



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and
Intermediary Oversight

CFTC letter No. 03-31
August 25, 2003
Interpretation
Division of Clearing and Intermediary Oversight

Dear:

This is in response to your letter dated August 7, 2003, to the Division of Clearing and Intermediary Oversight (“DCIO”) of the Commodity Futures Trading Commission (“Commission”). You requested on behalf of your client, “Bank”, confirmation that the Bank’s trust deposit account product (“Trust Account”) as described in your letter meets the requirements of §4d(a)(2) of the Commodity Exchange Act¹ (the “Act”) and Commission Rules 1.20 and 1.25 as applicable², for the deposit of segregated customer funds by registered futures commission merchant (“FCM”) customers of the Bank. You have further stated that, believing that the Trust Account satisfies the above-mentioned requirements, and given its safety and liquidity, there should be no question that an FCM may deposit secured amount funds in a Trust Account consistent with the provisions of Commission Rule 30.7.³

FACTS

You have represented that:

- The Bank is a commercial bank chartered under the laws of the State of New York and is a member of the Federal Reserve System and the Federal Deposit Insurance Corporation.
- The Trust Account will be a cash deposit account maintained with the Bank’s institutional trust department that is recorded on the trust ledger of the Bank.
- The Trust Account will be appropriately titled in the name of the FCM for the benefit of commodity customers and that the Bank will identify the funds in the Trust Account as FCM commodity customer segregated funds in its records.
- The Trust Account agreement will provide that the Bank segregate the Trust Account in its books and records, and that the cash in the Trust Account will at no time secure directly or indirectly any loan made by the Bank to the FCM.
- The Trust Account will not be subject to any right, charge, security interest, lien or claim of any kind in favor of the Bank or any person claiming through the Bank.

¹ 7 U.S.C. §1 *et seq.* (2000).

² 17 C.F.R. §1.20 and §1.25. Commission rules referred to herein are found at 17 C.F.R. Ch. 1 (2003).

³ 17 C.F.R. §30.7.

- The Bank will provide proper acknowledgements that it was informed that the funds in the Trust Account are those of commodity customers and that such funds are being held in accordance with the Act and the rules and regulations thereunder.
- The trustee of the Trust Account will have no authority to invest the funds in the Trust Account but will only have a safeguarding function with respect to the funds in the Trust Account.
- The funds deposited by FCMs into Trust Accounts will at all times be immediately available for withdrawal on demand.

You have stated that a return would be paid on funds deposited in a Trust Account, “A”. You have further obtained an opinion of banking counsel “B” that restrictions or requirements relating to the conditions under which interest may be paid under bank regulations are not applicable to the Trust Account.

ANALYSIS

Section 4d(a) of the Act requires FCMs to segregate customer funds from their own funds, but permits them to commingle the funds of their individual customers for convenience and deposit such funds in accounts at banks or trust companies.⁴ Commission Rule 1.20 expands on this requirement to provide that “customer funds when deposited with any bank, trust company, clearing organization or another futures commission merchant shall be deposited under an account name which clearly identifies them as such and shows that they are segregated as required by the Act and this part.”⁵ In addition, Commission Rule 1.20 provides that “[e]ach registrant shall obtain and retain in its files...a written acknowledgement from such bank, trust company, clearing organization, or futures commission merchant, that it was informed that the customer funds deposited therein are those of commodity or option customers and are being held in accordance with the provisions of the Act and this part.”⁶ Commission Rule 1.20 further provides that “customer funds may be invested in instruments described in [Rule] 1.25.”

Commission Rule 1.25 permits FCMs to invest their customers’ funds in certain investment instruments subject to specific conditions.⁷ However, DCIO does not need to address the issue of whether the use of such Trust Account constitutes a “permitted investment” of customer funds under 1.25 since the funds are on deposit in an enumerated good location for purposes of CFTC Rule 1.20, that is, a bank or trust company. Therefore, the issue for DCIO is whether the characteristics of the Trust Account render it ineligible to be a depository for

⁴ §4d(a)(2) provides in part that “money, securities, and property [of customers] shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held: *Provided, however,* That such money, securities, and property of the customers of such futures commission merchant may, for convenience, be commingled and deposited in the same account or accounts with any bank or trust company...” 7 U.S.C. §6d(a)(2).

⁵ 17 C.F.R. §1.20(a).

⁶ *Id.*

⁷ 17 C.F.R. §1.25.

segregated customer funds under §4d(a)(2) of the Act, Commission Rule 1.20 and interpretive guidance applicable thereto.

In this regard, in Financial and Segregation Interpretation 9,⁸ Commission staff stated that certain interest-bearing bank deposit accounts are unacceptable for the deposit of segregated customer funds because such accounts are subject to withdrawal restrictions under applicable banking regulations and are not immediately available.⁹

Interpretation No. 9 states

Although it is permissible to deposit customer funds in a bank, it has always been the [DCIO's] position that customer funds deposited in a bank cannot be restricted in any way, that such funds must be held for the benefit of customers and must be available to the customer and the FCM immediately upon demand. Based upon that position, the [DCIO] has not allowed customer funds to be deposited in savings accounts since savings accounts are time deposits which are subject to delayed withdrawal if the bank chooses to exercise its reserved right to delay withdrawal.

Interpretation No. 9 also cites Administrative Determination 29 of the Commodity Exchange Authority, the Commission's predecessor agency, dated September 28, 1937, as support for this position, which provides "the deposit, by a futures commission merchant, of customers' funds . . . under conditions whereby such funds would not be subject to withdrawal upon demand would be repugnant to the spirit and purpose of the Commodity Exchange Act. All funds deposited in a bank should in all cases be subject to withdrawal on demand."

Although you have stated that the Trust Account would pay a return, you have also represented that the funds in a Trust Account would at all times be immediately available for withdrawal on demand, and that banking law restrictions on such withdrawal availability are not applicable to the Trust Account. Specifically, in reliance upon the opinion of your banking counsel, you have represented that the Trust Account would be free of any restrictions on the withdrawal of funds deposited in the Trust Account immediately upon demand. Accordingly, you note that the concerns enumerated with respect to interest-bearing bank deposit accounts that are the subject of Interpretation No. 9 as described above do not apply to the Trust Account.

Moreover, DCIO notes that the Trust Account would otherwise comply with the requirements of Commission Rule 1.20 that the account name clearly identify the funds as customer funds which are segregated, and that the funds in such account are appropriately acknowledged as being segregated funds by the depository.

⁸ Financial and Segregation Interpretation No. 9 – Money Market Deposit Accounts and Now Accounts, reprinted in Comm. Fut. L. Rep. (CCH) ¶ 7,119 (November 23, 1983) ("Interpretation No. 9").

⁹ Interpretation No. 9 disallowed the deposit of segregated customer funds into certain interest bearing and money market deposit accounts based upon the applicability of a requirement that depository institutions reserve the right to require seven days prior notice of withdrawals or transfers from those accounts.

August 25, 2003

Based upon the representations set forth in your letter and supporting material which you have provided, DCIO agrees with your analysis that the deposit of customer funds into the Trust Account would be permitted under the Act and Commission Rule 1.20.

CONCLUSION

Without expressing any opinion or position with respect to the interpretation or application of banking regulations, if as stated in your representations above and your accompanying opinion of banking counsel that any withdrawal restrictions would be inapplicable to the Bank's Trust Account, and so long as the Trust Account is properly titled and acknowledged by the Bank as represented in your letter, the Trust Account is acceptable for the deposit by FCMs of their segregated customer funds.

Further, concerning the statement contained in your letter with respect to the Trust Account being an appropriate deposit location for secured amounts under Commission Rule 30.7, DCIO agrees that, based upon your representations as enumerated above, if the Trust Account is appropriate for the deposit of segregated customer funds it also satisfies the requirements of Commission Rule 30.7 with respect to secured amounts.

The position taken herein is based upon the representations that have been made to DCIO. Any different, changed, or omitted facts or conditions might require DCIO to reach a different conclusion. You must notify DCIO immediately in the event that there is any change from the facts as presented to us concerning the Trust Account. Further, this letter represents the position of DCIO only and does not necessarily represent the views of the Commission or any other division or office of the Commission.

If you have any questions concerning this correspondence, please contact Jennifer C.P. Bauer, an attorney on my staff, at (202) 418-5472.

Very truly yours,

Jane Kang Thorpe
Director