

**REGISTERED INVESTMENT COMPANIES: FUTURES MARGIN AND
THIRD-PARTY CUSTODIAL ACCOUNTS**

Commodity Futures Trading Commission Staff announced on May 5, 2005, that, subject to a limited exception, registered investment companies (“RICs”) may no longer employ third-party custodial or safekeeping accounts to hold futures margin. The change was effected by an amendment to Financial and Segregation Interpretation No. 10 and will take effect nine months after notice of the amendment is published in the Federal Register. The use of third-party custodial accounts generally will be prohibited, except in the case where a RIC or its adviser is affiliated with the futures commission merchant (“FCM”) carrying the RIC’s account. FCMs that permit their RIC customers to use third-party accounts outside of the exception will be in violation of Commodity Exchange Act (“CEA”) requirements with respect to the segregation of customer funds.

Futures margin is the good faith deposit required to maintain a position in futures and options on futures contracts under the CEA. The CEA’s futures margin deposit and segregation requirements are designed to protect futures customers as well as the markets by ensuring that sufficient assets are available to satisfy futures contract obligations. CFTC rules require each FCM to report daily to its designated self-regulatory organization the amount of funds on deposit in customer segregated accounts. An FCM may not use the funds of one customer to satisfy the margin requirement of another customer.

CFTC Staff adopted Interpretation 10 in 1984 to facilitate access to the futures markets by RICs consistent with SEC requirements. At that time, SEC rules required RIC assets to be held by a bank, a member of a national securities exchange or a national securities depository. Consequently, Interpretation 10 permitted the use of third-party custodial accounts. In 1996, the SEC adopted Rule 17f-6, which permits, but does not require, a RIC to deposit futures margin directly with an FCM, provided that the FCM is not an affiliated person of the RIC or an affiliated person of such affiliated person. The RIC’s adviser is an affiliated person under the Investment Company Act of 1940. Current Interpretation 10 requires the FCM to authorize any withdrawals from a third-party custodial account. Despite that requirement, CFTC Staff noted, there have been documented instances of withdrawals from such accounts without the FCM’s permission. Transfers made without the knowledge of the FCM result in errors in reporting of customer funds on deposit, as well as in undermargined accounts, which could harm other FCM customers and the market itself. As a result, CFTC Staff determined to amend Interpretation 10 generally to prohibit the use of third-party custodial accounts.

The following conditions apply to the limited circumstance in which a third-party custodial account is permitted. CFTC Staff stated that this exception will exist only as long as the SEC prohibits RICs from depositing futures margin with affiliated FCMs.

1. The custodial account must be maintained in the name of the FCM for the benefit of the customer. The account may not be maintained in the name of the RIC or its adviser.
2. The FCM must have an unfettered ability to liquidate open positions in a futures account that goes into deficit or becomes undermargined.
3. The FCM must be able to withdraw funds from the custodial account without interference from the customer.
4. The customer (and its fiduciary) may access the funds in the custodial account only through the FCM.
5. Custodial accounts will be considered subject to the customary provision in a futures customer account agreement that all property in the account or held on behalf of the customer is pledged to the FCM and is subject to a security interest in the FCM's favor to secure any indebtedness at any time owed by the customer to the FCM.
6. A third-party custodian may not be an affiliate or a fiduciary of the customer. This means that a RIC may not maintain a custodial account at a bank with which it has other relationships that make the bank an affiliate or fiduciary of the RIC.

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