sifma asset management group

MANAGED FUNDS ASSOCIATION

March 18, 2019

Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, DC 20219
Attention: Legislative and Regulatory Activities Division
Docket ID OCC-2018-0030; RIN 1557-AE44

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Ann E. Misback, Secretary
Docket No. R-1629; RIN 7100-AF22

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Robert E. Feldman, Executive Secretary
RIN 3064-AE80

Re: SIFMA AMG and MFA Comment on Proposed Standardized Approach for Calculating the Exposure Amount of Derivative Contracts

Dear Sirs and Madams:

The Securities Industry and Financial Markets Association's Asset Management Group ("**SIFMA AMG**") and Managed Funds Association ("**MFA**")[1] appreciate the opportunity to comment on the proposed rule (the "**Proposal**") issued by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (the "**Agencies**") to implement the standardized approach for counterparty credit risk ("**SA-CCR**") as a replacement for the current exposure method ("**CEM**") in the U.S. capital rules.[2] SIFMA AMG members, on behalf of their clients, and MFA members use futures and cleared swaps, as well as other derivatives, for a range of purposes, including as a means to manage or hedge investment risks such as changes in interest rates, exchange rates, and commodity prices.

Post-crisis capital requirements that have raised capital requirements for banking organizations offering derivatives to clients, such as the supplementary leverage ratio ("**SLR**"), have reduced market liquidity, imposed barriers to access derivatives, and increased systemic risk. For example, with respect to central clearing, data provided in this letter shows that SIFMA AMG member clients have experienced reduced access to derivatives clearing services and higher clearing fees following the implementation of post-crisis capital requirements; additionally, in times of stress, such capital requirements may significantly

---

[1] See Annex B for descriptions of SIFMA AMG and MFA.

[2] 83 Fed. Reg. 64,660 (Dec. 17, 2018).

New York | Washington

120 Broadway, 35th Floor | New York, NY 10271-0080 | P: 212.313.1200 | F: 212.313.1301
www.sifma.org

disadvantage banking organizations from acquiring a failing clearing member's book of client positions through a "port," which would leave clients exposed and without access to clearing services.

In this context, we are concerned that, according to the Agencies, banking organizations' "exposure amounts would ***increase*** for derivative contracts with . . . asset managers, investment funds, and pension funds" under SA-CCR.[3] We believe this increase in exposure is a result of SA-CCR's excessive layers of conservativism, with buffers effectively built into its treatment of initial margin, calibration of supervisory factors and the alpha factor, and approaches to netting and diversification. This letter offers specific recommendations for how to implement SA-CCR in a more risk-sensitive and less punitive manner than is set forth in the Proposal, in order to prevent SA-CCR from amplifying the negative effects of the current regulatory capital regime on end users that use derivatives to hedge their risks.

I. Executive Summary

We urge the Agencies to adopt SA-CCR in a manner that will decrease, rather than increase, exposure values compared to CEM for banking organizations when they offer derivatives to asset managers, investment funds, and pension funds. For the reasons described below, the Agencies should make the following changes to the Proposal to make the final SA-CCR rule less likely to increase exposure values and more risk-sensitive:

- In the SLR, recognize the effect of cash and non-cash forms of initial margin and variation margin in reducing a banking organization's replacement cost ("**RC**") and potential future exposure ("**PFE**") when clearing derivatives for clients.

- In risk-based capital requirements, recognize more fully the effect of initial margin in reducing a banking organization's risk-weighted assets, such as by providing for dollar-for-dollar recognition of collateral and/or by reducing the Proposal's 5 percent PFE floor. The revised treatment of initial margin in risk-based capital requirements should also apply to client cleared derivatives exposures in the SLR.

- Reduce and make more granular the Proposal's supervisory factors for certain credit, commodity, and equity asset classes.

- Eliminate the 1.4X alpha multiplier.

- Allow all transactions subject to a qualifying master netting agreement ("**QMNA**") to be part of the same netting set.

- Permit chains of FX to be part of the same exchange rate hedging set, interest rate derivatives with different reference currencies to be part of the same interest rate hedging set, and commodity derivatives in different sub-classes to be part of the same hedging set.

The remainder of this letter discusses each of these recommendations in greater detail.

---

[3] 83 Fed. Reg. at 64,685 (emphasis added).

II. In the SLR Context, SA-CCR Should Recognize the Exposure-Reducing Effect of Initial Margin and Variation Margin for Client Cleared Derivatives Exposures, Consistent with the Risk-Based Version of SA-CCR

A. Failure to Recognize the Exposure-Reducing Effect of Initial Margin or Variation Margin Provided by a Client Results in Overstatement of a Banking Organization's Actual Economic Exposure From Derivatives Clearing

Derivatives clearing for clients is fundamentally a low-exposure and, historically, low-return business for banking organizations. When a clearing member banking organization acts as agent for a client's centrally-cleared over the counter ("**OTC**") derivative transaction, and guarantees the client's performance to a central counterparty ("**CCP**"), the probability and extent to which the clearing member will be required to step in and make a payment to the CCP is substantially mitigated by variation and initial margin[4] posted by the client, for the following reasons:

- The client is required to post cash variation margin in the amount necessary to settle the entire amount of any deficiency related to the market value of the derivative. The amount of variation margin transferred is adjusted to reflect the current mark-to-market value of the position.

- The client is also required to post robust amounts of initial margin at all times. For example, Commodity Futures Trading Commission ("**CFTC**") regulations and CCP rules require the client to post an amount of initial margin to cover the CCP's exposure, meaning an amount of assets that would cover a loss with an established confidence level of at least 99 percent.[5]

- Initial margin is required by law and CCP rules to be held in the form of extremely highly liquid assets and to be segregated from the clearing member's own assets. Because the initial margin is so liquid and is segregated, it is available to offset the amount that the clearing member would be required to pay the CCP in the event that the client defaulted. Additionally, the clearing member's margin and risk management programs are highly regulated. For example, the CFTC imposes regular reporting and notification requirements related to margin deficiencies.

- The clearing member is only economically "on the hook" to the extent the client defaults and the amount the client owes is not covered by its initial margin and variation margin, both of which are addressed daily by margin calls. Even though the clearing member's guarantee covers the entire amount of the client's default, the liquid margin available to the clearing member or CCP ensures that the economics are the same as if the clearing member's guarantee covered the amount of the client's default net of margin.

As a result, variation and initial margin plainly reduce the clearing member's economic exposure arising out of its guarantee to the CCP.

Yet, the SLR in its current form, and as set forth in the Proposal, fails to recognize the exposure-reducing effect of initial margin. Instead, a banking organization that clears a derivative for its client is required to calculate its leverage exposure arising out of its guarantee to the CCP as if the client had not posted ***any*** initial margin. This result is at odds with economic reality – the banking organization's ***leverage***

---

[4] When we refer to "initial margin" in this letter, the term includes excess variation margin, which is treated as initial margin for risk management purposes.

[5] *See* 17 C.F.R. § 39.13(g)(2)(iii).

exposure for the transaction grossly exceeds its ***actual economic exposure***. As the CFTC stated in its comment letter on the Proposal, "[f]ailing to reduce a clearing member's exposure by the segregated client margin it holds results in an inflated measure of the clearing member's exposure for a cleared trade."[6] And this result is inconsistent with the SLR's practical and appropriate treatment of securities financing transactions, whereby a banking organization acting as agent for a client and providing a guarantee of its client's transaction is permitted to deduct from its leverage exposure the amount of collateral posted by the client.[7]

B. Data Demonstrates the Harm to End Users of the SLR Failing to Recognize the Exposure-Reducing Effect of Initial Margin Provided by a Client in a Cleared Derivative Transaction

The SLR's current substantial overstatement of a clearing member's actual economic exposure in a cleared derivative transaction has disincentivized banking organizations from providing clearing services to our members and their clients. As a result, SIFMA AMG members and their clients and MFA members have faced reduced access to clearing services and have paid higher prices for such access, or expect such adverse consequences without an appropriate revision to the SLR. SIFMA AMG member data showing these effects is set forth in Annex A to this letter.

SIFMA AMG's data is consistent with clients' survey responses to the 2018 qualitative survey of the international standard-setting bodies' Derivatives Assessment Team. The Derivatives Assessment Team's final report of November 2018 (the "**DAT Report**") states that over two-thirds (68 percent) of the 44 clients who responded reported encountering difficulties of some type in accessing clearing services.[8] According to clients responding to the DAT Report that were off-boarded by a clearing member, the most common reason for such off-boarding was capital constraints that a Basel III requirement imposed on the clearing member.[9] An overwhelming majority (88.2 percent) of client clearing service providers reported that the Basel leverage ratio (including the SLR) negatively impacted their ability to offer client clearing services, while nearly-two thirds (64.7 percent) reported a "significant" negative impact.[10] Additionally, the DAT Report states that all but one client clearing service provider that have adjusted fees cited regulatory capital costs as the reason.[11]

Moreover, clients that use derivatives solely for risk management purposes rather than speculation – including pension funds, mutual funds, and life insurance companies – tend to have smaller, more directional, and longer-term derivatives portfolios, and use less active trading strategies. These attributes make such clients' trades particularly disadvantaged under the SLR denominator. Consequently, these clients have been

---

6 *See* CFTC, Commissioners Submit Comment on Prudential Regulators' Proposed Rulemaking (Feb. 19, 2019), *available at* https://www.cftc.gov/PressRoom/PressReleases/7873-19?utm_source=govdelivery (hereinafter, "**CFTC Letter**").

7 See section _.10(c)(4)(ii)(F) of the capital rules. While this treatment is available where a banking organization's guarantee is legally limited to the difference between the value of the loaned asset and the value of the collateral, a clearing member's guarantee of a client's OTC derivative trade with a CCP is effectively net of initial margin provided.

8 *See* Derivatives Assessment Team, Incentives to Centrally Clear Over-the-Counter (OTC) Derivatives: A Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms – Final Report, at p. 49 (Nov. 19, 2018), *available at* http://www.fsb.org/2018/11/fsb-and-standard-setting-bodies-publish-final-report-on-effects-of-reforms-on-incentives-to-centrally-clear-over-the-counter-derivatives ("Some smaller clients and some of those with more directional portfolios report experiencing difficulties gaining and/or maintaining access to central clearing.").

9 *Id.* at pp. 49-50.

10 *Id.* at p. 65.

11 *See id.* at p. 51.

disproportionately harmed by the SLR and its failure to recognize the exposure-reducing effect of initial margin.[12]

C. Recognizing the Exposure-Reducing Effect of Initial Margin and Variation Margin Provided by a Client in a Cleared Derivative Transaction Would Decrease Systemic Risk

Since the Agencies introduced the SLR in 2013, a series of large banking organizations have shut down their client clearing businesses in the United States or around the globe,[13] and banking organizations have not newly entered the clearing business. Indeed, the DAT Report found that just ***five*** firms, all bank-affiliated, account for over 80 percent of total client margin for cleared interest rate swaps in the United States, United Kingdom and Japan. The DAT Report also found that most clients have a relationship with just a single client clearing service provider, which underscores how vulnerable clients are to the loss of clearing services if another major banking organization exits the market.[14] We believe the cumulative effect of these market exits and increased concentration has been a substantial reduction in clearing capacity in the market. According to the CFTC, "[u]nless the treatment of client margin changes under SA-CCR, clearing members will continue to limit the provision of clearing services or exit the clearing business and the worrisome trend of clearing member consolidation will continue."[15]

It is important to view these market exits in context. Clearing mandates implementing the Pittsburgh G20 Commitments have required certain swaps that previously were bilateral transactions to be centrally cleared. These mandates have created significant demand for clearing services and have resulted in a dramatic rise in overall clearing volumes in recent years. There has also been substantial end user interest in voluntary clearing of certain non-mandated derivatives. A decrease in the number of firms willing to supply these services due to increased capital costs over the same period underscores just how difficult the SLR has made it for banking organizations to continue to clear derivatives for clients.

Given current levels of concentration, SIFMA AMG and MFA have serious concerns about the systemic risk potentially posed by the concentration of clearing members, as well as the portability of a failing clearing member's book of cleared derivatives to other clearing members in times of system-wide stress. In a time of system-wide stress, when capital buffers decline, the SLR is more likely to serve as a binding capital constraint on banking organizations throughout the market. Additionally, in times of stress, CCPs are likely

---

[12] *See id.* at p. 3 ("Some smaller clients and some of those with more directional portfolios report experiencing difficulties gaining and/or maintaining access to central clearing.").

[13] *See* Deutsche Bank Walks Away From US Swaps Clearing, Financial Times (Feb. 9, 2017), *available at* https://www.ft.com/content/2392bc42-ee47-11e6-930f-061b01e23655; Nomura Exits Swaps Clearing for US and European Customers, Financial Times (May 12, 2015), *available at* https://www.ft.com/content/e1883676-f896-11e4-be00-00144feab7de; State Street Exiting Swaps Clearing Business, Citing New Rules, Bloomberg (Dec. 4, 2014), *available at* https://www.bloomberg.com/news/articles/2014-12-04/state-street-exiting-swaps-clearing-business-citing-new-rules; RBS to Wind Down Swaps Clearing Units, Reuters (May 19, 2014), *available at* http://uk.reuters.com/article/uk-rbs-primeservices-divestiture-idUKKBN0DY0PU20140519; BNY Mellon Closes U.S. Derivatives Clearing Business, Pension & Investments (Dec. 20, 2013), *available at* http://www.pionline.com/article/20131210/ONLINE/131219993/bny-mellon-closes-us-derivatives-clearing-business. Additionally, the Chicago Mercantile Exchange recently withdrew a proposal to establish direct clearing, which could have provided a less capital-intensive pathway to clearing for some of the largest clients. *See* CME Abandons Buy-Side Direct Clearing Initiative, Risk Magazine (Nov. 30, 2018), *available at* https://www.risk.net/derivatives/6171461/cme-abandons-buy-side-direct-clearing-initiative.

[14] DAT Report at p. 19.

[15] CFTC Letter at p. 5.

to increase margin requirements, which would indirectly increase banking organizations' capital requirements to the extent clients provide initial margin in the form of cash that goes on banking organizations' balance sheets. In these circumstances, a banking organization might be required to raise capital in order to acquire a book of cleared derivatives from a failing clearing member, which would make the banking organization much less willing to step in to acquire the book. The SLR would therefore be pro-cyclical, intensifying market stress at exactly the wrong moment. This pro-cyclical effect is likely to be more pronounced given the small numbers of clearing members currently in the market.

Revising the Proposal to recognize the exposure-reducing effect of initial margin and variation margin in a client cleared derivatives transaction in the SLR SA-CCR calculation would be likely to decrease systemic risk by eliminating a key barrier to porting of client's positions to other banking organizations in times of stress. Effective porting strengthens the resilience of the banking system because it reduces the knock-on effects of a clearing member's default, and because banking organizations of all sizes are themselves clients.[16] Likewise, revising the Proposal to recognize the exposure-reducing effect of initial margin and variation margin in a cleared derivatives transaction in the SLR would promote access to clearing services by removing a significant disincentive for banking organizations to offer such services, as the CFTC stated in support of such a revision.[17]

In implementing an offset for initial margin in the SLR SA-CCR calculation, the Agencies should do so by aligning the SLR's treatment of client cleared derivatives with that of SA-CCR in risk-based capital requirements, with the effect of allowing both cash and non-cash forms of initial margin and variation margin provided by a client to offset the banking organization's RC and PFE. This treatment was proposed as Option 3 of the Basel Committee's October 2018 consultation,[18] which SIFMA AMG and MFA supported in a comment letter to the Basel Committee.[19]

III. In the Risk-Based Context, SA-CCR Should Recognize the Risk-Reducing Effect of Initial Margin More Meaningfully Than in the Proposal

The Proposal sets forth an exponential formula and floor of 5 percent for the PFE multiplier that we understand results in substantially less than full recognition of initial margin. We do not believe this conservativism is necessary or appropriate. In the event of a client's default, all of the client's initial margin (and variation margin) will be applied against amounts owed to the client's counterparty. SA-CCR separately accounts for the possibility that margin could decline in value by imposing standard supervisory haircuts on margin held in the form of securities.

The final rule should therefore recognize the effect of initial margin in risk-based capital requirements more meaningfully than the Proposal does. The final rule could do so by providing for dollar-for-dollar recognition of margin (subject to haircuts), as is done in CEM. It could also do so by recalibrating the 5 percent PFE floor downward in view of (1) CCP rules for cleared swaps that require the posting of

---

16 *See* DAT Report at p. 17.

17 *See* CFTC Letter at p. 5 ("We believe an SLR calculation that allows initial margin to offset potential future exposures would remove an unnecessary obstacle to banks offering client clearing services, consistent with G20 mandates and Dodd-Frank.").

18 *See* Basel Committee on Banking Supervision, Leverage Ratio Treatment of Cleared Derivatives (Oct. 18, 2018), *available at* https://www.bis.org/bcbs/publ/d451.htm.

19 *See* SIFMA AMG and Managed Funds Association Comment on Basel Committee Leverage Ratio Consultation (Jan. 15, 2019), *available at* https://www.sifma.org/resources/submissions/leverage-ratio-treatment-of-client-cleared-derivatives/. Section IV of our comment letter to the Basel Committee discusses why Option 3 is superior to Option 2 of the October 2018 leverage ratio consultation.

initial margin sufficient to cover a loss with an established confidence level of at least 99 percent,[20] and (2) margin requirements for uncleared swaps that require the posting of initial margin sufficient to cover PFE consistent with a one-tailed 99 percent confidence level over a 10-day close-out period.[21]

The Agencies should also apply this treatment to client cleared derivatives in the SLR so that SA-CCR recognizes initial margin and variation margin to the same degree in the SLR and risk-based capital requirements for cleared derivatives, consistent with Option 3 of the Basel Committee's October 2018 leverage ratio consultation.

IV. The Agencies Should Reduce the Proposal's Supervisory Factors for Certain Asset Classes to Align With Those Asset Classes' Risk Profiles

We recommend a reduction of the Proposal's supervisory factors for certain credit, commodities, and equity derivatives based on the following principles:

- ***Credit*** – The Proposal would inappropriately "gold plate" the Basel Committee's supervisory factors for single-name credit derivatives through its conversion of external credit ratings into alternative criteria. The Proposal would contain just three gradations of issuer credit quality compared to seven in the Basel Committee standard, which would result in higher supervisory factors for the most creditworthy issuers. The Basel Committee's two lowest-risk categories for single-name credit derivatives – AAA- and AA-rated issuers – are assigned a 0.38% supervisory factor, but the Proposal's lowest-risk category – "investment grade" – would be assigned a 0.5% supervisory factor. The most creditworthy issuers in the United States are no more prone to default than are the most creditworthy issues in other jurisdictions, and accordingly, the final U.S. SA-CCR standard should not include a higher supervisory factor for investment grade issuers than the Basel Committee's lowest supervisory factor. We also support the Agencies exploring alternative criteria that would permit more granularity in the categorization of issuer creditworthiness, consistent with the Dodd-Frank Act's restrictions on the use of external credit ratings. Finally, we commend the Agencies for not increasing the Basel Committee's supervisory factors for indexed credit derivatives, unlike the Proposal's treatment of single-name credit derivatives.

- ***Commodities*** – The Proposal would also inappropriately gold plate the Basel Committee's supervisory factors for oil and gas derivatives by combining those derivatives with the electricity category and assigning the higher Basel supervisory factors for electricity to the entire combined energy category. The Agencies' stated rationale for this treatment is that SA-CCR does not permit diversification benefits among sub-classes of commodities, and therefore additional commodity sub-classes could reduce the number of derivative contracts across which a banking organization may hedge.[22] However, the solution to this shortcoming of SA-CCR is to allow the oil and gas and electricity categories to be part of the same hedging set, not to combine them into a single category with a higher supervisory factor.

- ***Equities*** – The Proposal's supervisory factors for equities are too high and too blunt. Specifically, the supervisory factors for equities should reflect more granularity based on the type of issuer or issuers. For instance, the final rule could distinguish between publicly-traded and private issuers,

---

20 *See* n. 5, above.

21 80 Fed. Reg. 74,839, 74,875 (Nov. 30, 2015).

22 83 Fed. Reg. at 64,671.

large cap and small cap issuers, and issuers based in advanced economies versus emerging economies, each of which has a different risk profile.

V. The Agencies Should Not Implement the Proposal's 1.4X Alpha Multiplier

The Agencies have not provided adequate policy or economic reasons for inclusion of the 1.4X alpha multiplier that the Proposal would apply to RC and PFE. The Basel Committee originally introduced the alpha multiplier to provide a measure of conservativism that captures model risk in internal models-based approaches, a consideration that has no relevance in standardized approaches such as SA-CCR.[23] According to the Agencies, the Basel Committee then included the alpha factor in SA-CCR because "a standardized approach, such as SA–CCR, should not produce lower exposure amounts than a modelled approach."[24] Whatever force this justification may have in non-U.S. jurisdictions where internal models-based approaches can substitute for standardized approaches, it simply does not apply in the United States, where the advanced approach serves as a floor to the standardized approach, and vice-versa. In the United States, internal models can, and sometimes do, result in greater capital requirements than standardized approaches.

Moreover, to the extent the Agencies included the alpha factor "to instill a level of conservativism,"[25] we respectfully note there are overlapping levels of conservativism elsewhere in SA-CCR that render the alpha factor unnecessary and excessive. For instance, the Agencies state that they calibrated the supervisory factors to reflect "stress volatilities observed during the financial crisis,"[26] despite the fact that post-crisis regulations such as margin requirements and clearing mandates have significantly decreased the risk to banking organizations of client defaults.

We therefore recommend that the Agencies eliminate the alpha multiplier in the final rule. At a minimum, the Agencies should consider reducing the multiplier and/or tailoring its application. For instance, when applied to RC, the on-balance sheet component of the SLR, the multiplier causes a significant deviation from the book value of a banking organization's assets, which is inconsistent with the basic premise of the SLR.

VI. SA-CCR Should Permit Netting of All Transactions Subject to a Qualifying Master Netting Agreement

All transactions subject to an industry-standard QMNA between counterparties create a single, legally-enforceable "net" obligation between them. Despite this basic principle of insolvency law, the Proposal would not allow trades conducted under the same QMNA that have different margin periods of risk ("**MPOR**") to be part of the same netting set such a banking organization can recognize the economic benefits of netting those trades. As a consequence, trades that are settled-to-market on a daily basis, which would be treated as unmargined derivative contracts under the Proposal, generally could not net against trades that are collateralized-to-market on a daily basis for purposes of SA-CCR because of the application of different MPORs. Likewise, cleared and bilateral trades generally could not be net against each other for purposes of SA-CCR because of their different MPORs. The Agencies have not articulated any policy rationale for this treatment and we do not believe that an adequate justification exists. MPOR is a regulatory

---

23 *See* Basel Committee on Banking Supervision, The Standardised Approach for Measuring Counterparty Credit Risk Exposures, at p. 1 (March 2014; rev. April 2014), *available at* https://www.bis.org/publ/bcbs279.htm ("[A]lpha equals 1.4, which is carried over from the alpha value set by the Basel Committee for the Internal Model Method (IMM).").

24 83 Fed. Reg. at 64,666.

25 *Id.*

26 *Id.*

capital construct that has no bearing on the legal enforceability of a netting agreement across different types of trades. The final rule should provide for all trades subject to a QMNA to be part of the same netting set, regardless of their MPOR.

VII. SA-CCR Should Permit Greater Diversification Benefits Within Asset Classes

The Proposal's hedging sets should be revised in the final rule to recognize the following economically significant correlations:

- ***Exchange Rates*** – Under the Proposal's rule text, hedging sets for FX derivatives must reference the same currency pair. However, as the preamble to the Proposal recognizes, a chain of FX derivatives with different currency pairs (for example, USD to GBP, GBP to EUR, and EUR to USD) can collectively net to a neutral or more neutral position. Indeed, in our members' experience, banking organizations view the counterparty credit risk of their FX derivative positions on a net open position basis, which reflects the net economic effect of a chain of such derivatives. We support the alternative definition of an exchange rate hedging set included in the preamble to the Proposal, such that SA-CCR recognizes these correlations among chains of FX derivatives within the same QMNA.

- ***Interest Rates*** – Under the Proposal, hedging sets for interest rate swaps must reference the same currency. The Proposal would not impose a requirement for settlement in the same currency for other types of non-FX hedging sets, such as credit, commodities, and equities, and the Agencies have not explained why interest rate hedging sets should uniquely be subject to such a requirement. Interest rate swaps with different reference currencies still hedge each other's interest rate risk effectively. SA-CCR should recognize interest rate swaps within the same QMNA as belonging to the same interest rate hedging set, even if they reference different currencies.

- ***Commodities*** – SA-CCR should permit commodity derivatives in different sub-classes to form part of the same hedging set, and thereby recognize diversification to the extent such derivatives are correlated.

* * *

We appreciate the Agencies' consideration of our comments. Should you have any questions, please do not hesitate to contact SIFMA AMG at Tim Cameron at (202) 962-7447 or tcameron@sifma.org or Jason Silverstein at (212) 313-1176 or jsilverstein@sifma.org, or its counsel at Covington & Burling LLP, Stephen Humenik at (202) 662-5803 or shumenik@cov.com or Randy Benjenk at (202) 662-5041 or rbenjenk@cov.com, or MFA at Laura Harper Powell at (202) 730-2600 or lharperpowell@managedfunds.org.

Respectfully submitted,

/s/ Timothy W. Cameron
Timothy W. Cameron, Esq.
Managing Director
Asset Management Group – Head
Securities Industry and Financial Markets Association

/s/ Jason Silverstein
Jason Silverstein, Esq.
Asset Management Group – Managing Director and Associate General Counsel
Securities Industry and Financial Markets Association

/s/ Laura Harper Powell
Laura Harper Powell, Esq.
Associate General Counsel
Managed Funds Association

<u>Annex A</u>

SIFMA AMG Member Survey Results

In June 2016, SIFMA AMG conducted a survey of its members to determine the effect of the SLR's failure to recognize the exposure-reducing effect of initial margin on their ability to access clearing services for clients. Twelve SIFMA AMG members responded to the survey, representing an aggregate of over $1 trillion in assets under management.[27] SIFMA AMG believes that if it were to conduct this survey again, the results discussed below would not change significantly and may even show a greater negative impact of the SLR on its members and their clients, given that the SLR became a binding minimum requirement on January 1, 2018. The survey had the following results:

Reduced Access to Clearing Services

SIFMA AMG's survey indicated that its members have had reduced access to cleared derivatives since the introduction of the SLR. For example, a significant number of the survey respondents had been asked to agree to a cap (*i.e.*, a limit on their clients' use of derivatives) on outstanding positions, as reflected in the following table:

Percentage of Respondents That Have Been Asked to Agree to a Cap on Outstanding Positions				
Futures	Options	Interest Rate Swaps	FX Swaps	Credit Swaps
33%	30%	50%	13%	55%

Some SIFMA AMG members had been forced by their clearing member to terminate clearing relationships (and seek clearing elsewhere, if possible), as reflected in the following table:

Percentage of Respondents That Have Terminated Clearing Relationships Involuntarily				
Futures	Options	Interest Rate Swaps	FX Swaps	Credit Swaps
8%	10%	30%	25%	18%

Higher Prices

Since the introduction of the SLR, clients have had to pay higher clearing fees to access cleared derivatives, as reflected in the following results from SIFMA AMG's member survey:

Percentage of Respondents That Have Been Asked to Increase Clearing Fees By Product				
Futures	Options	Interest Rate Swaps	FX Swaps	Credit Swaps
50%	50%	60%	50%	64%

Similarly, SIFMA AMG members have relinquished to their clearing members a greater proportion of income from the reinvestment of posted initial margin:

	Percentage of Respondents That Have Relinquished to Their Clearing Members a Greater Portion of Income from the Reinvestment of Posted Initial Margin				
	Futures	Options	Interest Rate Swaps	FX Swaps	Credit Swaps
Cash	33%	30%	30%	25%	27%
Securities	8%	10%	10%	0%	9%

---

27 *See* SIFMA AMG Letter to Basel Committee on Banking Supervision (June 30, 2016), *available at* https://www.sifma.org/wp-content/uploads/2017/05/sifma-amg-submits-comments-to-the-basel-committee-on-banking-supervision-on-revisions-to-the-basel-iii-leverage-ratio-framework.pdf.

A substantial number of SIFMA AMG members had been asked by their clearing member to reroute execution business to it, that is, in order to avoid larger increases in clearing fees, to use the same firm for both trade execution and as their clients' clearing account holder. It is common for SIFMA AMG members to use one or more firms for execution, and separate firms for the clearing accounts of the entity the SIFMA AMG member is managing. Clients pay separate fees for clearing and for execution of derivatives. Investment advisers acting as fiduciaries have an obligation to obtain "best execution" for clients' transactions, meaning that the terms for each client transaction generally must be the most favorable terms reasonably available under the circumstances.[28] As a result, SIFMA AMG members often must accept higher *clearing* fees for their clients to obtain lower *execution* fees:

Percentage of Respondents That Have Been Asked to Reroute Execution Business to Avoid Larger Increases in Clearing Fees				
Futures	Options	Interest Rate Swaps	FX Swaps	Credit Swaps
58%	50%	40%	25%	27%

SIFMA AMG members have experienced higher fees particularly where they post initial margin in the form of cash:

	Percentage of Respondents That Have Been Charged Increased Fees for Posting Initial Margin				
	Futures	Options	Interest Rate Swaps	FX Swaps	Credit Swaps
Cash	42%	40%	40%	13%	27%
Securities	17%	10%	20%	0%	9%

We believe these results establish that the SLR has been a ***direct cause*** of the increase in client fees. Despite the fact that cash is the safest and most liquid form of margin, our members' experience has been that some clearing members prefer not to have clients post margin in the form of cash. Banking organizations acting as clearing members often prefer initial margin to be in the form of securities because under operative accounting standards, cash initial margin posted to a banking organization is generally reflected on the bank's balance sheet, which adds to the bank's total leverage exposure under the SLR.

[28] *See* Securities Brokerage and Research Services, Release No. 34-23170 (Apr. 23, 1986); In the Matter of Kidder, Peabody & Co., Inc., et al., Investment Advisers Act Release No. 232 (Oct. 16, 1985); Securities Exchange Act Release No. 12251 (Mar. 24, 1976); Securities Exchange Act Release No. 9598 (May 9, 1972).

Annex B

Descriptions of SIFMA AMG and MFA

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.

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 over time. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.