June 30, 2023

Submitted electronically

Mr. Christopher Kirkpatrick
Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Derivatives Clearing Organization Risk Management Regulations to Account for the Treatment of Separate Accounts by Futures Commission Merchants (RIN 3038–AF21)

Dear Mr. Kirkpatrick:

On behalf of its members, Managed Funds Association[1] ("**MFA**") appreciates the opportunity to submit comments to the Commodity Futures Trading Commission (the "**CFTC**" or "**Commission**") on the proposed amendments to the derivatives clearing organization ("**DCO**") risk management rules that would permit futures commission merchants ("**FCMs**") that are clearing members to treat the separate accounts of a single customer as accounts of separate entities for purposes of margining and other CFTC regulations (the "**Proposal**").[2]

MFA supports the Commission's efforts to codify into regulation the limited no-action relief granted in CFTC Letter 19-17[3] and provide additional clarity and certainty as to the scope of the relief provided. The Proposal, however, would pose risks of unintended consequences that could potentially upend longstanding practices of the FCMs and their customers, in part due to the prescriptive nature of the Proposal. The risk management practices of FCMs have proven

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[1] MFA represents the global hedge fund and alternative asset management industry and its investors by advocating for regulatory, tax, and other public policies that foster efficient, transparent, and fair capital markets. MFA's more than 170 member firms collectively manage nearly $2.2 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has a global presence and is active in Washington, Brussels, London, and Asia. www.managedfunds.org.

[2] Derivatives Clearing Organization Risk Management Regulations To Account for the Treatment of Separate Accounts by Futures Commission Merchants, 88 Fed. Reg. 22934 (Apr. 14, 2023) (the "**Proposal**") available at https://www.govinfo.gov/content/pkg/FR-2023-04-14/pdf/2023-06248.pdf.

[3] CFTC Letter No. 19-17, *Advisory and Time-Limited No-Action Relief with Respect to the Treatment of Separate Accounts by Futures Commission Merchants*, available at https://www.cftc.gov/csl/19-17/download.

exceedingly resilient during episodes of considerable market stress during and since the 2008 financial crisis. We would suggest that the prescriptive rules proposed by the Commission accordingly are unnecessary and moreover, insufficient evidence exists that the Proposal would be beneficial to FCMs or the markets more broadly.

I. Executive Summary

A. The proposed amendments to the DCO regulations to set forth a timeframe for FCM margin calls would not improve the safety and soundness of the FCM, nor do they reflect the established and efficient margining practices in today's futures markets that have developed between the FCM and asset managers trading on behalf of the FCM's customers. The customer's location, products it trades and other factors require flexibility in allowing FCMs, consistent with their own risk management practices, to establish appropriate cut-off times.

B. It is imperative that the Proposal reflect the practical importance of grace periods to allow for margin to be transferred without the FCM having to declare an event of default or the commencement of a cure period, both of which would be heavy-handed approaches that are unnecessary to address an administrative or operational error that is easily corrected and not in and of itself an indicator of customer or FCM distress.

C. The Proposal should be revised to codify CFTC Letter 20-28 as it relates to the Commission's interpretation of Commission Rule 1.56 and the limited recourse language widely used in agreements between investment managers and FCMs, dealers, and banks.

II. Discussion

MFA supports the objectives of the Proposal and believes that robust FCM risk management practices benefit customers, investors, and contribute to the overall integrity of our commodities and financial markets. We recommend, however, that the Commission revise the Proposal to reflect the detailed, robust, and evolving risk management practices used by FCMs today. Apart from the fact that FCMs engage in robust risk management practices because the survival of their business depends on it, FCMs are obligated under CFTC Rule 1.11 to manage risk effectively. FCMs are obligated to "establish, maintain, and enforce a system of risk management policies and procedures designed to monitor and manage the risks associated with the activities of the [FCM]."[4]

FCM risk management obligations are designed to be flexible and adaptable by each FCM with respect to its own business, customers, and adaptive to varying market conditions and stresses. It is imperative that each FCM have the flexibility to customize its risk management

[4] 17 C.F.R. § 1.11(c).

program to the specific activities of the FCM and its customers. MFA as such would suggest that the Proposal, as it relates to margining practices and cut-off times, be revised to reflect the fact that the Proposal would overlay the existing risk management programs implemented at each FCM.

A. The Commission's Proposed 39.13(j)(4) Relating to a "One Business Day Margin Call" Is Overly Prescriptive and Contrary to Longstanding, Established Industry Guidelines and Practices

MFA supports same-day margining but is of the view that the Commission's proposed mandatory one business day margin call is overly prescriptive and, respectfully, fails to consider market realities and the longstanding, effective practices that have developed over the years between FCMs and the asset managers that trade on behalf of FCM customers. Proposed 39.13(j)(4) would impose a one business day margin call for each separate account such that "if the margin call is issued by 11:00 a.m. Eastern Time ("ET") on a United States business day, it must be met by the applicable customer no later than the close of the Fedwire Funds Service on the same United States business day."[5] Clearing members, moreover, would be prohibited from contractually agreeing to delay issuance of a margin call after 11:00 a.m. ET on any given United States business day or to otherwise engage in practices intended to cause such a delay.

The Proposal fails to consider that legitimate reasons exist for firms to impose different margin call deadlines for different clients. FCMs and the asset managers that trade on behalf of FCM clients have over time developed operational workflows and risk management processes that address particular characteristics and challenges based on specific markets, products, clients, custodians, and fund structures involved. Commission Letter 19-17 recognized these operational complexities of FCM margining practices by affording firms greater operational flexibility in prescribing margin cut-off times. MFA would recommend that the Proposal be revised to more closely align with the flexibility afforded in CFTC Letter 19-17, rather than the proposed, unyielding 11:00 a.m. ET deadline. MFA would note that FCMs and asset managers for the past several years have been operating under the very flexibility of CFTC Letter 19-17 that the Proposal would codify, in particular the requirement that FCMs and customers cannot contractually arrange for "longer than a one business day period for a margin call to be met."[6]

Consistent with each of their risk management programs, FCMs should be afforded the flexibility needed to administer a program of same-day margining that best suits its and its customer's needs, considering geography, structure, and product. Some FCMs may make all daily margin calls at a specific time and some may make margin calls at various times, depending on the location and nature of the customer. A requirement for same-day margining, we would suggest, is best achieved by allowing the FCM and each of its customers to establish

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[5] Proposal at 22941.

[6] *See supra* note 3, at p. 4.

same-day margin deadlines that are appropriate for that customer, so long as the FCM receives margin owed by the next morning. If the customer's location requires processing overnight and across jurisdictions, for example, its accounts may have margin calls earlier than 11:00 a.m. ET to ensure that the FCM receives the required margin the next morning at the latest. An 11:00 a.m. ET margin deadline may be too late for such customers to ensure that margin calls are met by the following morning, and for this reason FCMs and their customers have negotiated earlier cut-off times so that FCM margin is received in a timely manner.

We lastly would note that a strict 11:00 a.m. ET cut-off time for margin calls is at odds with long-established industry practice. The Joint Audit Committee Margins Handbook (the "**Margins Handbook**")[7] advises that a "reasonable time" may be "deemed acceptable for the collection of required margin calls." The Margins Handbook defines "a reasonable time" "to be less than five business days for customers and less than four business days for noncustomers and omnibus accounts."[8] We would encourage the Commission to revise the proposal to align more closely with this longstanding guidance. We also would note that the National Futures Association has decades of experience examining members for compliance under the Margins Handbook. MFA moreover would suggest that the Commission rules and efforts are better focused on situations where market participants seek to evade the margin requirements, rather than technical deficits that can and are resolved in through prudent risk management as they have been for many years in the ordinary course of business.

B. Industry Risk Management Practices Require Express Preservation of a "Grace Period" Before Declaring the Commencement of a Cure Period or Default

While MFA appreciates the stated purpose of the one business day margin call -- to ensure that deficiencies are corrected in a timely manner[9] -- the Proposal would inject considerable uncertainty into the contours of a "timely" identification a shortfall and its "timely" correction. FCMs, asset managers, and FCM customers have long recognized the need to allow for some agreed-upon grace period for shortfalls resulting from administrative or operational issues that do not stem from an inability to pay.

MFA would suggest that a grace period supports the timely identification and correction of shortfalls, rather than an attempt to avoid meeting a margin call. If an asset manager is one of several managers acting as subadvisers for the same fund, for example, an administrative or technological issue with one subadviser could result in that subadviser not making a margin call and, absent a grace period, require each subadviser to revert to margining on a gross basis rather

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7 National Futures Association Joint Audit Committee, Margins Handbook, 26 (June 1999) available at https://www.nfa.futures.org/members/member-resources/files/margins-handbook.pdf.

8 *Id*. at 6.

9 Proposal at 22941.

than with each individual subadviser. This could result in delays in the return of excess margin the other subadvisers and reduced transparency of the margin limits among all subadvisers. The sudden removal of excess margin from one subadviser's account to meet a margin deficit in an another's furthermore would be disruptive to the subadviser and its management of the account, even though the subadviser is current in its margin obligations. MFA requests that any future regulation regarding a grace period be proposed in a subsequent rulemaking with adequate opportunity for notice and comment.

While MFA appreciates the Commission's attempt to address administrative and operational issues, the requirement that a failure to meet margin obligations due to an unforeseen administrative error or operational issue raises more questions than it answers and should be removed. The Proposal states that such an issue must be "unusual," a term that is subjective and very much in the eye of the beholder. The same can be said for the Proposal's requirement that the investment manager to act "diligently and in good faith"[10] -- diligent according to whom? MFA is unsure what factors would be used to determine diligence and would note that, with benefit of hindsight, any event could be argued to have been "reasonably foreseen."[11]

The Commission historically has applied a more principles-based approach with respect to margin regulation to recognize differences in FCMs and other market participants and has therefore largely avoided the interpretive challenges of the prescriptive nature of the Proposal. MFA would encourage the Commission to take a similar approach as it relates to any codification of CFTC letter 19-17.

C. The Commission Also Should Codify the Interpretation of Rule 1.56 Provided in CFTC Letter 20-28

Commission Letter 20-28 was welcome news to many FCM customers in its recognition of the legal limitations on FCM customers, notwithstanding the previous interpretation of the Joint Audit Committee ("**JAC**"). Many investment managers have negotiated limited recourse provisions into derivatives trading agreements with FCMs, banks, and dealers to reflect the contractual and commercial reality that the discretionary authority of the investment manager is limited to the specific assets where it has been designated as manager. The manager's clients typically do not authorize the manager to encumber client assets that are managed by another investment manager.

JAC Alert 19-03 interpreted Commission Rule 1.56, which prohibits FCMs from guaranteeing against customer loss, as invalidating limited recourse language of FCM

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10 *See* Proposal at 22953.

11 *See id.*

agreements.[12] The challenge for many FCM customers is that they are prohibited by law from agreeing to anything *but* limited recourse language and their investment manager, acting as agent for its client, cannot agree to expand recourse beyond that which its client would be permitted to accept directly. The Commission recognized as much, and interpreted Rule 1.56 in CFTC Letter 20-28[13] to make clear that "no specific or express language" must be contained in customer agreements to meet Rule 1.56 since customer liability may be limited "due solely to external law applicable to that beneficial owner that operates independent of contractual agreements … includ[ing] state laws establishing separate accounts of insurance companies and cases of sovereign immunity, or similar cases."[14]

The effect is that cross-margining, in the event of a margin shortfall, may be unavailable for such customers, thereby further arguing for the preservation of a grace period under the Proposal. The fact that several types of FCM customers, such as state public funds and insurance company accounts, are legally prohibited from allowing margin owed in one account to be paid from the assets of another account, does not change with the Proposal. Many state statutes similarly require that liabilities owed by a particular public fund account are limited to the assets in that account, notwithstanding the fact that the state public fund, through multiple managers, may have several accounts with a single FCM. A grace period is necessary for these large, institutional multi-manager accounts that are FCM customers, determined in good faith and cooperation between the FCM and the investment manager, and consistent with applicable margin deadlines.

Absent a grace period, the FCM may be left with the unpleasant choice of declaring either the commencement of a cure period or an event of default, each of which would be burdensome on both the FCM and the client, and unnecessary since any margin deficiency is not the result of the customer's financial inability to address a margin deficiency. This proposed approach, respectfully, fails to recognize the robust and evolving risk management programs implemented and maintained by the FCMs.

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MFA supports the Commission's stated goal of codifying earlier Commission Staff letters to provide additional certainty, but in doing so, the Proposal would sweep away long-standing established practices between FCMs and investment managers, on behalf of the

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12 JAC Regulatory Alert #19-03, *CFTC Regulation 1.56(b) – Prohibition of Guarantee Against Loss* (May 14, 2019) available at http://www.jacfutures.com/jac/jacupdates/2019/jac1903.pdf.

13 CFTC Letter No. 20-28, *Supplemental Advisory and Time-Limited No-Action Relief with Respect to the Treatment of Separate Accounts by Futures Commission Merchants* (Sept. 15, 2020) available at https://www.cftc.gov/csl/20-28/download.

14 *Id*. at 3.

manager's clients. MFA respectfully recommends that the Commission revise the proposal to preserve these long-standing practices, which each FCM has implemented and refined over time in accordance with its RMP and particular to each of the investment manager's clients that trade with the FCM.

MFA appreciates the opportunity to comment on the Proposal and thanks the Commission for its consideration of our comments. If you have any questions about these comments, or if we can provide additional information, please do not hesitate to contact Jeff Himstreet, Vice President and Senior Counsel, or the undersigned at 202.730.2600.

Respectfully Submitted,

/s/ Jennifer W. Han

Jennifer W. Han
Executive Vice President
Chief Counsel & Head of Regulatory Affairs

cc: The Honorable Rostin Behnam, Chairman
The Honorable Kristin Johnson
The Honorable Christy Goldsmith Romero
The Honorable Summer Mersinger
The Honorable Caroline Pham