

Joint Audit Committee

REGULATORY UPDATE

TO: Chief Financial Officers
Chief Compliance Officers

#10-06

DATE: June 22, 2010

SUBJECT: CFTC Regulation 1.25 and SEC Rule 22e-3 – Redemption of Interests in Money Market Mutual Funds

On February 23, 2010, the SEC adopted Rule 22e-3, which was effective May 5, 2010 and allows a money market mutual fund (“MMMF” or “fund”) to suspend redemptions and postpone payment of redemption proceeds to facilitate an orderly liquidation of the fund under certain circumstances.

CFTC Regulation 1.25 allows MMMFs as a permitted investment of customer segregated funds provided the MMMFs meet certain requirements including, but not limited to, the requirement that they must be legally obligated to redeem an interest and make payment in satisfaction thereof by the business day following a redemption request (i.e. “next-day redemption”). FCMs are responsible for reviewing a fund’s prospectus to ensure that the MMMF complies with all applicable requirements of CFTC Regulation 1.25 including the “next-day redemption” requirement.

CFTC Regulation 1.25 allows certain exceptions to the “next-day redemption” requirement. One of the exceptions is emergency conditions set forth in Section 22(e) of the Investment Company Act. The CFTC’s Division of Clearing and Intermediary Oversight has determined that the suspension of redemption and postponement of payment pursuant to SEC Rule 22e-3 falls within the scope of exceptions permitted under CFTC Regulation 1.25(c)(5)(ii)(D). Thus, an MMMF which has authority to suspend redemption and postpone payments pursuant to SEC Rule 22e-3 is still considered good for segregation, 30.7 and capital provided it meets all requirements of CFTC Regulations.

The CFTC has issued a staff letter (attached) outlining the details of the impact of SEC Rule 22e-3 as it relates to CFTC Regulation 1.25.

If you have any questions, please consult your DSRO.



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Division of Clearing and
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Ananda Radhakrishnan
Director

June 3, 2010

Debra K. Kokal
Director, Audit Department
CME Group
20 South Wacker Drive
Chicago Illinois 60606

Re: Guidance Regarding Commission Regulation 1.25

Dear Ms. Kokal:

This letter provides guidance regarding new Securities and Exchange Commission (SEC) rule 22e-3 (Rule 22e-3)¹ and its impact on the investment of customer funds under Commission Regulation 1.25 (Reg. 1.25).²

Rule 22e-3, adopted by the SEC February 23, 2010 and effective May 5, 2010, allows a money market mutual fund (MMMF or fund) to suspend redemptions and postpone payment of redemption proceeds to facilitate an orderly liquidation of the fund.³ Below, the Division provides an overview of the Reg. 1.25 treatment of MMMFs, outlines Rule 22e-3, and discusses the interplay of Reg. 1.25 and Rule 22e-3. The Division concludes that Rule 22e-3 falls within the parameters of Reg. 1.25(c)(5)(ii)(D) and therefore the status of an MMMF that otherwise qualifies as a Reg. 1.25 permitted investment will not change as a result of the new rule.

Overview of Reg. 1.25 treatment of MMMFs/Next-Day Redemption

Reg. 1.25(a) provides a list of permitted investments for customer segregated funds, among them, interests in MMMFs.⁴ Reg. 1.25(c) sets forth certain requirements for MMMFs and, in particular, requires that “[a] fund shall be legally obligated to redeem an interest and to

¹ 17 C.F.R. § 270.22e-3.

² 17 C.F.R. § 1.25.

³ See 75 Fed. Reg. 10,060, 10,117 (Mar. 4, 2010).

⁴ Reg. 1.25(a)(1)(viii).

make payment in satisfaction thereof by the business day following a redemption request.”⁵ This “next-day redemption” requirement is a significant feature of Reg. 1.25 and is meant to ensure adequate liquidity.⁶

There are exceptions to the next-day redemption requirement, however. Reg. 1.25(c)(5)(ii) lists four:

- A) non-routine closure of the Fedwire or applicable Federal Reserve Banks;
- B) non-routine closure of the New York Stock Exchange (NYSE) or general market conditions leading to a broad restriction of trading on the NYSE;
- C) declaration of a market emergency by the SEC; or
- D) emergency conditions set forth in Section 22(e) of the Investment Company Act of 1940 (Section 22(e)).⁷

Section 22(e) identifies three emergency conditions:

- (i) for any period (A) during which the NYSE is closed other than customary week-end and holiday closings or (B) during which trading on the NYSE is restricted;
- (ii) for any period during which an emergency exists as a result of which (A) disposal by the company of securities is not reasonably practicable or (B) it is not reasonably practicable for such company fairly to determine the value of its net assets; or
- (iii) for such other periods as the SEC may by order permit for the protection of security holders of the company.

Further, Section 22(e) allows the SEC to determine, by rules and regulations, the conditions under which “(i) trading shall be deemed to be restricted and (ii) an emergency shall be deemed to exist within the meaning of [Section 22(e)].”

New SEC Rule 22e-3

As part of its recent MMMF rulemaking, the SEC adopted Rule 22e-3 which permits MMMFs to suspend redemptions and postpone payment of redemption proceeds in order to facilitate an orderly liquidation of the fund.⁸ 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,⁹ and the board, including a majority of its

⁵ Reg. 1.25(c)(5)(i).

⁶ See 70 Fed. Reg. 5585 (Feb. 3, 2005) (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.”).

⁷ 15 U.S.C. 80a-22(e).

⁸ See 75 Fed. Reg. at 10,088.

⁹ Rule 22e-3(a)(1).

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disinterested directors, must irrevocably approve the liquidation of the fund.¹⁰ In addition, prior to suspending redemption, the fund must notify the SEC of its decision.¹¹

Interplay of Reg. 1.25 and Rule 22e-3

As noted above, Reg. 1.25(c)(5)(ii)(D) provides, as an exception to the next-day redemption requirement, “[e]mergency conditions set forth in section 22(e)....” While the circumstances addressed by Rule 22e-3 are not specifically identified in Section 22(e)(i)-(iii), the Division considers Rule 22e-3 to be a “rule or regulation” as contemplated by the final paragraph of Section 22(e), which states that the SEC “shall by rules and regulations determine the conditions under which (i) trading shall be deemed to be restricted and (ii) an emergency shall be deemed to exist....” Therefore, suspension of redemption and postponement of payment pursuant to Rule 22e-3 falls within the scope of Reg. 1.25(c)(5)(ii)(D). As a result, the status of an MMMF that otherwise qualifies as a Reg. 1.25 permitted investment will not change due to the SEC’s adoption of Rule 22e-3.

This letter is based upon Rule 22e-3 as it is currently written and any new, different or changed material facts or circumstances might render this letter void. Moreover, this letter represents the position of the Division only and does not necessarily represent the views of the Commission or those of any other division or office of the Commission. If you have any questions concerning this correspondence, please contact Jon DeBord, Attorney-Advisor, at 202-418-5478 or jdebord@cftc.gov.

Sincerely,



Ananda Radhakrishnan
Director

¹⁰ Rule 22e-3(a)(2).

¹¹ Rule 22e-3(a)(3).