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August 4, 2000

Ms. Jean A. Webb, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: **Proposed Rules Concerning Intermediaries - Changes to CFTC Rule 1.25 Concerning the Investment of Customer Funds**

Dear Ms. Webb:

The purpose of this letters is to offer comment and a request for clarification about the proposed changes to CFTC Rule 1.25. Prior to doing so, I would first like to provide you with some general background about Brown Brothers Harriman & Co. ("BBH") and its involvement in the futures industry.

BBH Background

Founded in 1818, BBH is licensed as a private bank with banking offices in New York, Boston and Philadelphia. BBH also maintains offices in Chicago, Los Angeles, Dallas, Charlotte, Naples, Palm Beach, London, Luxembourg, Dublin, Zurich, Tokyo, Hong Kong and Grand Cayman. BBH has five principal businesses. These include global custody, investment management, commercial banking, foreign exchange and corporate finance. Global custody is BBH's largest business with $850 billion of securities in safekeeping held primarily for institutional clients in approximately 90 countries. Investment management is BBH's second largest business with approximately $37 billion of assets under management. Of this amount, $15 billion are equity securities and $22 billion are fixed income securities. Of the $22 billion in fixed income securities under management, $10 billion are managed in what BBH classifies as liquidity-oriented portfolios. BBH defines liquidity-oriented portfolios as investment management assignments that have principal investment tenets of capital preservation and high liquidity.

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Servicing the futures industry is considered a core BBH business that involves four of its principal activities -- custody, investment management, commercial banking and corporate finance. BBH is a margin settlement bank for the Board of Trade Clearing Corporation, the Chicago Mercantile Exchange, the New York Clearing Corporation, the New York Mercantile Exchange and its COMEX Division and the Options Clearing Corporation. Over 40 CFTC registered futures commission merchants ("FCMs") that are clearing members of these clearing organizations use BBH for the services described above. As a margin settlement bank, BBH acts as a financial intermediary for the pledging of securities as original margin and the payment of variation margin to these clearing organizations. BBH is an investment advisor for the management of both proprietary and customer funds as defined in the Commodity Exchange Act. We are the sole investment advisor to the Chicago Mercantile Exchange's Interest Earning Facility ("IEF") which currently holds approximately $1 billion in margin assets. We also directly manage funds for FCM clients. Finally, we have served as a financial advisor to FCMs and commodity exchanges in the evaluation of acquisitions and strategic partnerships.

In New York and Chicago, BBH has staff that is dedicated to servicing the commodity futures industry, and BBH is active in the Futures Industry Association ("FIA"). I am a past president of the FIA's Financial Management Division and a current director of its Operations Division. BBH staff regularly speaks at FIA events discussing banking and investment management issues that affect the futures industry. Additionally, a BBH Partner is a Public Director of the New York Board of Trade.

Comments

BBH applauds the CFTC's initiative to amend Rule 1.25. BBH believes that this rule change will improve the competitiveness of the U.S. exchange traded futures industry. Amending this rule as proposed will move the U.S. markets towards parity with its international competitors and the over-the-counter (OTC) markets. The added investment returns that should be achieved by expanding the CFTC investment guidelines would improve the financial performance of FCMs thus allowing these firms and the U.S. futures markets to be more competitive. We also believe that the proposed investment guidelines are consistent with the CFTC's charter of approving investment alternatives that have the principal investment tenets of preserving capital and maintaining high liquidity and with FCMs' fiduciary responsibilities to safeguard their customers' margin assets.

It is well documented that the U.S. exchange traded futures industry's dominance is being challenged by both foreign competitors and the OTC market. Additionally, Internet based and electronic exchanges may present further challenges to exchange traded products. There are various ways in which a market can be more competitive. They include, but are not limited to, superior product, price discovery, liquidity, and ease and cost of execution. Associated with the cost of trading is not only the expense of executing and clearing a trade but the net cost-of-capital. The net cost-of-capital, for both FCMs and their clients, is the difference between the cost of capital and the interest income that can be generated on margin assets. Compared to the

U.S. futures market, international futures clearing organizations and the OTC market have allowed a more robust selection of permitted margin instruments. The ability to invest in such higher yielding instruments reduces the effective cost of trading. The proposed CFTC rule change will reduce the cost of trading on domestic futures exchanges and make them more competitive.

FCMs are under pressure to pay their customers a higher interest rate on the cash that their customers maintain for margin purposes. There has been an inconsistency between a FCM's permitted investment alternatives and the investments which the FCM's customers use when making their own investment decisions. Institutional and retail clients alike will use money market instruments and money market mutual funds which provide higher investment returns than those assets permitted under existing CFTC Rule 1.25. The existing investment guidelines for customer funds are more restrictive than the investment practices of the customers that the Commodity Exchange Act seeks to protect. As a result, FCMs have to pay a higher interest rate on cash deposits than they can earn, and their interest expense is frequently higher than interest income. Since the customers use money market instruments and money market mutual funds for their own investments, they believe that they are compromising on the rate of interest income that they receive from their FCMs.

The proposed rule change is being implemented at an important time. Allowing FCMs to invest in a broader range of money market instruments will allow them to manage the negative consequences of a shrinking pool of Treasury obligations.

It has been well publicized that as a result of record U.S. Government budget surpluses, the Treasury has initiated a debt buyback program. In particular, the Treasury has brought about the following changes:

1. Over the past three years, $360 billion in debt has been paid off. During 2001, $464 billion in U.S. Treasury securities are maturing and the following year there will be $382 billion in securities maturing. This debt may not be refinanced;
2. Since January 2000, $17.5 billion in bonds with remaining maturities of 15 to 25 years have been repurchased. By the end of the year, the total should reach $30 billion with buybacks of $1 billion to $3 billion per month;
3. The issuance of three-year notes has been eliminated;
4. The frequency of one-year bill, five-year note and thirty-year bond auctions has been reduced. Noteworthy to FCMs is the reduction of one-year bill auctions from monthly to quarterly. These securities are typically used by FCMs to extend the duration of their investment portfolios. They are in short supply and may be eliminated entirely by the U.S. Treasury;
5. The auction size of two-year notes, ten-year notes and bills has been substantially reduced.

It is widely anticipated that the Federal Government's annual budget surplus range of $175-200 billion will increase to $500 billion by the latter part of this decade. The Congressional Budget Office ("CBO") is forecasting that surpluses over the next decade will accumulate to over $4 trillion by 2010. A surplus of this size would potentially allow the U.S. Treasury to retire the entire amount of the $3.6 trillion in publicly held U.S. Government debt by 2006. The CBO projections are subject to a great deal of variability given the assumptions inherent in their forecast. Nonetheless, even when the potential for spending growth and/or tax cuts is factored in, it is still likely that the budget will remain in surplus and that publicly held Treasury securities will decline.

FCMs currently hold approximately $60 billion of customer funds in U.S. Treasury securities, 1.6% of the total of publicly held U.S. Treasury debt. This does not include securities held for margining proprietary positions of FCMs. Exchange clearinghouses primarily accept U.S. Treasury securities as margin for both customer and proprietary trading. Some domestic clearinghouses do accept letters of credit, but there are limitations to the amount that can be used and as a result, the majority of original margin is met with U.S. Treasury securities. There is no publicly available data reporting the amount of U.S. Treasury securities held to margin FCMs' proprietary trading. We believe that it could be as much as half the amount held in customer accounts.

The substantial reduction in U.S. Treasury securities will have a meaningful adverse effect on the operations of FCMs and the competitiveness of the U.S. futures industry. As the pool of U.S. Treasury securities shrinks, the spread between U.S. Treasury securities and other money market instruments will continue to widen as it has done during the recent phase of the U.S. Treasury debt buyback initiative. During the period between 1993 through 1998, the average spread between the three-month Treasury bill and the Federal funds rate has been negative 10 basis points. For the period between 1998 and 2000, this spread has widened to negative 30 basis points. For the last three months, this spread has further widened to negative 45 basis points.

As we discussed above, there is already a disparity between what FCMs can pay their clients because of existing restrictive guidelines and what their clients expect as these clients are already investing in the instruments included in the proposed rule change. If the existing investment guidelines for customer funds are not expanded, this disparity will worsen as the pool of U.S. Treasury securities continues to shrink.

Requests for Clarification

We would greatly appreciate if you could provide clarification on the following provisions of the proposed rule change that relates to money market mutual funds and repurchase agreements.

Clarification #1

Relevant CFTC Regulation

Sec. 1.25 (b) (1) (D): "Money market mutual funds that are rated by an NRSRO must be rated at the highest rating of the NRSRO or, if the fund is not rated, investments made by the fund must comply with the requirements applicable to direct investments under this section."

Assumption:

1. A SEC registered 2a7 money market mutual fund ("MMMF") that is not rated by a NRSRO wishes to accept customer funds from a FCM under the proposed regulation.

2. The MMMF has investments in entities that are related to the FCM, but are within the required 5% issuer limitation.

Clarification Requested:

1. May the FCM invest in this MMMF as long as it is managed by an independent fiduciary and the MMMF complies with the 5% issuer limitation?

2. Must the MMMF comply with the requirements for repurchase agreements outlined in proposed CFTC Rule 1.25 Section (d)?

BBH's Opinion:

BBH believes that MMMFs that comply with SEC 2a7 should be allowed to invest in obligations of FCMs and their affiliates even if the FCM has purchased shares in the MMMF. Additionally, MMMFs should not be required to comply with the repurchase agreement requirement of proposed CFTC Rule 1.25. Preventing MMMFs from investing in obligations of FCMs and their affiliates and requiring that they execute amended repurchase agreements unnecessarily restrict MMMFs.

We believe that it is appropriate that when a FCM is self-directing the investment of its customer funds it be prohibited from investing in its own or related obligations. It is common practice that when a fiduciary has discretion over the investment of customer funds it does not invest in its own or related obligations. When a FCM is self-directing its investment, this prohibition is manageable as the only unallowable securities are its own or related obligations. This becomes unmanageable for a MMMF that is servicing a large number of FCMs. Because many FCMs are affiliated with large, world-class financial institutions, preventing the use of their securities by MMMFs eliminates a large and important group of money market instruments. We believe that the third party investment advisor relationship of a MMMF and complying with the 5% issuer limitation will prevent an FCM from improperly investing customer funds in its own or related obligations.

Clarification #2

Relevant CFTC Regulation

Sec. 1.25 (c) (1): "Generally, the fund must be registered with the Securities and Exchange Commission as a money market mutual fund, in compliance with applicable requirements."

Assumption:

MMMFs are registered either under the Investment Company Act of 1940 ("'40 Act") or under both the '40 Act and the Securities Exchange Act of 1933 ("'33 Act"). MMMFs registered under the '40 Act can only be offered for sale to accredited investors under a SEC Regulation D ("Reg. D") private placement. MMMFs that are registered under both the '40 Act and the '33 Act can be offered through a public sale.

Clarification Requested:

Providing that a '40 Act only registered MMMF complies with Reg. D, is such MMMF permissible for the investment of customer funds under the proposed rule change?

BBH's Opinion:

BBH believes that MMMFs registered only under the '40 Act should be permitted for the investment of customer funds provided, as required by law, that the FCM is an accredited investor as defined in Reg. D. These funds are required to follow the same SEC Rule 2a7 investment guidelines and as such, provide the same level of safety and soundness that '33 Act registered MMMFs provide. Because '33 Act MMMFs are sold publicly to non-accredited investors, their sale practices are more highly regulated. As a result, these MMMFs have higher costs that are passed through to investors via lower returns. The majority of FCMs are institutional investors and are accredited investors as defined in Reg. D. These accredited investors should be permitted to purchase shares in MMMFs offered under a Reg. D private placement and enjoy the higher returns offered to institutional investors.

Clarification #3

The proposed rule change does not address concentration limits for repurchase transactions.

Clarification Requested:

In the case of repurchase agreements, will credit rating requirements and concentration limits be based on the repurchase agreement counterpart or the underlying securities subject to the repurchase agreement?

BBH's Opinion:

Providing that the underlying securities are delivered to a custody account owned and controlled by a FCM directly investing customer funds (as required in the rule change) or a MMMF, we recommend that the credit rating requirements and concentration limits be based on the underlying securities of the repurchase agreement. Furthermore, the issuer should apply to the aggregate of direct investments and securities held pursuant to a repurchase agreement.

We hope you have found our comments useful and we look forward to hearing from you with respect to the clarifications that we have requested. If you have any questions or comments, please do not hesitate to contact me by telephone at 212-493-7970 or by e-mail at bob.push@bbh.com.

Sincerely

Robert C. Push
Senior Vice President