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OFC. OF THE SECRETARIAT

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December 5, 2001

COMMENT

Ms. Jean A. Webb
Secretary to the Commission
Commodity Futures Trading Commission
1155 21ST Street NW
Washington DC 20581

Mr. Jonathan G. Katz
Secretary to the Commission
Securities and Exchange Commission
450 Fifth Street
Washington DC 20549-0609

Re: Treatment of Customer Funds, 66 *Fed. Reg.* 50786 (October 4, 2001)
CFTC: Proposed Rule 41.42 – Treatment of Customer Funds
SEC File No. S7-17-01

Dear Ms. Webb and Mr. Katz:

The Futures Industry Association ("FIA") and Securities Industry Association ("SIA") (collectively, the "Associations")[1] are pleased to submit these comments on the rules that the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") (collectively, the "Commissions") have proposed governing the treatment of security futures products and related customer funds.[2] The proposed rules appear to meet the statutory directive of avoiding conflicting or duplicative regulations affecting fully registered broker-dealer/FCMs, while generally leaving to each such entity the decision with respect to the manner in which such funds and positions are held. Subject to our comments below, we are pleased to support the proposed rules.

Where Security Futures Products May be Held

The Associations strongly support the provisions of proposed CFTC Rule 41.42(a) and SEC Regulation 15c3-3(o)(1). These proposed rules grant a fully registered broker-dealer/FCM the authority, as the broker-dealer/FCM elects, to hold customer security futures products in either a securities account or a futures account, as those terms are defined in the proposed rules. The

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[1] FIA is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 50 of the largest futures commission merchants ("FCMs") in the United States, the majority of which are also registered broker-dealers. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international.

SIA's members include more than 740 securities firms (including investment banks, broker-dealers, and mutual fund companies) that are active in all US and foreign markets and in all phases of corporate and public finance. The US securities industry manages the accounts of more than 80 million investors directly and indirectly through corporate, thrift and pension plans.

[2] The proposed rules directly affect only fully registered broker-dealers/FCMs. Broker-dealers that are notice-registered with the CFTC as FCMs are required to comply with the relevant provisions of the Securities Exchange Act of 1934 and the SEC's regulations thereunder. FCMs that are notice registered as broker-dealers with the SEC are required to comply with the relevant provisions of the Commodity Exchange Act and the CFTC's regulations thereunder.

broker-dealer/FCM may, but is not required to, permit each customer to choose the type of account in which these products are held.

Whether such positions are held in a securities account or a futures account depends on a number of factors, many of which are driven by each firm's back office systems and the costs of any necessary changes to those systems necessary to support these products. Allowing firms to select how to carry the positions will enable firms to utilize the most cost-effective solutions when determining how to support this product.

The Associations note that the *Federal Register* release is silent on whether a broker-dealer/FCM, if it so elects, may allow a customer to hold certain security futures products in a security account and other security futures products in a futures account. It is possible that a customer employing various trading strategies might prefer to hold certain positions in the securities account while holding other security futures positions in the futures account. For example, a customer may wish to hold narrow-based index positions in a futures account with its positions in broad based index contracts, while holding futures on individual securities in a securities account with the cash securities. Such a result is entirely appropriate, and we ask that the Commissions confirm that this would be permissible.[3]

Disclosure

The Associations are not opposed to the requirement that broker-dealer/FCMs provide their customers that trade security futures products with the type of disclosure described in proposed CFTC Rule 41.42(b) and SEC Regulation 15c3-3(o)(2). However, we believe that, if such disclosure is required, all firms, including notice registered broker-dealers and FCMs, should be placed on a level playing field and be required to provide disclosure to their customers. It is interesting to note that fully registered broker-dealer/FCMs currently are required to place the Securities Investor Protection Corporation ("SIPC") membership sign in the entry area for their firm. At no point, however, is the firm required to disclose in advance that the customer does not have these protections for many of the types of accounts maintained with the broker-dealer/FCM.

The Associations also strongly object to any written acknowledgment requirement. The Associations note that securities options customers are not required to acknowledge receipt of the Options Disclosure Document. We see no reason why the disclosure required under these proposed rules should be treated differently. Also, as the Commissions have noted, NASD Regulation, Inc. and the National Futures Association are developing a security futures disclosure document patterned after the Options Disclosure Document. We understand that this disclosure

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[3] The Associations do not object to the proposed requirement that a broker-dealer/FCM establish written "policies" relating to the manner in which it will hold customer securities futures products. However, the use of the term "policies" alone may imply that firms will have in place a set of objective standards that would govern the appropriate location of a particular customer's securities futures products. As described above, such an objective determination may not be realistic. In practice, therefore, a firm may authorize an individual or committee to exercise discretion with respect to the location of a customer's securities futures products based on considerations relevant to each customer. To clarify that this practice is permissible, we suggest that the Commissions replace references to "policies" with references to "policies or procedures".

document will contain the information required under these proposed rules. We also understand that customers will not be required to acknowledge receipt of the security futures disclosure document. Accordingly, we believe that no such written acknowledgment should be required for the disclosure proposed under these rules.[4]

Changes in Account Type

The Associations support the provisions of proposed CFTC Rule 41.41(c) and SEC Regulation 15c3-3(o)(3), which authorize a fully registered broker dealer/FCM to change the type of account in which a customer's security futures products are held. However, if a broker-dealer/FCM is required to provide notification of the change to its customer, the Associations object to any written acknowledgment requirement. The requirement that the customer acknowledge in writing receipt of the notice effectively vests in the customer rather than the broker dealer/FCM the ability to choose the type of account in which the customer's security futures products are held. If the customer simply refuses to sign the acknowledgment, the broker dealer/FCM would be prohibited from making the change. At the very least, the intended change could be delayed significantly, which could adversely affect the ability of the firm to conduct business in an efficient manner and could adversely affect the customer.

Finally, as written, the proposed rules require a broker-dealer/FCM to notify the customer first when the broker dealer/FCM determines to make a change and again "promptly" after the change has been made. The Associations recommend that the Commissions revise the proposed rules to permit a broker dealer/FCM to make one notification.

Recordkeeping and Reporting Requirements

The Associations endorse the Commissions' statement that the applicable recordkeeping requirements should follow the type of account in which the security futures products are held. We, therefore, support proposed CFTC Rule 41.42(d) and SEC Regulation 15c3-3(o)(4), which provide that the applicable recordkeeping and reporting requirements of the broker-dealer/FCM will be governed by the type of account in which a customer's security futures products are held. We also note that proposed CFTC Rule 41.42(e) provides that an FCM, including a fully registered broker-dealer/FCM that elects to carry security futures products in a futures account, must comply with the requirements of Rule 1.33, governing customer confirmations and monthly statements. The proposed rules are silent with respect to the applicability of Regulation 10b-10, however. We request that the SEC confirm that the provisions of Regulation 10b-10 do not apply to a broker-dealer/FCM that carries security futures products in a futures account.

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[4] If the Commissions nonetheless require a written acknowledgment of this disclosure, the Commissions should clarify the meaning of the term "each owner of the account" as used in proposed CFTC Rule 41.42(b)(2) and SEC Regulation 15c3-3(o)(2)(ii). In particular, we ask that the Commissions confirm that the account owner of an omnibus account is the FCM, broker-dealer or foreign broker carrying the underlying accounts. For accounts of partnerships or limited liability companies, the signature of one general partner or manager would be sufficient. Similarly, a commodity pool operator would be the only required signature for an account of a commodity pool. Finally, consistent with the existing practices for securities accounts, the signature of the advisor for purposes of third party controlled accounts will be deemed sufficient.

Records to be Preserved

The Associations do not object to the proposed amendments to SEC Regulation 17a-4. However, we are concerned by a statement in the accompanying *Federal Register* release, which implies that a broker-dealer/FCM would have to include in its account opening documents a provision requiring security futures customers to provide documentation of cash transactions underlying exchanges of security futures products for the underlying securities. 66 *Fed.Reg.* 50786, 50792. As the Commissions note, proposed Regulation 17a-4(k) is similar to CFTC Rule 1.35(a-2)(1). FCMs generally do not have a specific provision in their account opening documents requiring customers to comply with requests for information from the CFTC or Department of Justice. Rather, FCMs rely on general provisions requiring the customer to comply with all applicable laws, rules and regulations. Broker-dealer/FCMs should be able to rely on the same type of provision with respect to security futures products carried in a securities account.

Conclusion

The Associations appreciate the opportunity to submit these comments on the Commissions' proposed rules relating to the treatment of security futures products and the related customer funds that fully registered broker-dealers/future commission merchants hold to margin, guarantee or secure transactions in security futures. If you have any questions regarding this letter, please contact the Chairman of the Joint Committee of the Associations, Jonathan Barton, of Morgan Stanley, at (212) 761-8805.

Sincerely,

John M. Damgard
President
Futures Industry Association

Mark E. Lackritz
President
Securities Industry Association

cc: Commodity Futures Trading Commission

Honorable James E. Newsome, Acting Chairman
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