MANAGED FUNDS ASSOCIATION

AIMA

November 19, 2018

Via Electronic Submission: rule-comments@sec.gov

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers (Release No. 34-84409; RIN 3235 – AL12; File No. S7-08-12)

Dear Mr. Fields:

Managed Funds Association[1] and the Alternative Investment Management Association[2] (together, "**we**") welcome the opportunity to provide comments to the Securities and Exchange Commission (the "**Commission**" or "**SEC**") on its proposed rule; reopening of comment period; request for additional comment[3] on its originally proposed "Capital, Margin, and Segregation

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1 Managed Funds Association ("**MFA**") represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

2 The Alternative Investment Management Association ("**AIMA**") is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused on the private credit and direct lending space. The ACC currently represents over 100 members that manage $350 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

3 83 Fed. Reg. 53007 (Oct. 19, 2018), available at: https://www.gpo.gov/fdsys/pkg/FR-2018-10-19/pdf/2018-22531.pdf ("**Reopening Release**").

Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers" (the "**Original Proposed Rules**")[4] related to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").[5] We appreciate the Commission's commitment to taking expeditious steps now toward finalizing its Title VII rules that will govern the U.S. security-based swaps ("**SBS**") market. Given the global nature of SBS markets and the derivatives markets generally, we believe the Commission has an important opportunity to achieve sufficient comparability with other derivatives regulatory regimes by adopting final SBS rules aimed at reducing risk in the U.S. SBS market while avoiding material inconsistencies and minimizing the risk of regulatory arbitrage across jurisdictions. Without such comparability, the Commission could put the U.S. SBS market at a competitive disadvantage relative to non-U.S. SBS markets, undermine substituted compliance and equivalence determinations, and create undue compliance complexity relative to the Title VII regimes of the U.S. prudential regulators[6] and the Commodity Futures Trading Commission ("**CFTC**").

After assessing the Reopening Release, we are very concerned that the Commission's proposed regime would diverge in material ways from other regulatory regimes that are already in place or are in the final stages of implementation. Such divergence could have profound adverse implications on the health and competitive viability of the U.S. SBS market. Accordingly, our views on certain potential modifications to the Original Proposed Rules are intended to assist the Commission in adopting comparable, robust and balanced final SBS rules that will promote efficiency, competition and capital formation[7] while also protecting customers, liquidity, and the overall functioning of the U.S. SBS market.

MFA and AIMA members are customers to Commission-regulated security-based swap dealers ("**SBSDs**") and major security-based swap participants ("**MSBSPs**", and together with SBSDs, "**SBS Entities**")[8] and our respective members are fiduciaries to the investors whose money they manage. As such, they are significant stakeholders in the U.S. SBS market. Therefore,

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[4] 77 Fed. Reg. 70213 (Nov. 23, 2012), available at: https://www.gpo.gov/fdsys/pkg/FR-2012-11-23/pdf/2012-26164.pdf ("**Original Proposing Release**").

[5] Pub. L. 111-203, 124 Stat. 1376 (2010).

[6] The U.S. prudential regulators are collectively, the Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Farm Credit Administration; and the Federal Housing Finance Agency.

[7] *See* Section 3(f) of the Securities Exchange Act of 1934 (the "**Exchange Act**").

[8] These terms have the meanings set forth in the joint final entity rules and interpretations adopted by the Commission and the CFTC that further define the terms swap dealer, security-based swap dealer, major swap participant and major security-based swap participant. *See* Commission and CFTC joint final rule; joint interim final rule; interpretations on "Further Definition of 'Swap Dealer,' 'Security-Based Swap Dealer,' 'Major Swap Participant,' 'Major Security-Based Swap Dealer' and 'Eligible Contract Participant'", 77 Fed. Reg. 30596 (May 23, 2012), and corrected by 77 Fed. Reg. 39626 (July 5, 2012), available at: http://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-10562.pdf.

we have a strong interest in offering constructive suggestions to the Commission that we believe will reduce the risks that our private fund manager members and their respective investors will encounter and strengthen the protections available to them.

In general, our responses below are informed by assessing our respective members' implementation experiences with the derivatives regulatory regimes adopted by other regulators to date. In the nearly six years that have elapsed since the Commission issued its Original Proposed Rules, other domestic regulators and many international regulators have finalized their respective rules on capital, margin, and segregation requirements for non-cleared and cleared derivatives. Particularly with respect to margin requirements for non-cleared derivatives, other regulators have closely conformed their rules to the international margin framework issued by the Working Group on Margining Requirements of the Basel Committee on Banking Supervision ("**BCBS**") and the International Organization of Securities Commissions ("**IOSCO**"), in which such other regulators and the Commission participated.[9] Given the material differences we have noted in the Commission's proposed requirements as compared to other regulators' requirements, we respectfully urge the Commission to consider the broader regulatory context that has developed for the derivatives markets and re-propose its Original Proposed Rules to achieve more comparable regulations with U.S. and non-U.S. regulators. If there are compelling reasons for the SEC's rules to diverge from those of other regulators, we respectfully urge the SEC to explain such reasons to justify such differences. Otherwise, we are concerned that the Commission's potentially disparate regulatory regime for SBS will reduce efficiency, competition and capital formation in the U.S. SBS and swaps markets.

I. Executive Summary

In addition to both MFA's and AIMA's prior comments on the Original Proposed Rules,[10] this letter focuses on responding to certain questions and potential modifications in the Reopening Release to assist the Commission in re-proposing appropriate risk-based margin and capital requirements that are of most concern to MFA and AIMA members. In particular, we respectfully urge the Commission to include the following modifications in the re-proposal and final rules:

- *Capital Relief for Cleared SBS*: Adopt the potential language modifications in the Reopening Release concerning the *risk margin amount* calculation for cleared SBS to ensure that such amount is determined solely by the total initial margin ("**IM**") required for cleared SBS (rather than the greater of that amount or the amount of the haircuts that would apply to cleared SBS positions).

[9] Available at: https://www.bis.org/bcbs/publ/d317.pdf.

[10] Available at: https://www.sec.gov/comments/s7-08-12/s70812-28.pdf ("**Original MFA Letter**") and https://www.sec.gov/comments/s7-08-12/s70812-31.pdf ("**Original AIMA Letter**" and, together with the Original MFA Letter, the "**Original Letters**").

- *Capital Charge for Counterparty Election of Individual IM Segregation with Independent Third-Party Custodian*: Eliminate the proposed capital charge or, at the very least, provide for an exception to the capital charge with conditions that would be satisfied by standard provisions of a typical tri-party account control agreement as outlined below.

- *IM Calculations under Uniform IM Model*: Permit SBSDs to use a standard industry model to increase transparency and decrease margin disputes among counterparties. Coordinate with global regulators to authorize enhanced risk sensitivity of IM models generally.

- *Portfolio Margining of SBS, Swaps, and Related Positions*: Coordinate with the CFTC to authorize an expanded scope of portfolio margining that includes both cleared and non-cleared SBS and swaps positions.

II. Capital

A. Capital Relief for Cleared SBS

In comment topic 1.b. of the Reopening Release, the Commission cites to MFA's comment letter recommendation to modify the originally proposed definition of *risk margin amount* to reflect the lower risk associated with central clearing.[11] The SEC asks if the input to the *risk margin amount* for cleared SBS should be determined solely by the total initial margin ("**IM**") required for cleared SBS (rather than the greater of that amount or the amount of the haircuts that would apply to cleared SBS positions). The stated purpose of this potential modification would be to simplify the calculation, align it with the clearing agency margin requirements, and more closely align it with the CFTC's existing rules and proposals. The SEC asks if this potential language modification would address our concern.

In response, we appreciate the Commission's thoughtful consideration of MFA's prior comments on this proposal. We believe the Commission's potential modifications to paragraph (c)(17) of existing Rule 15c3-1 and paragraph (c)(6) of proposed Rule 18a-1[12] would adequately address our concern.

B. Capital Charge for Counterparty Election of Individual IM Segregation with Independent Third-Party Custodian

Section 3E(f) of the Exchange Act grants an SBSD's counterparties the right to elect to post IM for non-cleared SBS to a segregated account with an independent third-party custodian. The Dodd-Frank Act added this section as a customer protection measure designed to prevent swap

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[11] *See* Reopening Release at 53009 fn. 16. *See also* Original Proposing Release at 70223-24.

[12] *See* Reopening Release at 53009.

market participants from facing the treatment received by certain swap counterparties in the context of the Lehman bankruptcy. These counterparties posted IM directly to a Lehman Brothers entity (not to a segregated account held by a third-party custodian), and the assets were swept into the debtor's estate. The counterparties became unsecured creditors of the debtor's estate with respect to any excess collateral they had posted, including IM.

Notwithstanding the purpose of Exchange Act Section 3E(f), the Original Proposed Rules imposed a 100% capital charge on SBSDs for IM held by a third-party custodian in a segregated account. The effect of the proposed capital charge would be the same from a capital perspective as if the counterparty had failed to post any IM at all (even if the SBSD has legal control of the collateral). In the Original Proposing Release, the SEC highlighted two primary concerns with IM posted to a third-party custodian in a segregated account: (1) that the collateral would not be in the physical possession and control of the SBSD, and (2) that the collateral would not be capable of being liquidated promptly by the SBSD without the intervention of another party.

As the SEC pointed out in the Reopening Release, commenters on the Original Proposed Rules, including MFA, have argued that the imposition of this capital charge would create costs to SBSDs that would be passed on to their counterparties and would discourage the use of segregation. Tri-party segregation is intended to protect counterparties' IM from risk of loss upon a SBSD bankruptcy (although its treatment is untested), while still preserving an SBSD's interests as a secured party (*e.g.*, a perfected security interest in, legal control of, and access to IM). Ultimately, funds posted as IM represent capital of our investors, including pension funds, retirement plans and endowments. Congress chose tri-party segregation as the mechanism to accomplish that end, and the SEC's imposition of a capital charge would have the effect of discouraging its use and thereby undermining the purpose of Exchange Act Section 3E(f). To date, no other regulator that has finalized or proposed capital rules for derivatives has included a special capital charge for IM held in a tri-party segregated account. Accordingly, we reiterate our request that this proposed capital charge be eliminated.

Recognizing the goal of Section 3E(f), the SEC proposes for comment in comment topic 4.a. of the Reopening Release the possibility of an exception to imposition of this capital charge. Specifically, the SEC proposes for consideration an exception based on three conditions: (1) the independent third-party custodian is a bank that is not affiliated with the counterparty; (2) the SBSD enters into an account control agreement with the custodian and the counterparty that provides the SBSD with the same control over the collateral as would be the case if the SBSD controlled the collateral directly (the "**Control Condition**"); and (3) the SBSD obtains a written opinion from outside counsel that the account control agreement is legally valid, binding, and enforceable in all material respects, including in the event of bankruptcy, insolvency, or a similar proceeding. The SEC asks for comment generally and asks specifically whether this exception would be practical.[13]

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[13] *See* Reopening Release at 53011.

In addition, in comment topic 4.b. of the Reopening Release, the SEC states that it is considering providing guidance on ways an SBSD could structure an account control agreement to meet the Control Condition and asks commenters to address whether an account control agreement should: (1) provide that the collateral will be released promptly and directed in accordance with the SBSD's instructions upon receipt of an effective notice from the SBSD; (2) provide that when a counterparty provides an effective notice to access the collateral, the SBSD will have sufficient time to challenge the notice in good faith and that the collateral will not be released until a prior agreed-upon condition has occurred; and (3) give priority to an effective notice from the SBSD over an effective notice from the counterparty, as well as priority to the SBSD's instruction about how to transfer the collateral in the event the custodian terminates the account control agreement.[14]

We appreciate the Commission's constructive proposal to include an exception to the capital charge for segregated IM if the SEC determines that the capital charge will not be eliminated. With appropriate modifications, this exception could be the basis for a fair and effective way to address the concerns raised by MFA and a wide range of other financial market participants.[15] Key to the effectiveness of this solution is that it provides the SBSD with sufficient control over the IM, be consistent with well-developed market practice, and not be overly-prescriptive or create uncertainty as to what constitutes an acceptable tri-party agreement. The first condition of the proposed exception (that the custodian be an unaffiliated bank) is reasonable and practical; the other two conditions raise issues, which we discuss below.

The third condition to the proposed capital charge exception is that the SBSD obtain a written opinion from outside counsel that deems the account control agreement legally valid, binding, and enforceable in all material respects, including in the event of bankruptcy, insolvency, or a similar proceeding. This would not be a typical requirement and we expect that it would add significant unnecessary costs (which would likely be passed on to the counterparty) and delay, particularly when considered across multiple counterparty relationships and multiple jurisdictions. We are very concerned that the legal opinion requirement would make reliance on the exception impractical and therefore would prevent market participants from relying on it.

The second condition, the Control Condition, requires the SBSD to enter into an account control agreement with the custodian and its counterparty that provides the SBSD with the same

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14 *See* Reopening Release at 53011.

15 *See* International Swaps and Derivatives Association, Inc.'s (ISDA) comments on the Original Proposed Rules, filed with the SEC on January 23, 2013, available at: http://www.sec.gov/comments/s7-08-12/s70812-17.pdf; SIFMA's comments on the Original Proposed Rules, filed with the SEC on February 22, 2013, available at: http://www.sec.gov/comments/s7-08-12/s70812-29.pdf; SIFMA AMG's comments on the Original Proposed Rules, filed with the SEC on February 22, 2013, available at: http://www.sec.gov/comments/s7-08-12/s70812-38.pdf; ICI's comments on the Original Proposed Rules, filed with the SEC on February 4, 2013, available at: http://www.sec.gov/comments/s7-08-12/s70812-20.pdf; ICI's supplemental comments on the Original Proposed Rules, filed with the SEC on December 5, 2013, available at: http://www.sec.gov/comments/s7-08-12/s70812-54.pdf; and AIMA's comments on the Original Proposed Rules, filed with the SEC on February 22, 2013, available at: http://www.sec.gov/comments/s7-08-12/s70812-31.pdf.

control over the collateral as would be the case if the SBSD controlled the collateral directly. However, as drafted, this condition is open-ended and somewhat ambiguous, and would not provide the requisite clarity to enable the parties to rely on it. In addition, imposition of this condition could likely raise concerns in the context of the bankruptcy that undermine the purpose of tri-party segregation.[16]

To make the exception more practical and workable, we suggest that the Control Condition be revised to permit that no capital charge be imposed if the SBSD enters into a tri-party custody agreement[17] with the custodian and the counterparty that provides the SBSD with legal control over, and access to, the counterparty's IM in the event of enforcement of the SBSD's rights against such IM. Such a condition would give the SBSD adequate protection in respect of the IM without unfairly disadvantaging the counterparty-pledgor. It would also have the benefit of being consistent with certain commonly-used provisions for tri-party custody arrangements that have been developed, and are widely used, by derivatives market participants. These standard provisions of tri-party custody agreements are outlined below:

- *SBSD has Legal Control of Collateral*. In the typical OTC derivatives tri-party account control agreement, the SBSD has a perfected security interest in both the account and the collateral contained therein under Articles 8 and 9 of the Uniform Commercial Code and/or the laws of such other jurisdiction as may be applicable. Legal control is established by the SBSD's power upon the delivery of a notice of exclusive control to instruct the custodian with respect to the collateral without further consent by a counterparty-pledgor.

- *SBSD has Access to Collateral upon Counterparty Default*. The SBSD, as secured party, will have the right upon a counterparty insolvency or other default to assert exclusive control and gain timely access to the collateral through the delivery of a notice of exclusive control to the custodian. A standard provision in a tri-party custody agreement is that the custodian will comply with all entitlement orders and other instructions from the secured party, without inquiry and without the consent of pledgor, in accordance with any notice of exclusive control.

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16 In the *Lehman Securities Investor Protection Corporation* proceeding, collateral (including excess margin) held in a tri-party account with an independent custodian (not directly with the relevant Lehman entity as discussed above) was found to be "customer property" and therefore part of the debtor's estate where the custody agreement established that the assets in the account were under the "dominion and control" of the debtor and where the debtor had the exclusive right to direct the custodian to release the assets in the account. *See* Sec. Investor Prot. Corp. v. Lehman Brothers Inc., 433 B.R. 127 (Bankr. S.D.N.Y. 2010).

17 Forms of agreement used by market participants to establish segregated collateral accounts for derivatives IM vary significantly. Parties may use an individually negotiated tri-party account control agreement or may participate in an established tri-party custodial platform with a suite of form documentation, among other things. Each of these variations may present different issues, but most will present common issues that are addressed in this letter.

We think these concepts could be reconciled with the provisions described in comment topic 4.b. of the Reopening Release with a few modifications.

In addition, we think the SEC's guidance related to the Control Condition should be revised to make clear that parties are free to negotiate in their account control agreements provisions that are protective of the counterparty-pledgor without attracting a capital charge. Examples of these provisions are as follows[18]:

- *Prior Notice Requirement for Access to Collateral and Dispute Right*. Parties should be free to negotiate provisions that require the SBSD, as secured party, to provide prior written notice of its intention to deliver a notice of exclusive control and that give the counterparty-pledgor the opportunity to dispute the basis for such intention, or alternatively, provisions that give the counterparty-pledgor the opportunity to dispute a notice of exclusive control for a period of time following receipt of a copy thereof (other than, in each case, in the event the counterparty commences formal insolvency proceedings or a regulator institutes such proceedings).

- *Access by Pledgor Upon SBSD Insolvency*. Parties should be entitled to negotiate provisions under which the counterparty-pledgor may gain immediate access to its IM (without the opportunity for challenge by the SBSD) as soon as the SBSD commences formal insolvency proceedings or a regulator institutes such proceedings. Given a formal filing, there is no factual dispute and no need for a challenge period.

- *Release of Security Interest*. Parties should be able to negotiate provisions providing that the security interest and lien granted to the SBSD in respect of any collateral posted by the counterparty-pledgor will be released upon default by the SBSD where the counterparty-pledgor has paid in full all of its obligations that are then due.

Based on the foregoing, we suggest that the conditions to the capital charge exception for segregated IM be revised as follows: (1) the independent third-party custodian is a bank that is not affiliated with the counterparty; and (2) the SBSD enters into an account control agreement or other agreement (or suite of agreements) governing the terms under which the custodian holds and releases collateral pledged by the counterparty as IM that (i) provides the SBSD with a perfected security interest in both the account and the collateral contained therein under Articles 8 and 9 of the Uniform Commercial Code and/or the laws of such other jurisdiction as may be applicable,[19] and (ii) gives the SBSD the right, upon termination of one or more security-based swaps due to the counterparty's insolvency or other event of default or similar condition, to assert exclusive

[18] Many of these provisions are included in the Form of Amendment to the 1994 ISDA Credit Support Annex subject to New York Law published by ISDA in 2011, available at: http://www2.isda.org/attachment/MzgxNg==/Form%20of%20Amendment%20to%20the%201994%20ISDA%20CSA%20to%20provide%20for%20the%20segregation%20of%20IA%20with%20a%20custodian.pdf.

[19] It is expected that an SBSD would confer with outside counsel in reaching a conclusion as to this condition.

control and gain timely access to the collateral through the delivery of a notice of exclusive control to the custodian (the "**Revised Control Condition**"). In addition, we suggest that the SEC make clear in its rules that the parties are free to negotiate in their tri-party custodial agreements provisions that are protective of the counterparty-pledgor without attracting a capital charge, so long as those provisions do not expressly conflict with the Revised Control Condition. Please see Annex I attached hereto for proposed rule language.[20]

We also suggest that the SEC issue guidance accompanying the capital charge exception that: (i) describes examples of the types of counterparty-pledgor protective provisions that may be acceptable (based on the examples provided above), and (ii) makes clear that reliance on the exception does not require the SBSD to obtain a written legal opinion.

We think the SEC's proposal to include an exception to the capital charge for segregated IM with the modifications described above would strike the right balance intended by Congress in adding Section 3E(f) to the Exchange Act[21] by both providing SBSDs with legal control of, and access to, counterparty IM when necessary and providing an appropriate degree of protection to counterparties with respect to their IM. Parties should be able to negotiate the terms of their account control agreements for tri-party segregation without the results of that negotiation giving rise to a capital charge. In our respective members' experience, SBSDs are capable of negotiating agreements that are protective of their rights as a secured party.

We reiterate our requests in our Original Letters that the proposed capital charge for segregated IM be eliminated. Alternatively, if the Commission determines to maintain the capital charge, we think the Commission's proposed exception and guidance with the modifications described above could lead to a workable solution.

III. Margin

A. IM Calculations under Uniform IM Model

In comment topic 6 of the Reopening Release, the SEC asks whether the margin rule should permit SBSDs to apply to use models other than proprietary capital models to compute IM, including applying to use a standard industry model to increase transparency and decrease margin

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20 Please note that Annex I contains proposed rule language for paragraph (c)(1)(ix)(B)(*3*) of Rule 18a–1. The same rule language would apply to the parallel provision contained in paragraph (c)(2)(xv)(B)(*3*) of Rule 15c3–1 with references to "security-based swap dealer" changed to "broker or dealer."

21 Protection of IM in this manner is also consistent with similar requirements of various regulators and the BCBS-IOSCO international margin framework. *See* "Margin Requirements for non-centrally cleared derivatives," issued on Sept. 2, 2013, by the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions, at Key principle 5, p. 19, available at: http://www.bis.org/publ/bcbs261.htm. That framework includes as a key principle that posted IM should be subject to arrangements that protect the pledgor "to the extent possible under applicable law" in the event of the secured party's bankruptcy.

disputes among counterparties.[22] We believe the SEC should do so, given the derivatives industry's widespread adoption of the common IM model developed by the International Swaps and Derivatives Association, Inc. ("**ISDA**"), known as the ISDA Standard Initial Margin Model (ISDA SIMM™). The ISDA SIMM™ has facilitated calculations of regulatory IM for non-cleared inter-dealer trades during the initial phases of the IM phase-in schedule for minimum IM requirements adopted by the U.S. prudential regulators, CFTC, and many international regulators in their respective uncleared margin rules (collectively, "**UMR**"). With the upcoming final phases of IM implementation under UMR on September 1, 2019 (Phase 4) and September 1, 2020 (Phase 5), our respective members expect that dealers may also calculate "regulatory IM" under the ISDA SIMM™.

Given this expectation, we reiterate MFA's prior comment request that the SEC should condition its approval of SBSD proprietary IM models by requiring SBSDs to make the basic functionality of their IM models available to and replicable by their counterparties. We also reiterate MFA's request that the SEC require SBSDs to apply the same base IM model for all counterparties, regardless of their creditworthiness or identity.[23]

The SEC's potential modifications to paragraph (d)(2)(i) of Rule 18a-3, as set forth in comment topic 6 of the Reopening Release, would require that the SBSD's model use a 99%, one-tailed confidence level with price changes equivalent to a ten business-day movement in rates and prices and must use risk factors sufficient to cover all material price risks inherent in the positions. The SEC would also authorize the model to recognize empirical correlations within each broad risk category, but not across broad risk categories.[24]

In response, we request that the SEC coordinate with other regulators to authorize enhanced risk sensitivity of IM models.[25] We recommend that the SEC should provide for a more flexible, risk-specific approach to determine and adjust the appropriate liquidation time horizon by product type or asset class.[26] To enhance the recognition of mutually offsetting transactions, we believe that the SEC should authorize SBSDs' internal IM models to account for risk offsets across suitably correlated cleared and non-cleared swap/SBS products and non-swap/SBS products within the same broad risk category pursuant to a single cross-product master netting agreement.[27]

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[22] *See* Reopening Release at 53013.

[23] *See* Original MFA Letter at pp. 15-16.

[24] *See* Reopening Release at 53013.

[25] *See* MFA's letter to BCBS-IOSCO on final stages of IM phase-in, dated Oct. 25, 2018 ("**MFA IM Phase-in Letter**") at pp. 5-7 (offering recommendations to enhance the use of IM models), available at: https://www.managedfunds.org/wp-content/uploads/2018/11/MFA-Letter-UMR-Implementation-Challenges-for-Final-Stages-of-IM-Phase-in.pdf.

[26] *See* Original MFA Letter at pp. 16-18.

[27] *Id.* at pp. 13-15. *See also* MFA IM Phase-in Letter at p. 5.

For example, a cross-product master netting agreement might include different products in the foreign exchange (FX)/interest rate category, including U.S. Treasury futures, Eurodollar futures, cleared interest rate swaps, non-cleared FX options, and repurchase agreements. Such cross-product portfolio margining arrangements account adequately for risks of a portfolio, while avoiding the capital inefficiencies of over-collateralization by reducing both the aggregate requirement to deliver IM and trading costs for market participants. It bears emphasizing that any IM model that permits cross-product master netting agreements would continue to be subject to all other regulatory requirements for IM models.

B. Portfolio Margining of SBS, Swaps, and Related Positions

In comment topic 9 of the Reopening Release, the SEC requests comment on potential rule language modifications permitting portfolio margining in the following scenarios: (1) An entity that is registered as a broker-dealer ("**BD**"), nonbank SBSD, and swap dealer to hold swaps in an SBS account to portfolio margin SBS with swaps and related cash market and listed options positions; (2) an entity that is registered as a futures commission merchant ("**FCM**"), nonbank SBSD, and swap dealer to hold SBS in a swap account to portfolio margin SBS with swaps and related futures positions; (3) an entity that is registered as a nonbank SBSD and swap dealer (but not as an FCM or BD) to hold swaps in an SBS account to portfolio margin SBS and swaps; (4) an entity that is registered as a swap dealer and SBSD (but not as an FCM or BD) to hold SBS in a swap account to portfolio margin SBS and swaps. In the case of scenarios (3) and (4), the SEC asks if the SBSD dually registered as a swap dealer may use a model to determine portfolio margin requirements for SBS and swaps that reference equity securities, provided the accounts do not hold cash market and listed options positions. The SEC also asks about whether such portfolio margining should be subject to conditions similar to those set forth in the Commission's exemptive order permitting portfolio margining of credit default swaps ("**CDS**") (*e.g.*, conditions regarding subordination agreements and disclosures).[28]

We appreciate the SEC's steps toward promoting portfolio margining by the potential expansion of portfolio margining to swaps and related positions. As requested in our Original Letters, a broader product scope for permissible portfolio margining would mean enhanced recognition of the offsetting positions within a customer's portfolio, resulting in IM efficiencies appropriate to the risk of the portfolio.[29] Given these efficiencies, Section 713 of the Dodd-Frank Act specifically encourages the SEC and the CFTC to work together to implement a regulatory framework that facilitates portfolio margining. While not expressly stated in the SEC's four scenarios of expanded portfolio margining, we are assuming that the SEC intends to include both cleared and non-cleared SBS and swaps positions. In the derivatives marketplace, portfolio margining has been widely used to allow an FCM with respect to cleared swaps, options and futures, or a BD with respect to cleared SBS, and an affiliated swap dealer, SBSD, major swap participant and MSBSP to calculate jointly the IM required to collateralize the risk exposure to a

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[28] *See* Reopening Release at 53014-15.

[29] *See* Original MFA Letter at pp. 13-15 and Original AIMA Letter.

single customer with respect to such cleared products and non-cleared swaps and SBS. In response to the SEC's potential rule language to implement enhanced portfolio margining in these scenarios, we suggest that the SEC clarify in a re-proposal that portfolio margining of cleared and non-cleared swaps and SBS would be permitted. The SEC should also clarify the practical impact of the potential language modifications in each scenario.

Consistent with Section 713 of the Dodd-Frank Act, we encourage the SEC to coordinate with the CFTC to determine appropriate conditions for enhanced portfolio margining. We believe the imposition of portfolio margining conditions by the commissions in these scenarios could be addressed in coordinated rulemakings or exemptive orders. For compliance purposes, we respectfully suggest that coordinated rulemakings would provide market participants with greater certainty and permanence than exemptive orders. To the extent that cross-margining of cleared swaps and SBS is permitted, we reiterate our view that a BD/FCM should be authorized to base its IM calculations on the clearinghouse's approved margin methodology in setting customer IM levels. As a condition to the cleared CDS customer portfolio margining program, the SEC imposed a requirement on clearing members to develop their own individual IM models which diverged from the CFTC's customer margin requirements. This individual margin model requirement has created market uncertainty and complexities, making it difficult for customers to have transparency into those models and to replicate IM calculations.

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We thank the Commission for the opportunity to provide these comments. We would welcome the opportunity for a meeting to discuss our views in greater detail. Please contact Laura Harper Powell, Associate General Counsel, MFA, at (202) 730-2600, and Adam Jacobs-Dean, Managing Director, Global Head of Markets Regulation, AIMA, at +44 20 7822 8380 with any questions the Commission or staff might have regarding this letter.

Respectfully submitted,

/s/ Laura Harper Powell

Laura Harper Powell
Associate General Counsel
Managed Funds Association

/s/ Adam Jacobs-Dean

Adam Jacobs-Dean
Managing Director,
Global Head of Markets Regulation
Alternative Investment Management Association

cc: The Hon. Jay Clayton, Chairman
The Hon. Kara M. Stein, Commissioner
The Hon. Robert J. Jackson Jr., Commissioner
The Hon. Hester M. Peirce, Commissioner
The Hon. Elad L. Roisman, Commissioner

Brett Redfearn, Director, Division of Trading and Markets
Elizabeth Baird, Deputy Director, Division of Trading and Markets
Michael A. Macchiaroli, Associate Director, Division of Trading and Markets
Thomas K. McGowan, Associate Director, Division of Trading and Markets
Randall W. Roy, Deputy Associate Director, Division of Trading and Markets

Annex I

(*3*) *Treatment of collateral held at a third-party custodian*. For the purposes of the deductions required pursuant to paragraphs (c)(1)(ix)(B)(*1*) and (*2*) of this section, collateral held by an independent third-party custodian as initial margin pursuant to Section 3E(f) of the Act or Section 4s(l) of the Commodity Exchange Act may be treated as collateral held in the account of the counterparty at the security-based swap dealer if:

(a) The independent third-party custodian is a bank as defined in Section 3(a)(6) of the Act that is not affiliated with the counterparty; and

(b) The security-based swap dealer, the independent third-party custodian, and the counterparty that delivered the collateral to the custodian have executed an account control agreement or other agreement (or suite of agreements) governing the terms under which the custodian holds and releases collateral pledged by the counterparty as initial margin that: (i) provides the security-based swap dealer with a perfected security interest in both the account and the collateral contained therein under Articles 8 and 9 of the Uniform Commercial Code and/or the laws of such other jurisdiction as may be applicable, and (ii) gives the security-based swap dealer the right, upon termination of one or more security-based swaps due to the counterparty's insolvency or other event of default or similar condition, to assert exclusive control and gain timely access to the collateral through the delivery of a notice of exclusive control to the custodian;

provided that nothing in this paragraph (c)(1)(ix)(B)(*3*) shall prohibit the security-based swap dealer and the counterparty from negotiating provisions that are protective of the counterparty so long as those provisions do not expressly conflict with the conditions hereof.