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Chris Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Center 1155 21st St. NW
Washington, DC 20581

Submitted via electronic filing: <https://comments.cftc.gov>

Re: Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations, RIN 3038-AF24

BlackRock, Inc. (together with its affiliates, “BlackRock”)¹ respectfully submits its comments to the Commodity Futures Trading Commission (“CFTC” or “Commission”) in response to the Commission’s request for comment on proposed amendments to its regulations governing the types of investments that Futures Commission Merchants (“FCMs”) and Derivatives Clearing Organizations (“DCOs”) may make with funds held for the benefit of customers trading futures, foreign futures, and cleared swap transactions (“Customer Funds”) (the “Proposal”).²

We appreciate the Commission’s commitment to safeguarding funds of customers engaging in CFTC-regulated derivative transactions as mandated in the Commodity Exchange Act (the “Act”). We also support the Commission’s commitment to conducting periodic reassessments of Regulation 1.25, which was initially adopted to implement Section 4d(a)(2) of the Act that authorizes FCMs and DCOs to invest customer funds in the instruments set forth in Section 4d(a)(2) (the “Permitted Investments”).³

We support the Commission’s Proposal to add certain short-term U.S. Treasury (“UST”) exchange-traded funds (“ETFs” or collectively hereafter, “short-term UST ETFs”) to the list of Permitted Investments. We support the joint petition filed by the Futures Industry Association (“FIA”) and CME Group (“CME”) as well as the petition from Invesco Capital Management regarding short-term UST ETFs. We agree with the analysis of the petitioners and the Commission that short-term UST ETFs may have

¹ BlackRock is one of the world’s leading asset management firms. We manage assets on behalf of individual and institutional clients across equity, fixed-income, liquidity, real estate, alternatives and multi-asset strategies. We manage retirement funds on behalf of millions of Americans, including public pension funds in 47 of the 50 states.

² See Regulation of Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations, 88 Fed. Reg. 223, (November 3, 2023), <https://www.cftc.gov/sites/default/files/2023/11/2023-24774a.pdf>

³ See *Title 17 – Commodity and Securities Exchanges*, 33 FR 14454 (Sept. 26, 1968), amending Regulation 1.25 and providing that FCMs and clearing organizations may invest customer funds in obligations of the U.S., in general obligations of any State or of any political subdivision of any State, or in obligations fully guaranteed as to principal and interest by the U.S.

characteristics consistent with other Permitted Investments and offer more flexibility and diversification opportunities. These short-term UST ETFs invest in high-quality liquid investments that are already Permitted Investments, offering a cost-effective, operationally efficient, and potentially more liquid vehicle for FCMs and DCOs to invest Customer Funds.

However, we believe that some modifications can be made to certain proposed conditions that would be consistent with and further the Commission's policy objectives. These adjustments would further enhance FCMs' and DCOs' ability to recognize the benefits of using short-term UST ETFs that meet CFTC specified requirements ("Qualified ETFs") and continue to use government money market funds ("Government MMFs") whose interests qualify as Permitted Investments ("Permitted MMFs") for the investment of customer funds while safeguarding principal and ensuring liquidity.

As reviewed in more detail below, we discuss the following recommendations in this letter:

- We suggest the Commission expand the investment types of Qualified ETFs and align the investment types for Qualified ETFs and Permitted Government MMFs by permitting Qualified ETFs to invest in the same types of instruments that Permitted Government MMFs may invest in, which would include cash, government securities (such as U.S. Treasury securities, securities fully guaranteed for principal and interest by the U.S. Government), and/or repurchase agreements that are fully collateralized.
- We believe the proposed requirement to mandate FCMs and DCOs become an Authorized Participant ("AP") is unnecessary, could potentially restrict the number of FCMs and DCOs that can invest in Qualified ETFs, and that the Commission's concerns can be addressed through existing practices.
- We recommend the Commission revise the Proposal's requirement that interests in short-term UST ETFs must be redeemable in cash by the FCM or DCO for Qualified ETFs to permit short-term UST ETFs to redeem either in cash (T+1) or in-kind with a same day settlement (T+0) option.
- We reiterate our support for mandating the acceptance of fixed income ETFs as margin collateral across DCOs.
- We support the Proposal to codify a two percent capital charge on ETFs.
- While we believe diversification is a key component of risk management and support the goal of concentration limits, we believe the current concentration limits construct for MMFs has proven to be effective and changes beyond adding ETFs to the existing concentration framework that applies to MMFs are unnecessary.

I. Permitted Investments & Investment Conditions

BlackRock supports the Commission's proposal to expand the list of Permitted Investments to include short-term UST ETFs. Expanding the range of available Permitted Investments to include interests in ETFs that meet specified conditions would provide FCMs and DCOs with greater flexibility and opportunities for capital efficiency in the investment of Customer Funds, without unacceptably increasing risk

to customers.⁴ We agree with the explanation provided by Invesco that short-term UST ETFs invest in a sub-set of the same high-quality liquid investments that are deemed as Permitted Investments under Regulation 1.25 (i.e., U.S. government securities), and that ETFs, as registered investment companies under the Investment Company Act of 1940, as amended, (“40 Act”), must comply with a number of Securities and Exchange Act (“SEC”) financial reporting requirements and liquidity risk management program requirements.⁵ We also agree with Invesco that the design and characteristics, such as daily price and investment holdings transparency, as well as intra-day trading and liquidity, are additional features that help make short-term UST ETFs efficient vehicles for investment of Customer Funds. However, we recommend certain changes to the proposed conditions for investing in such ETFs, as discussed below.

A. Investment Types and Required Percentage of Investment

The Commission is proposing to limit Qualified ETFs to funds that are passively managed and seek to replicate the performance of a published short-term U.S. Treasury security index. For purposes of the Proposal, short-term U.S. Treasury securities are bonds, notes, and bills with a remaining maturity of 12 months or less, issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury.⁶

We suggest the Commission expand the investment types of Qualified ETFs and align the investment types for Qualified ETFs and Permitted Government MMFs by permitting Qualified ETFs to invest in the same types of instruments that Permitted Government MMFs may invest in, which would include cash, government securities (such as U.S. Treasury securities, securities fully guaranteed for principal and interest by the U.S. Government), and/or repurchase agreements that are fully collateralized. Investing in high-quality and liquid investments similar to the proposed investment types can enhance the safety and resilience of an ETF. Further, as the Commission noted in the Proposal, “ETFs that maintain portfolios primarily comprised of high-quality and liquid investments are better able to redeem interest without placing excessive downward pressure on the net asset values (“NAVs”)” of the ETFs.”⁷

We believe this amendment to the composition requirement is in line with the objectives of Regulation 1.25 of preserving principal and maintaining liquidity of the investments while providing ETFs with portfolio management flexibility, particularly during times of stress, and enabling the ETFs to align more accurately with the risk profile of Permitted Investments.

Additionally, should the Commission choose to move forward with a portfolio threshold for short-term UST ETFs, it is critical in our view that such a requirement not unnecessarily require an amendment to those ETFs' stated investment policies or associated registration statement disclosure. We therefore ask the Commission to clarify that an investment requirement would be satisfied by funds that maintain investments that meet the specified thresholds, even if the fund's prospectus permits the fund to hold securities outside of these thresholds. Most ETFs are transparent, and,

⁴ FR 88 81248

⁵ FR 88 81248

⁶ FR 88 81250

⁷ FR 88 81250

as required for ETFs in-scope of Rule 6c-11 under the 40 Act (“Rule 6c-11” or the “ETF Rule”), publish their holdings daily, which would support investors' ability to monitor an ETFs' holdings relative to any investment threshold.

B. Requirement that an FCM or DCO be an Authorized Participant

We are concerned with the proposed requirement to mandate FCMs and DCOs become an AP for all Qualified ETFs they may want to utilize.⁸ While many FCMs are also APs for some ETFs, including some short-term UST ETFs, we believe that the requirement that FCMs and DCOs must be an AP to a short-term UST ETF to invest customer funds in that ETF is unnecessary, and that the Commission's concerns can be addressed through existing practices that are utilized when an AP acts on an agency basis on behalf of its clients who seek to transact with an ETF in a primary market transaction, as described below. We also believe this requirement could potentially restrict the number of FCMs and DCOs that can invest in Qualified ETFs without a corresponding benefit.

The Commission notes that FCMs and DCOs are likely to purchase and redeem the shares of a Qualified ETF through primary market transactions intermediated by APs rather than purchasing and selling the ETF shares in the secondary market, because the price of the shares in the secondary market may differ from the NAV, and the sale of the shares in the secondary market may delay the liquidation of the instruments.⁹ The Commission also notes that an FCM's or a DCO's purchase or redemption of Qualified ETF shares through intermediated transactions with APs raises two concerns. First, if an FCM or a DCO invests Customer Funds in shares of a Qualified ETF by purchasing the shares through an AP, the FCM or DCO would need to take Customer Funds out of the segregated account maintained in compliance with Section 4d of the Act and/or Part 30 of the Commission's regulations to purchase the ETF shares. As a result, customer segregated accounts may not be fully funded, thus potentially violating Commission regulations that require FCMs to maintain, at all times, in the segregated account, money, securities, and property in an amount that is at least sufficient in the aggregate to cover their total obligations to all customers. Also, the transfer of Customer Funds to the unaffiliated AP may be in contravention of Commission regulations that provide that Customer Funds may only be deposited with a bank or trust company, a DCO, or another FCM. Second, if an FCM or a DCO uses an unaffiliated AP to redeem its Qualified ETF shares, the redemption of the ETF shares may be protracted, preventing the redemption and liquidation of the shares to occur within one business day following the submission of the redemption request, as required by Regulation 1.25.¹⁰

It is important to note that ETFs possess dual pricing attributes: market price and the NAV, along with two corresponding levels of liquidity. All investors, including FCMs and DCOs can buy and sell Qualified ETFs at transparent intraday prices on the secondary market, settling on a delivery-versus-payment basis. Furthermore, the recently revised SEC settlement rules could address any concerns regarding the requirement for next-day redemption for exchange trades.¹¹ Starting in May 2024, to

⁸ FR 88 81251

⁹ FR 88 81250

¹⁰ FR 88 81250

¹¹ [SEC Finalizes Rules to Reduce Risks in Clearance and Settlement](#), February 15, 2023

comply with the SEC's final rule on shortening the settlement cycle for broker-dealers from two business days after the transaction date ("T+2") to the end of the business day following the transaction date ("T+1"), all shares transacted in the primary market will have to clear and settle by T+1. Therefore, we believe that FCMs and DCOs should retain the ability to buy and sell ETF shares in the primary market through other APs or through exchange trading, particularly given the ability to transact in ETF shares on-exchange is one of the key benefits of accessing these transparent, low-risk and liquid investments through an ETF structure.

Additionally, the CFTC's Proposal to require FCMs and DCOs to be APs could discourage DCOs in particular from investing in eligible ETFs. Potential operational burdens and registration requirements for becoming an AP may outweigh the potential benefits of investing customer funds in ETFs.¹² The ETF Rule defines an "authorized participant" as a member or participant of a clearing agency registered with the Commission, which has a written agreement with the ETF or one of its service providers that allows APs to place orders for the purchase and redemption of creation units. Unlike mutual funds, ETFs do not sell or redeem individual shares. Instead, APs purchase and redeem ETF shares directly from ETFs in "creation units."¹³ Only APs can purchase and redeem shares directly from an ETF at NAV per share and only in creation unit aggregations. Not only may DCOs not meet these requirements to register as an AP, but they may also not be transacting in sizes that meet minimum creation unit sizes for permitted ETFs or in creation unit increments.

C. Permitting Qualified ETFs to Redeem In Cash or In-Kind

Under the Proposal, interest in short-term UST ETFs must be redeemable in cash by the FCM or DCO in its capacity as AP to satisfy the conditions required to be a Qualified ETF. In an in-kind redemption, an AP receives a pre-specified basket of securities representing the underlying index in exchange for ETF shares. In-kind redemptions are standard for many ETFs as they provide an efficient way for portfolio managers to execute changes in an ETF's portfolio. The SEC acknowledged the benefits of in-kind redemptions in Rule 6c-11, stating "ETFs that meet redemptions in cash may maintain larger cash positions to meet redemption obligations, potentially resulting in cash drag on the ETF's performance. The use of cash baskets also may be less tax-efficient than using in-kind baskets to satisfy redemptions, and may result in additional transaction costs for the purchase and sale of portfolio holdings."¹⁴ Moreover, short-term UST ETFs that CME accepts as initial margin collateral offer same-day settlement for in-kind redemptions.

We recommend the Commission revise the requirements for Qualified ETFs to permit Treasury ETFs to redeem either in cash (T+1) or in-kind with a same day settlement (T+0) option.

¹² Operational burdens may include entering into Authorized Participant agreements with each ETF issuer and building and maintaining connectivity to ETF issuers' order taking platforms, among others.

¹³ The Rule defines "creation unit" to mean a specified number of ETF shares that the ETF will use to (or redeem from) an authorized participant in exchange for the deposit (or delivery) of a basket and a cash balancing amount (if any). See *rule 6c-11(a)(1)*

¹⁴ Rule 6c-11 adopting release, p. 83

D. ETFs as Acceptable Collateral

The Commission proposes to require, as a condition for qualification as a Permitted Investment, that Qualified ETFs be acceptable by a DCO as performance bonds from clearing members to margin customer trades. Although qualification as acceptable collateral by a DCO is not determinative of qualification as a Permitted Investment, the Commission preliminarily believes that limiting Qualified ETFs to funds that have met a DCO's criteria of eligibility as a performance bond represents an additional safeguard.¹⁵

Fixed income ETFs provide liquidity, transparency, and efficient access to markets in all market conditions. Globally, ETFs have acted as "shock absorbers" during many volatile trading periods as buyers and sellers transacted on the exchange, at real-time prices. Specifically, during March 2020, investors increasingly turned to ETFs to efficiently rebalance holdings, hedge portfolios, and manage risk, especially when liquidity dried up in the underlying bond market.¹⁶

Moreover, we believe that mandating acceptance of fixed income ETFs as margin collateral would create additional capacity and liquidity in the collateral pipeline, helping to further alleviate unintended liquidity pressures from margin call during stressed times. As such, BlackRock believes that all DCOs should accept Qualified ETFs as margin collateral from clearing members for customer trades.

BlackRock supports the CFTC ensuring more consistent collateral standards across DCOs and expanding the universe of liquid assets that can be posted as uncleared margin to include short-term UST ETFs by providing clarification that shares of an ETF are "redeemable securities." Consequently, shares of such an ETF would meet the criteria for eligible uncleared margin collateral under the CFTC Rules 17 C.F.R. § 23.156(a)(1)(ix).

E. Permitted MMFs

While we agree with the Commission that Permitted MMFs should be "government money market funds," we have concerns with the Proposal's rationale for the limitation on the scope of MMFs that qualify as Permitted Investments and such conditions. We disagree with the characterizations of MMFs and investor behavior during March 2020 and the Global Financial Crisis. While Prime MMF outflows were indeed elevated during March 2020, the CFTC fails to acknowledge the broader "dash for cash" during that time and liquidity strains across asset classes. We believe the market dislocations highlighted the need for holistic reforms to the short-term funding markets, beyond just MMFs.¹⁷

II. Capital Charges and Concentration Limits

A. Capital Charges

¹⁵ FR 88 81251

¹⁶ BlackRock ViewPoint, "[Lessons from COVID-19: ETFs as a Source of Stability](#)," July 2020

¹⁷ BlackRock ViewPoint, "[Lessons from COVID-19: U.S. Short-Term Money Markets](#)," July 2020

The Commission is proposing that FCMs be required to apply a capital charge equal to two percent of the fair market value of its U.S. Treasury ETF shares.¹⁸ With respect to Qualified ETFs, neither SEC Rule 15c3-1 nor Appendix A to SEC Rule 15c3-1 explicitly addresses capital charges for ETFs primarily comprised of U.S. Treasury securities. SEC Rule 15c3-1(c)(2)(vi)(D)(1) does specify a two percent capital charge for a broker-dealer's net position in redeemable securities of a Prime MMF or a Permitted Government MMF. As the CFTC noted in the Proposal, the SEC issued no-action relief in 2022 regarding the broker-dealer net capital treatment of U.S. Treasury ETFs meeting certain requirements, and provided guidance to registered securities brokers or dealers that staff would not recommend an enforcement action to its Commission if a broker or dealer applied a capital charge of two percent of the market value of ETFs shares held in the size of a creation units.¹⁹ This relief has allowed broker-dealers to accept qualified short-term UST ETFs as collateral for futures and cleared swaps from clients without incurring additional punitive capital charge.

BlackRock supports the CFTC's Proposal to codify a two percent capital charge on ETFs as it appropriately aligns with the SEC capital requirements for MMFs.

B. Concentration Limits

The proposed amendments to Regulation 1.25(b)(3) contain both asset-based and issuer-based concentration limits applicable to Permitted Investments. The asset-based concentration limit restricts the total amount of Customer Funds that an FCM or a DCO may invest in a particular Permitted Investment to a defined percentage of the total funds held in segregation by the FCM or DCO. The issuer-based concentration limit caps the total amount of Customer Funds that may be invested in instruments offered by, or managed by, a particular issuer to a defined percentage of the total funds held in segregation by the FCM or DCO.²⁰

We believe that diversification is a key component of risk management and as such we understand the current concentration limits under Regulation 1.25(b)(3) help to ensure the safety of Customer Funds. In fact, the current construct in Regulation 1.25 has proven to be effective for MMFs and we believe that changes beyond adding ETFs to the existing concentration framework that applies to MMFs are unnecessary as they introduce additional complexity to a framework that is operating as intended.

III. **Support for GMAC Proposal to Add Clearing Agencies as Permitted Repo Counterparties**

At the CFTC's Global Markets Advisory Committee (GMAC) meeting on November 6, 2023, the Global Market Structure Subcommittee made a recommendation that the Commission amend Regulation 1.25(d)(2) to permit DCOs and FCMs to invest customer funds pursuant to repos cleared by a covered clearing agency registered with the SEC under section 17A of the Securities Exchange Act. Currently, FCMs and DCOs may only enter a repo opposite a "permitted counterparty" and clearing agencies are excluded from the types of permitted counterparties. We

¹⁸ FR 88 81260

¹⁹ SEC Division of Trading and Markets, [letter](#) re: "Net Capital Treatment of Certain U.S. Treasury Exchange-Traded Funds," June 2, 2022

²⁰ FR 88 81255

agree with the supporting rationale as discussed in the Subcommittee's recommendation and encourage the Commission to amend Regulation 1.25(d)(2) accordingly.²¹

We thank the Commission for providing BlackRock the opportunity to comment on the Proposal. Please contact the undersigned if you have any questions or comments regarding BlackRock's views.

Sincerely,

Joshua Penzner, Managing Director, US Head of Institutional iShares Bond ETFs

Eileen Kiely, Managing Director, Deputy Head of Counterparty Risk

Samantha DeZur, Managing Director, US Head of Regulatory Affairs & Capital Markets Policy

²¹ CFTC [GMAC Meeting](#), November 6, 2023