December 23, 2019

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Center, 1155 21st St. NW
Washington, D.C. 20581

Submitted via: CFTC Comment Portal

Re: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Commodity Futures Trading Commission (RIN:3038-AE89)

Dear Sirs and Madams:

The Asset Management Group of the Securities Industry and Financial Markets Association ("**AMG**" or "**SIFMA AMG**")[1] appreciates the opportunity to provide comment to the Commodity Futures Trading Commission (the "**CFTC**") on the Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (the "**Proposal**").[2] AMG is supportive of the Proposal's amendments to the margin requirements that would incorporate the recent Basel Committee on Banking Supervision and the International Organization of Securities Commissions' ("**BCBS-IOSCO**") statement extending the implementation of the remaining phases of the initial margin requirements for non-centrally cleared derivatives ("**UMR**"). While the changes in the Proposal serve to codify helpful relief, these changes alone will not remediate the substantial challenges faced by asset managers and their clients during the final phases of UMR implementation, and therefore, we believe further changes to the UMR are necessary.

AMG appreciates the CFTC's commitment to ensure a robust and workable uncleared margin framework and is supportive of the proposal to both extend the compliance schedule of the UMR by one year and split the final implementation phase into two phases, $50 billion and $8 billion, respectively. In doing so, the CFTC acknowledged industry concerns that delays may occur due to the limited number of entities able to provide certain necessary IM services for the significant amount of counterparties being phased-in during the final stages of implementation.[3] Moreover, the Commission also recognized "the relatively small amount of swap activity of the financial end users that would be subject to the one-year extension," noting data estimates of the CFTC's Chief Economists' Office that the average AANA per entity in the current phase 5 is $54 billion compared to an average $12.71

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[1] SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.
[2] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 84 Fed. Reg. 56950 (October 24, 2019), available at https://www.cftc.gov/sites/default/files/2019/10/2019-22954a.pdf?utm_source=govdelivery.
[3] The Proposal at 56951.

trillion AANA for each entity in phases 1, 2, and 3 and $1 trillion in phase 4.[4] While AMG agrees with these concerns, and we commend the CFTC for their current review of the margin framework via the Proposal and recently announced Global Markets Advisory Subcommittee on Margin,[5] the proposed changes only take a step towards alleviating issues faced by asset managers and their clients in the near term.

To that end, we believe there are substantial implementation challenges that would not be resolved by an extension of the compliance date, and in response to these challenges, AMG recently submitted a letter to global regulators on the remaining stages of the initial margin phase-in (the "**AMG September Letter**").[6] In the AMG September Letter, and more recently in AMG's response to the recent U.S. Prudential Regulators' proposal to amend the margin requirements[7], we proposed certain scoping and implementation solutions for which we believe will allow for a more orderly implementation of the UMR. A summary of these solutions is provided below.

Scoping Issues and Potential Solutions:

1. **Address Burdensome Daily Calculation of Initial Margin by Allowing Annual Calculation of Initial Margin and/or Six-Months Grace Period for Documentation:** Under the current regime, once an asset manager's client has crossed the final two thresholds for initial margin phase-in, $50 billion and $8 billion notional, the asset manager and swap dealers must monitor and calculate the potential initial margin ("**IM**") amounts daily even in circumstances where the account is not near the $50 million threshold ("**IM Threshold**"). The types of market participants captured in these final phases, large in number compared to prior phases (around 700 entities and 7,000 relationships) and presenting collectively a small percentage of outstanding notional amounts (around 11% of the AANA across all phases), has resulted in a number of in-scope market participants that do not always exceed the $50 million counterparty threshold.[8] As such, this daily obligation applied to market participants is overly burdensome, in particular those with smaller AANA calculations closer to $8 billion. This challenge is exacerbated for a beneficial owner with multiple separately managed accounts through multiple asset managers ("**SMA**"), where an asset manager only has knowledge of the derivatives trading it engages in on behalf of an SMA client and does not have transparency into other derivative trading by the SMA client (either

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[4] Richard Haynes, Madison Lau, and Bruce Tuckman, *Initial Margin Phase 5* (October 24, 2018), available at https://www.cftc.gov/sites/default/files/About/Economic%20Analysis/Initial%20Margin%20Phase%205%20v5_ada.pdf (the "**CFTC Margin Study**").

[5] Request for Nominations for the Subcommittee on Margin Requirements for Non-Cleared Swaps Under the Global Markets Advisory Committee, 84 Fed. Reg. 57706 (October 28, 2019), available at https://www.cftc.gov/sites/default/files/2019/10/2019-23496a.pdf. *See also*, Statement of Commissioner Dawn D. Stump for CFTC Open Meeting (October 16, 2019), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement101619 (stating, "During a recent meeting of the Global Markets Advisory Committee, we learned that in addition to the tremendous operational efforts required of market participants, regulatory parameters more suited to the counterparties involved in earlier implementation phases may need to be refined for application in this final phase. The issues are so vast that the Committee determined to recommend the creation of a subcommittee that can advise the Commission on considerations to prudently address these challenges.")

[6] *See* SIFMA AMG Comment Letter, Margin Requirements for Non-Centrally Cleared Derivatives – Remaining Stages of Initial Margin Phase-In, September 13, 2019, available at https://www.sifma.org/wp-content/uploads/2019/09/SIFMA-AMG-Letter-on-the-Margin-Requirements-for-Non-Centrally-Cleared-Derivatives-Final-9-13-19.pdf.

[7] *See* SIFMA AMG and ACLI Comment Letter, Margin and Capital Requirements for Covered Swap Entities, December 9, 2019, available at https://www.sifma.org/wp-content/uploads/2019/12/Margin-and-Capital-Requirements-for-Covered-Swap-Entities-SIFMA-AMG_ACLI-Response-12.09.19-v.final_.pdf (the "**US PR Letter**")

[8] *See* the CFTC Margin Study at 1.

directly or through other asset managers). While CFTC Letter No. 19-16[9] was helpful because it provided some clarity around when a counterparty would be required to have specific initial margin documentation in place upon reaching the IM Threshold, there remain many clients (both funds and SMAs) that would incur significant burdens and costs to daily monitor their accounts and may suffer trading disruptions, requirements to terminate or novate trades, negative performance, and more importantly, the inability to implement prudent risk and portfolio management if the IM Threshold is near or exceeds $50 million. In order to mitigate these concerns, SIFMA AMG is offering the following proposed solutions:

- Permit the calculations of the $50 million IM threshold to be done annually, rather than daily, using the same measurement period that is used for performing AANA calculations.

- Provide at least a 6-months grace period for firms, following notice from the applicable swap dealer that aggregate IM [for a client] required to be exchanged under the regulations equals or exceeds the IM threshold, to complete the necessary documentation and system set-ups to be complaint with the UMR.

2. **Remove Physically Settled FX Swaps and Forwards from AANA Calculations:** Current regulations require physically settled FX swaps and forwards to be included in the AANA calculations but do not require margin to be exchanged for such trades. It is inconsistent for the rules to exclude physically settled FX swaps and forwards from the margin calculation but include them in the calculation of AANA. Including physically settled FX swaps and forwards carry costs that hurt market participants who would not otherwise be in scope for initial margin because of both burdensome monitoring, and potentially having to post margin if in-scope products (with notionals far below the AANA thresholds) result in having to post and collect initial margin merely as a result of their out of scope FX activity. This result is ironic given that deliverable FX transactions are overwhelmingly used to hedge risk, for example, risks resulting from differences between the investor's home currency (e.g., U.S. dollar) and the denomination of the investment (e.g., a range of emerging market currencies for an emerging market equity investment strategy). Asset managers have begun observing these anomalies in reviewing indicative Phase 5 and 6 calculations. For example, one asset manager has identified a fund that may exceed the Phase 6 AANA threshold due to $10 billion notional in deliverable FX and $1 billion notional in non-deliverable forwards and swaps/ swaptions. Because this fund is a global fixed income strategy, it hedges all currency to USD as the investment currency of the fund.

   Given these costs combined with the irrelevance of deliverable FX for swaps initial margin calculations, the SIFMA AMG requests that physically settled FX swaps and forwards be removed from the AANA calculation.

3. **Scoping of Seeded Funds:** Current US UMR rules would require the consolidation of seeded funds based on a GAAP test which is not warranted given the limited and passive nature of the relationship between seeded funds and their sponsors. Such consolidation is not required for UCITS-regulated funds under the EU's adoption of the UMR, which may create an opportunity for regulatory arbitrage and competitively disadvantage U.S. markets. AMG continues to urge

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[9] CFTC Letter No. 19-16, Initial Margin Documentation Requirements (July 9, 2019), available at https://www.cftc.gov/PressRoom/PressReleases/7960-19 (*Stating*, "This advisory clarifies that while no specific IM documentation is required prior to reaching the $50 million IM threshold, DSIO expects that [Covered Swap Entities] will take appropriate steps to have the required IM documentation upon reaching the IM threshold.)

regulators to not require a seeded fund to aggregate its notional exposures with those of its parent or other commonly consolidated entities for purposes of calculating is AANA. To accomplish this exclusion, we recommend that the CFTC consider the following language which would serve as a carve-out for seeded funds:

> "Investment funds that are managed by an investment advisor are considered distinct entities that are treated separately when applying the threshold (as long as the funds are distinct legal entities that are not collateralized by or are otherwise guaranteed or supported by other investment funds or the investment advisor in the event of fund insolvency or bankruptcy) and shall not be considered to be an "affiliate" or "margin affiliate" of any other entity for a period of three years after such investment fund commences trading."

Such an interpretation would be consistent with BCBS-IOSCO[10] standards and the Prudential Regulators' recognition of seeded funds in the Volcker Rule.[11]

Absent any changes to the AANA consolidation requirements for seeded funds under the existing UMRs, it may become prohibitively expensive for newly seeded funds to use derivatives or FX because of the mandatory IM requirements that they may be subject to and the resulting substantial costs on returns for investors. This would not be due to the seeded fund's individual swap activity presenting any systemic risk, but solely as a result of the UMR requirement to aggregate its AANA calculations with a sponsor or commonly consolidated entities that may have material swaps exposures, despite those entities having neither transparency as to, nor control over, the seeded fund's trading. In addition, given the disparity between the EU's approach and other jurisdictional requirements, EU regulated funds may choose to only trade with EU dealers and thus, this may result in a shift in liquidity and a competitive disadvantage for US and other markets as some market participants take advantage of the regulatory arbitrage opportunities.

4. **GAAP Accounting Analysis for Certain Privately-Run Entities:** Certain privately-run entities, including non-public and mutual insurance companies, do not routinely perform GAAP accounting analysis on their enterprises. For example, non-public and mutual insurance companies are subject to statutory accounting standards. For these entities, it is a significant expense to perform GAAP accounting analyses for the limited purpose of determining whether an entity's investment and use of uncleared over-the-counter derivatives is subject to initial margin solely as a result of the combined over-the-counter derivatives activity of such entity together with other entities that *would* be consolidated under a GAAP analysis. This analysis is not a one-time event, but is required on an ongoing basis as new entities are formed or merged into other entities. Certain industry participants would accordingly like to engage with regulators to determine if an alternative approach may be available for companies that are not otherwise required to perform GAAP accounting analysis (or, depending on the jurisdiction, IFRS).

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[10] BCBS-IOSCO Margin Requirements for Non-Centrally Cleared Derivatives (March 2015), available at https://www.bis.org/bcbs/publ/d317.pdf. (*See* Footnote #10, stating "Investment funds that are managed by an investment advisor are considered distinct entities that are treated separately when applying the threshold as long as the funds are distinct legal entities that are not collateralised by or are otherwise guaranteed or supported by other investment funds or the investment advisor in the event of fund insolvency or bankruptcy.")

[11] *See* the AMG September Letter at 7.

Implementation Issues and Potential Solutions:

1. **Use of Money Market Funds ("MMFs"):** The current definition of forms of eligible margin contains restrictive language that would broadly disqualify many (if not most) MMFs currently used by asset managers, specifically, the limitation that "the [money market] fund's assets may not be transferred through securities lending, securities borrowing, repurchase agreements, reverse repurchase agreements or other similar means"[12]. As further noted in the AMG September Letter, we believe this restriction to be unwarranted and request it be removed from the relevant section noted herein.

2. **Minimum Transfer Amounts ("MTA") for SMAs:** We request that the CFTC codify the relief offered in DSIO's No-Action Letter 17-12 that allows for asset managers to apply no greater than a $50,000 MTA to each separate SMA it manages.

3. **Application of MTAs under the UMR:** Separately, we are appreciative of, and request the Commission codify, the recently issued No-Action Letter 19-25 granting time-limited relief from enforcement if a swap dealer or major swap participant applies separate MTAs for its initial margin and variation margin obligations on uncleared swap transactions with each swap counterparty, provided that the combined initial margin MTA and variation margin MTA per swap counterparty does not exceed $500,000, subject to certain conditions.

Accordingly, while AMG is supportive of the Proposal's changes to the implementation schedule of the UMR, we respectfully request the CFTC consider the suggested solutions above.

We appreciate your consideration of this letter and look forward to discussions that will address the issues raised. Please do not hesitate to contact Jason Silverstein, at jsilverstein@sifma.org or at 1-212-313-1176, or Tim Cameron at tcameron@sifma.org. or at +1-202-962-7447.

Sincerely,

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[12] 12 CFR 237.6 (CFTC eligible collateral); 12 CFR 237.7 (CFTC segregation of collateral). We note that similar language is found in the U.S. Prudential Regulations, specifically: 12 CFR 45.6 (Comptroller of Currency eligible collateral); 12 CFR 45.7 (Comptroller of Currency segregation of collateral); 12 CFR 237.6 (Federal Reserve eligible collateral); 12 CFR 237.7 (Federal Reserve segregation of collateral); 12 CFR 349.6 (FDIC eligible collateral) 12 CFR § 349.7 (FDIC segregation of collateral); 12 CRF 624.6 (FCA eligible collateral); 12 CFR 624.7 (FCA segregation of collateral); 12 CFR 1221.6 (FHFA eligible collateral); 12 CFR 1221.7 (FHFA segregation of collateral).

CC: The Honorable Chairman Heath P. Tarbert, Commodity Futures Trading Commission
The Honorable Commissioner Brian D. Quintenz, CFTC
The Honorable Commissioner Rostin Behnam, CFTC
The Honorable Commissioner Dawn DeBerry Stump, CFTC
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