provides that the remaining maturity of any second tier security may not exceed 45 days; (v) provides that at least 10 percent of its assets must be "daily liquid assets," *i.e.*, cash, direct obligations of the United States, and securities

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Commission determines that such investments are no longer "consistent with the objectives of preserving principal and maintaining liquidity."

(including repurchase agreements) that will mature or are subject to a demand feature that is exercisable and payable within one business day; and (vi) more generally, requires a money market fund to hold securities that are sufficiently liquid to meet reasonably foreseeable shareholder redemptions. In complying with this latter requirement, money market mutual funds are expected to consider the characteristics of the fund's investors and their likely redemptions as a factor in determining liquidity needs.

The amended rule also further enhances transparency with respect to the securities held by each money market mutual fund, thereby facilitating an FCM's ability to conduct appropriate due diligence before investing in a money market mutual fund.[21] The rule requires a money market mutual fund, within five business days of each month-end, to post on its website a report listing the name of the issuer, the category of investment, the CUSIP number, the principal amount, the maturity date as determined under Rule 2a-7 for purposes of calculating weighted average maturity, the final maturity date, the coupon or yield, and the amortized cost value. Funds must also post the weighted average maturity and weighted average life of their portfolios. This information must be maintained on the fund's Web site for at least six months.

Separately, the money market mutual fund is required to file a monthly report with the SEC on Form N-MFP within five business days of each month-end. The Form N-MFP contains both fund-specific and portfolio specific information. The fund-specific information includes the shadow price per share for the fund and each of its classes. The portfolio-specific information includes the category of investment of each portfolio security, the designated NRSROs and ratings, the maturity date, the market value, and whether the portfolio security is illiquid. The SEC will compile the reports filed by each money market mutual fund into a central data base and will make the reports publicly available 60 days after the end of the relevant month.

The Associations believe that money market mutual funds, including prime funds, constitute an appropriate investment, providing an efficient and effective means of investing customer funds that are no less safe than direct investments in securities permitted under Rule 1.25. The Associations considered whether investments in money market mutual funds should be limited to funds that invest solely in US Treasury securities or in funds that invest only in Rule 1.25 permitted investments. We concluded that FCMs should continue to have authority to invest in prime funds as currently permitted in Rule 1.25, subject to the concentration limits recommended above. US Treasury money market mutual funds, in particular, generally are not as large as prime funds and, consequently, do not lend themselves to investments by institutional investors, in particular, FCMs, which may be required to redeem (and purchase) large numbers of shares frequently.

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[21] The Associations understand that FCMs have an obligation to conduct appropriate due diligence before investing customer assets in any investment, including money market mutual funds.

We encourage the Commission to revise the Proposed Amendments to adopt the concentration limits suggested above.

Repurchase and Reverse Repurchase Transactions

The Commission has proposed to change substantially the manner in which FCMs are permitted to enter into repurchase and reverse repurchase agreements. Specifically, the Commission has proposed to prohibit FCMs from entering into such transactions with bank and broker-dealer affiliates, as currently permitted under Rule 1.25(d), and, further, has proposed that the aggregate value of any repurchase or reverse purchase agreements that an FCM enters into with any one permitted counterparty cannot exceed 5 percent of total assets held in segregation. Separately, the Commission would prohibit so-called "in-house" transactions (provided the FCM is also a broker-dealer), as currently permitted under Rule 1.25(e).

The Associations cannot support the proposed amendments. As explained below, FCMs have much greater certainty with respect to the securities received and are exposed to substantially less counterparty risk to the extent that they enter into transactions with affiliates.

Securities Subject to Repurchase Agreements. As proposed to be revised, Rule 1.25 appears to provide that an FCM may not engage in repurchase transactions with customer-owned securities, unless such securities are permitted investments under the rule. Consequently, if a customer deposits securities that are permitted under applicable exchange and DCO rules but that are not permitted investments under Rule 1.25, an FCM would not be able to enter into a repurchase transaction with such securities. We do not believe it is the Commission's intent to prohibit an FCM from exchanging potentially less liquid securities for cash or more highly liquid securities that are permitted investments under the rule. We ask the Commission to clarify its position in this regard.[22]

Five percent concentration limit. We are concerned that imposing a concentration limit of 5 percent may actually decrease liquidity and increase operational and systemic risk.[23] FCMs require a fluid and timely mechanism for effecting clearing organization settlements, which generally occur twice daily. Clearing members may be required to execute and unwind reverse repurchase agreements intra-day within a very brief period of time. Adding to the

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22 As noted above, the Commission has proposed rules governing the treatment of collateral posted with swap dealers and major swap participants to margin uncleared swaps and, in connection therewith, has proposed to restrict the investment of such funds to those securities permitted under Rule 1.25. The proposed rules do not address what collateral is eligible to be posted as margin, however. In light of these proposed rules, we expect that the Commission will take a similar approach with respect to funds held in connection with cleared swaps. If the Commission moves forward with the proposed rules, the ability to engage in repurchase transactions with customer-owned securities that do not comply with Rule 1.25 will be essential.

23 The proposed concentration limit would require an FCM seeking to actively manage customer assets through the use of repurchase and reverse repurchase agreements to maintain accounts at approximately 25 different banks or broker-dealers to assure that the 5 percent limit is never hit.

complexity, DCOs strictly define the securities they will accept. An FCM, therefore, must review the securities received under reverse repurchase transactions to insure that they are eligible for delivery to the DCO and comply with applicable concentration limits. Requiring an FCM to effect reverse repurchase transactions with multiple counterparties under tight time frames will substantially increase an FCM's operational risk and invite errors.

If the Commission determines to maintain a concentration limit, we recommend a concentration limit of 25 percent for transactions with independent counterparties and affiliated broker-dealers or banks.

Affiliate transactions. In support of its proposal to prohibit repurchase and reverse repurchase transactions with affiliates, the Commission suggests that "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."[24] We disagree. Although affiliates within a financial holding company are not immune from the strains that another affiliate may experience, it does not follow that assets held in an FCM's customer segregated account would be at greater risk. To the contrary, we submit that funds or securities held in connection with such transactions are at no greater risk in the event of a default than they would be in the event of a default (or financial distress) of a non-affiliated counterparty.

The provisions of current Rule 1.25(d) are designed to assure that, whether a transaction is with an affiliate or a non-affiliate, the customer segregated account is never at risk. Pursuant to Rule 1.25(d), agreements to repurchase or resell securities, including agreements with affiliates, are subject to a number of requirements, including: (i) 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 the rule and which states that the parties intend the transaction to be treated as a purchase and sale of securities; (ii) the term of the agreement is no more than one business day, or reversal of the transaction is possible on demand; (iii) securities transferred to the FCM or DCO under the agreement are held in a safekeeping account with a bank, a DCO, or the Depository Trust Company in an account that complies with the requirements of Commission Rule 1.26; (iv) the FCM or DCO 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 FCM or DCO; (v) the transfer of securities to the customer segregated account is made on a delivery versus payment basis in immediately available funds;[25] (vi) an actual transfer of

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[24] 75 Fed.Reg. 67642, 67651 (November 3, 2010).

[25] Specifically, as set forth in the rule, 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 FCM's or DCO's funds or securities purchased on behalf of customers. The transfer or credit of securities covered by the agreement to the FCM's or DCO's customer segregated custodial account is made simultaneously with the disbursement of funds from the FCM's or DCO's customer segregated cash account at the custodian bank. On the sale or resale of securities, the FCM's or DCO's customer segregated cash account at the custodian bank must receive same-day funds credited to such segregated

securities to the customer segregated custodial account by book entry is made consistent with Federal or State commercial law, as applicable; (vii) the agreement makes clear that, in the event of the bankruptcy of the FCM or DCO, any securities purchased with customer funds that are subject to an agreement may be immediately transferred; and (viii) 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 the agreement or to make a priority claim for the difference between the 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.[26]

These terms and conditions should be more than sufficient to assure that the customer segregated account and foreign futures and foreign options secured amount account are protected in the event of an FCM bankruptcy and, in particular, that such funds receive the priority established in the commodity broker liquidation provisions of subchapter IV, Chapter 7, of the Bankruptcy Code.

In support of its proposal to prohibit FCMs from effecting repurchase and reverse repurchase transactions with affiliates, the Commission refers to a press release the SEC issued in March 2008, in which the SEC responded to frequently asked questions regarding the circumstances surrounding the sale of the Bear Stearns Companies to JP Morgan Chase & Co. The press release accurately notes that, although Bear Stearns "continued to have high quality collateral to provide as security for borrowings, as concerns grew late in the week, market counterparties became less willing to enter into collateralized funding arrangements" with the company.

It is not clear how the inability of Bear Stearns to borrow from third parties supports the proposed prohibition. The problems that Bear Stearns experienced may have prevented the company from entering into new repurchase or reverse repurchase agreements, but there is no indication that the rights and obligations of the parties with respect to outstanding transactions were ever in doubt. In any event, as the SEC press release also notes, the Bear Stearns regulated entities were at all times in compliance with all applicable capital requirements and the customer funds held by these entities were not in danger.

In-house transactions. For many of these same reasons, the Associations urge the Commission to continue to permit FCMs that are also registered broker-dealers to engage in transactions currently authorized under Rule 1.25(e). Although an FCM cannot contract with

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account simultaneously with the delivery or transfer of securities from the customer segregated custodial account.

26 Master Repurchase Agreements typically require 102 percent "collateralization," protecting the value of the account in the event of a decline in the market value of the underlying securities that are transferred. The FCM monitors the value of the securities and, if the value of the securities approaches 100 percent, issues a margin call to the counterparty. In the event the value of the securities declines below the cash invested, the FCM must take a capital charge for the deficiency.

itself, Rule 1.25(e) imposes requirements that were carefully designed to provide protections comparable to those set our in Rule 1.25(d), summarized above.

In this regard, for example, Rule 1.25(e) provides securities may be transferred to or from the customer segregated account under the rule only in accordance with the following requirements, including: (i) the securities are priced each day based on the current mark-to-market value; (ii) the securities are held in a safekeeping account with a bank, a DCO, or the Depository Trust Company in an account that complies with the requirements of Commission Rule 1.26; (iii) the securities may not be used in another similar transaction and may not otherwise be hypothecated or pledged, except such securities may be pledged on behalf of customers at another futures commission merchant or DCO; (iv) no transfer of securities to the customer segregated custodial account will be recognized as accomplished until the securities are actually received by the custodian of such account, and upon unwinding of the transaction, the customer segregated cash account must receive same-day funds credited to such account simultaneously with the delivery or transfer of securities from the customer segregated custodial account; and (v) no transfer of money to the customer segregated cash account will be recognized as accomplished until the money is actually received by the custodian of the customer segregated cash account and upon unwinding of the transaction, the customer segregated custodial account must receive the securities simultaneously with the disbursement of money from the customer segregated cash account; (vi) an actual transfer of securities by book entry is made consistent with Federal or State commercial law, as applicable; and (vii) at all times, securities transferred to the customer segregated account are reflected as "customer property."

As with affiliate transactions, these terms and conditions should be more than sufficient to assure that the customer segregated account and foreign futures and foreign options secured amount account are protected in the event of an FCM bankruptcy and, in particular, that such funds receive the priority established in the commodity broker liquidation provisions of subchapter IV, Chapter 7, of the Bankruptcy Code.

For all of the above reasons, we therefore urge the Commission to withdraw its proposals to impose a concentration limit of 5 percent on the aggregate value of repurchase or reverse purchase agreements that an FCM may enter into with any one permitted counterparty and its proposals to prohibit repurchase and reverse repurchase transactions with affiliates and "in-house" transactions.

Foreign Futures and Options Secured Amount

The Associations agree with the Commission's proposal to align the investment standards of Rule 30.7 with the standards applicable to Rule 1.25.[27] We also support the Commission's proposal to revise the standards that a foreign bank or trust company must meet to hold an

[27] As the Commission noted in the Federal Register release accompanying the Proposed Amendments, FIA endorsed this recommendation in its July 2009 comment letter.

FCM's foreign futures and foreign options secured amount. As revised, Rule 30.7(c)(1) provides that, to the extent such funds are held outside of the United States, the foreign futures and foreign options secured amount may be held (i) in a bank or trust company that has in excess of $1 billion of regulatory capital, or (ii) the designated depository of a member of a foreign board of trade or a foreign clearing organization.[28] An FCM would no longer be permitted to select an eligible depository based on the credit rating of the depository's (or it's parent's) commercial paper or long term debt; nor would a customer be permitted to designate the depository in which that customer's secured amount could be held.

Acknowledgment Letters

The Associations support the proposed amendment to Commission Rule 1.25(c)(3) to clarify that an FCM that invests customer assets in a money market mutual fund must contain an acknowledgment letter from the entity "that has substantial control over the fund's assets and authority to facilitate the redemption and payment or transfer of customer segregated funds." In this regard, however, we ask the Commission to confirm that, in those circumstances in which an FCM deposits customer funds with a bank or other depository and thereafter instructs the bank to invest such customer funds in a money market fund, the bank is the appropriate entity from which the FCM should obtain the acknowledgment letter.

Effective Date

The Associations note that the Commission has not indicated when the Proposed Amendments would become effective, if they are adopted as final. In light of the significant changes to Rule 1.25 the Commission has proposed, we request that any rules the Commission adopts have an effective date no earlier than 180 days following publication in the Federal Register.

Conclusion

As the Commission noted in the accompanying Federal Register release, the current provisions of Rule 1.25 were adopted after careful analysis and consideration over a period of six years. It is unfortunate, therefore, that, in proposing such a substantial narrowing of the permitted investments under the rule, the Commission has afforded the industry only a 30-day comment period. The bulk of the Proposed Amendments are not required to be adopted under the Dodd-Frank Act, and we would urge the Commission to delay action on the Proposed Amendments until the industry and the public have sufficient time to consider their implications.

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[28] The Commission has asked whether a leverage ratio or a capital adequacy ratio requirement consistent with or similar to those in the Basel III accords would be an appropriate additional safeguard for a bank or trust company located outside the United States. The Associations note that the Basel III accords are not final and that no bank, wherever located, currently meets these capital adequacy ratio requirements. Although we are not opposed to an additional test to measure a bank's safety, we were unable in the limited time available to identify an appropriate test.

We would be pleased to meet with the staff to discuss our comments in greater detail. If the Commission has any questions concerning the matters discussed in this letter, please contact Barbara Wierzynski, FIA's Executive Vice President and General Counsel, at (202) 466-5460 or Mary Johannes, ISDA's Head of U.S. Public Policy, at (202) 756-4541.

Sincerely,

John M. Damgard
President
Futures Industry Association

Robert A. Pickel
Executive Vice Chairman
International Swaps and Derivatives Association, Inc.

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner

Division of Clearing and Intermediary Oversight
Ananda Radhakrishnan, Director
Phyllis Dietz, Associate Director
Jon DeBord, Attorney-Advisor

Agency Market Profile

Agency Market

- There is approximately 1.8 trillion in term debt outstanding from the main four issuers as of November, 2010
  - Billions are issued each day by the four major issuers in the market: Fannie Mae, Freddie Mac, Federal Home Loan Banks, and Federal Farm Credit Banks
  - On top of the regular daily issuance of floating rate notes, discount notes, callables, and bullets, the issuers typically sell 1-2 large benchmark bonds each month
- The four major issuers are perceived with very little differentiation in credit quality and liquidity
- Major market investors are money market funds, large domestic and foreign money managers and bank portfolios, central banks, insurance companies, and state & local governments
- Agency spreads have returned to pre-conservatorship levels
- Agency discount notes have the same yield as Treasury bills

The Agency Market Remains Stable, With Strong Transparency and Liquidity

- Agency spreads have returned to pre-conservatorship levels versus both Treasuries and Swaps. Reduced volatility from a spread and rate perspective has reduced and closed the gap in bid/ask spreads.

- Large, liquid deals have been a trademark of Agency syndicated new issues. Fannie Mae's average syndicated deal size thus far in 2010 is $5.8bn, and Freddie Mac's average size is $3.5bn.

- TRACE reporting, which started in March 2010, allows market participants to view market clearing levels for all trades, dramatically increasing the level of pricing transparency in the market. TRACE reporting for Agency MBS is targeted for May 16, 2011.

Understanding Regulatory Developments in the Agency Market[1][2]

1. **Conservatorship**: On September 7, 2008, Treasury announced that it has placed Fannie Mae and Freddie Mac in conservatorship
   - Defined by Treasury as a legal process transferring all oversight powers to the FHFA; Treasury's press release noted that obligations will continue to be met and the company will continue to operate as normal

2. **Capital Injection**: Treasury entered into a Senior Preferred Stock Purchase Agreements with Fannie and Freddie
   - In exchange for entering into these agreements, Treasury receives $2 billion of senior preferred stock in each GSE, and warrants representing 79.9% ownership in each GSE if exercised (at a nominal price); this action essentially erased the preferred and common equity tranches of Fannie Mae and Freddie Mac
   - To date, approximately $150 billion has been injected in Fannie & Freddie. Available US Treasury capital support is unlimited through 2012
   - Freddie Mac estimated in their latest 10Q filing with the SEC, $149.3 billion of US Treasury capital support will be available beyond 2012

3. **Federal Reserve Agency Bond Purchase Program:** The Federal Reserve Bank of New York conducted open market purchases of Fannie Mae, Freddie Mac, and Federal Home Loan Bank syndicated non-callable debt
   - $172bn was purchased

4. **Support of the Agency MBS Market**: The Federal Reserve Bank of New York purchased $1.25 trillion Agency MBS which materially increased the US Government stake in the GSEs.

(1) Federal Housing Finance Agency Fact Sheet: "Questions and Answers on Conservatorship" (2) Treasuries' Senior Preferred Stock Purchase Agreement and all subsequent amendments

Agency Debt Remains Liquid Across Maturities and actively quoted on public trading platforms[1]

Tradeweb On The Run Agencies — Important Notice

Yield | Change | ASW

Issuer	Cpn	Mat	Yield	Spread
2 yr	0.500	N12	99-312/31+	0.512/508
FHLB	0.875	812	0.607-600	9.5/ 8.8
FHLMC	0.375	N12	0.665-650	15.3/ 13.8
FNMA	0.375	D12	0.670-652	15.8/ 14.0
3 yr	0.500	N13	99-05 /052	0.790/787
FHLB	4.000	913	0.860-853	7.0/ 6.3
FHLB	3.625	O13	0.931-923	14.1/ 13.3
FHLMC	0.875	O13	0.952-935	16.2/ 14.5
FNMA	0.750	D13	1.005-998	21.5/ 20.8
FHLB	0.875	D13	1.003-983	21.3/ 19.3
5 yr	1.375	N15	98-30 /302	1.597/596
FHLMC	2.875	215	1.521-505	-7.6/ -9.2
FNMA	2.375	715	1.686-666	8.9/ 6.9
FHLMC	1.750	915	1.755-742	15.8/ 14.5
FNMA	1.625	O15	1.797-787	20.0/ 19.0

Issuer	Cpn	Mat	Yield	Spread
7 yr	2.250	N17	99-22+/23	2.296/294
FNMA	5.000	217	2.352-334	5.6/ 3.8
FNMA	5.000	517	2.431-417	13.5/ 12.1
FHLB	4.875	517	2.339-327	4.3/ 3.1
FNMA	5.375	617	2.464-461	16.8/ 16.5
FHLB	5.000	N17	2.486-466	19.0/ 17.0
FHLMC	5.125	N17	2.589-576	29.3/ 28.0
FHLMC	4.875	618	2.741-729	44.5/ 43.3
10 yr	2.625	N20	97-12+/13	2.929/927
FHLMC	3.750	319	2.917-897	-1.2/ -3.2
30 yr	4.250	N40	100-29+/30	4.196/195
FNMA	7.250	530	4.291-279	9.5/ 8.3
FNMA	6.625	N30	4.337-311	14.1/ 11.5
FHLMC	6.750	331	4.349-328	15.3/ 13.2
FHLMC	6.250	732	4.358-334	16.2/ 13.8

Source: Tradeweb; pricing as of 12:24pm, December 1, 2010 (Comprised of 15 Dealer quotes)

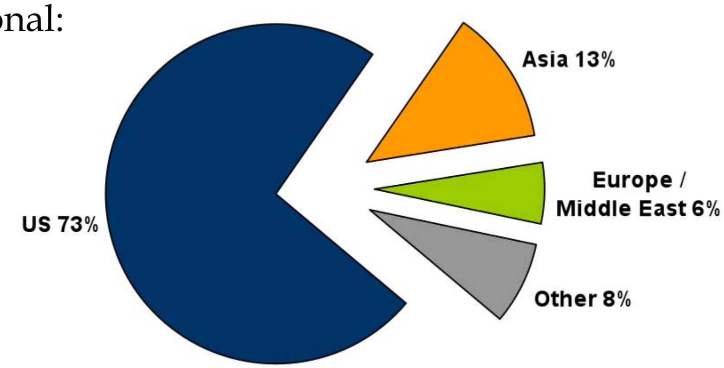
Agency Debt Remains Liquid Across Maturities and actively quoted on public trading platforms[2]

Source: Bloomberg (15 to 20 Dealer quotes, depending on issue)

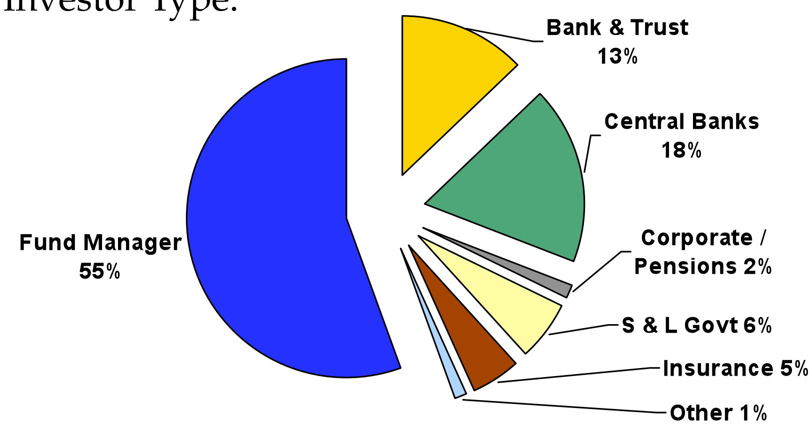
Profile Of A New Agency Deal

Typical Agency Distribution Profile

- Regional:



- Investor Type:



Source:: Fannie Mae and Freddie Mac websites

Key Points

- Average deal size across Fannie Mae and Freddie Mac is $3.5bn in 2010
- Each deal done this year has performed versus both Treasuries and Swaps
- Order books are typically 1.5-2x oversubscribed
- FINRA'S TRACE reporting mandate for Agency Debt product has increased the transparency for market participants. All debt issued greater than 1 year is subject to TRACE reporting
- New issue concessions have closed from 6-8bps in 2008-2009 to 0-2bps in the most recent deals