

December 7, 2020

[rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Vanessa A. Countryman, Secretary  
Securities and Exchange Commission  
100 F St. NE  
Washington, DC 20549-1090

**Re: Proposed Order Granting Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection With the Portfolio Margining of Swaps and Security-Based Swaps That Are Credit Default Swaps [File Number S7-13-12]**

Dear Ms. Countryman:

The Securities Industry and Financial Markets Association’s Asset Management Group (“**SIFMA AMG**”)<sup>1</sup> and the Managed Funds Association (“**MFA**”)<sup>2</sup> appreciate the opportunity to provide comments to the Securities and Exchange Commission (“**SEC**”) regarding the SEC’s proposed order (“**2020 Proposed Order**”)<sup>3</sup> to supersede and replace its 2012 order (“**2012 Order**”)<sup>4</sup> granting exemptive relief in connection with the portfolio margining of cleared security-based swaps (“**SBS**”) and swaps that are credit-default swaps (“**CDS**”). SIFMA AMG and MFA commend the SEC for its thoughtful and measured consideration of the market’s experience and requests in connection with the 2012 Order and, with the limited modifications as discussed below, urge the SEC to make the 2020 Proposed Order permanent to facilitate portfolio margining of cleared CDS.

### **Executive Summary**

Clearing of CDS transactions is of central importance to the proper and efficient functioning of derivatives markets and our members remain committed to clearing CDS, including single-name CDS, within a safe and

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<sup>1</sup> 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 customers 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.

<sup>2</sup> MFA represents the global alternative investment industry and its investors by advocating for public policies that foster efficient, transparent, fair capital markets, and competitive tax and regulatory structures. MFA supports member business strategy and growth via proprietary access to subject matter experts, peer-to-peer networking, and best practices. MFA’s more than 140 member firms collectively manage nearly \$1.6 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, London, Brussels, and Asia, supporting a global policy environment that fosters growth in the alternative investment industry.

<sup>3</sup> *Proposed Order Granting Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection With Portfolio Margining of Swaps and Security-Based Swaps that are Credit Default Swaps*, 85 Fed. Reg. 70657 (Nov. 5, 2020).

<sup>4</sup> *Order Granting Conditional Exemptions under the Securities Exchange Act of 1934 in Connection with Portfolio Margining of Swaps and Security-based Swaps*, Exchange Act Release No. 68433 (Dec. 12, 2012) 77 Fed. Reg. 75211 (Dec. 19, 2012).

efficient framework. An effective portfolio margin regime that addresses and mitigates unnecessary inconsistencies and conflicts is essential to such a framework. We believe that the exemptive relief provided by the 2012 Order promotes clearing and more efficient and effective risk management in the US credit derivatives market by: (1) facilitating systemic risk reduction; (2) providing capital efficiencies; (3) improving buy-side access to clearing and removing economic barriers to customer clearing; (4) promoting competitive equality; and (5) improving the efficiency and effectiveness of risk management.<sup>5</sup>

SIFMA AMG and MFA, therefore, are supportive of an approach that seeks generally to preserve the *status quo*, while implementing incremental changes to further enhance the regime. Thus, our comments are directed primarily to improvements that would refine the existing portfolio margining framework for cleared CDS. In addition, we believe that in making any incremental changes, it is critical that the SEC remains cognizant of the significant time and expense that industry participants have already invested towards developing the various risk, operations and compliance infrastructures needed to implement that model. We, therefore, also address and comment on the costs and operational challenges related to implementing any such improvements.

### **Market Participants Have Not Expressed Interest in SEC SBS Accounts**

As the SEC is aware, clearing houses that are jointly registered as a clearing agency and derivatives clearing organization (“**Clearing Agency/DCOs**”), firms that are dually registered as a futures commission merchant (“**FCMs**”) and broker-dealer (“**BD/FCMs**”), and their customers alike have invested significant resources in developing a CDS clearing model in compliance with the 2012 Order. While we commend the SEC for considering provisions to allow for operational flexibility, we concur with the SEC’s assessment that, at this time, there is a lack of market interest in exploring a new arrangement to portfolio margin cleared CDS in an SEC SBS account. As such, in response to question 6 of the request for comment, we support the proposed elimination of conditions set out at (a)(1) and (a)(2) of the 2012 Order relating to expanding the CDS portfolio margining program to SEC SBS accounts.

More generally, we are not aware that any Clearing Agency/DCO or a clearing house that is solely registered with the SEC as a clearing agency (together with Clearing Agency/DCOs, “**CCPs**”) currently makes available any securities account or SBS account for the clearing of single-name CDS as part of a CDS portfolio margining program or otherwise, and therefore the clearing of single-name CDS, which has been identified as an imperative<sup>6</sup> is only possible through the cleared swaps customer accounts at both Clearing Agency/DCOs and BD/FCMs. For all the reasons set out in our prior letters<sup>7</sup> and those of the industry more generally, we

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<sup>5</sup> See MFA letter to the SEC on ICE Clear Credit’s petition for an order permitting portfolio margining of single-name credit default swaps and broad-based indices, filed with the SEC on December 21, 2011, available at: <https://www.managedfunds.org/wp-content/uploads/2011/12/CFTC-Comment-Letter-in-Support-of-ICE-Portfolio-Margining-Petition-Final-MFA-Letter.pdf>; see also MFA letter to the SEC on ICE Clear Credit’s petition for an order permitting portfolio margining of single-name credit default swaps and broad-based indices, filed with the SEC on June 13, 2012, available at: <https://www.managedfunds.org/wp-content/uploads/2012/06/SEC-Comment-Letter-in-Support-of-ICE-Portfolio-Margining-Petition-Final-MFA-Letter.pdf>.

<sup>6</sup> See joint letter from MFA, SIFMA, and ISDA, dated December 16, 2015, committing to clearing single-name CDS, available at: <https://www.managedfunds.org/wp-content/uploads/2015/12/12.16.2015-Single-Name-CDS-Release.pdf>.

<sup>7</sup> See joint letter from MFA, the American Council of Life Insurers, and Alternative Investment Management Association to SEC Chairman White and CFTC Chairman Gensler, dated May 10, 2013, with a request for action by both commissions to improve coordination and to facilitate portfolio margining for customers in the cleared CDS market, available at: <https://www.managedfunds.org/wp-content/uploads/2013/05/CDS-Customer-Portfolio-Margining-Final-MFA-Coalition-Letter.pdf> (the “Buy-Side Coalition Letter”); MFA letter in response to the SEC “Order Granting Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection With Portfolio Margining of Swaps and Security-Based Swaps”, 77 Fed. Reg. 75211 (Dec. 19, 2012), filed with the SEC on February 11, 2013, available at: <https://www.managedfunds.org/wp-content/uploads/2013/02/SEC-Portfolio-Margining-Exemptive-Order-MFA-Final-Letter.pdf>; MFA letter to the SEC on ICE Clear Credit’s petition for an order permitting portfolio margining of single-

would encourage the SEC to support this model rather than require the market to establish an untested CDS clearing model for which there is currently no market infrastructure, which would be extremely costly to create and for which there is no customer appetite. Therefore, we respectfully request that the SEC confirms that, under the portfolio margining program, single-name CDS may always be cleared through a CFTC cleared swaps account and be subject to the margin and risk management regime proposed in the 2020 Proposed Order.

### **Proposed Revisions to the Requirements to the Non-Conforming Subordination Agreements to More Closely Align with Customer Protection Objectives**

We generally believe that the modifications to conditions set out at (b)(1)(ii) and (b)(2)(ii) of the 2012 Order, as set forth in the 2020 Proposed Order, are appropriate. However, we have a concern that the subordination language in the 2020 Proposed Order could be read to require the subordination of all claims a customer may have against a BD/FCM. In response to question 5 of the request for comment, we believe that the language should be further tailored to ensure that it only requires the subordination of a customer's claims for assets subject to a portfolio margining arrangement and not other claims the customer may have against the BD/FCM, such as, for example, separate claims the customer may have as a securities customer in relation to a securities account. We therefore propose the following changes to the condition set out at (b)(1)(ii) of the 2020 Proposed Order:

as well as an affirmation by the cleared swaps customer that ~~claims to~~, solely with respect to the distribution of "customer property" as defined in SIPA or 11 U.S.C. 741 and, for the avoidance of doubt, without prejudice to its entitlement to "customer property" as defined in 11 U.S.C. 761, its claims against the BD/FCM for such money, securities or property will be subordinated to the claims of securities customers and security-based swap customers.

We believe that these changes would provide clarity that is consistent with the expectations of the rights of customers in the event of a BD/FCM insolvency and it is important to reduce the risk of challenge to those rights. We are also concerned that BD/FCMs may determine that compliance with the conditions under the 2020 Proposed Order may require them to amend existing agreements with cleared swaps customers and affiliates participating in the portfolio margin program. In response to question 5 of the request for comment, we can attest that such an approach would place a significant burden on our member firms.

We therefore urge the SEC to consider how parties can ensure they are in compliance with the amended requirements in the proposed order through means that are less burdensome and operationally more realistic. We respectfully recommend that the SEC confirms that the modifications in the 2020 Proposed Order are merely clarifications of its intention for the 2012 Order, and that it expects that existing customer documentation entered into in compliance with the 2012 Order be interpreted accordingly. We would further recommend that the SEC confirm that the use of negative consents or notifications by BD/FCMs, confirming that existing subordination arrangements should be interpreted consistently with the 2020 Proposed Order, would offer sufficient certainty. Moreover, for BD/FCMs whose existing subordination arrangements are in compliance with the conditions under the 2020 Proposed Order but for reference to the 2012 Order, we would

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name credit default swaps and broad-based indices, filed with the SEC on June 13, 2012, available at : <https://www.managedfunds.org/wp-content/uploads/2012/06/SEC-Comment-Letter-in-Support-of-ICE-Portfolio-Margining-Petition-Final-MFA-Letter.pdf>; MFA letter to the CFTC on ICE Clear Credit LLC's petition dated October 4, 2011 for an order permitting portfolio margining of swaps and security-based swaps, filed with the CFTC on December 21, 2011, available at: <https://www.managedfunds.org/wp-content/uploads/2011/12/CFTC-Comment-Letter-in-Support-of-ICE-Portfolio-Margining-Petition-Final-MFA-Letter.pdf>; and MFA letter to the CFTC on ICE Clear Europe Limited's petition dated May 31, 2012 for an order permitting commingling of customer funds and portfolio margining for swaps and security-based swaps, filed with the CFTC on December 14, 2012, available at: <https://www.managedfunds.org/wp-content/uploads/2012/12/CFTC-Comment-Letter-in-Support-of-ICE-Clear-Europe-Petition-Final-MFA-Letter.pdf>.

request that the SEC clarify that no further documentation or amendments would be required in respect to such arrangements.

### **We Support the SEC’s More Flexible Approach to Internal Risk Management Program Standards**

We welcome the SEC’s move away from a prescriptive approach to imposing a pre-determined margin collection requirement and towards a more flexible approach to internal risk management program standards. In support of this position, we request that the SEC consider further modifying the 2020 Proposed Order to clarify that the SEC will not impose a minimum margin requirement and that it will permit deference to the Commodity Futures Trading Commission (“CFTC”), where appropriate, as discussed below.

SIFMA AMG and MFA members agree that BD/FCMs should establish and maintain integrated internal risk management programs designed to help ensure an awareness of, and accountability for, the risks taken throughout the firm. We support the SEC’s position that BD/FCMs should maintain a system for addressing those risks by independently measuring the potential future credit risk to cleared swaps customers and affiliates participating in the CDS portfolio margin program under different stress scenarios (*e.g.*, through risk limits, threshold triggers, house margin, heightened monitoring or other controls). To allow for greater consistency across the market, however, we suggest an approach that demonstrates further coordination between the SEC and the CFTC. Specifically, we suggest that the SEC permit BD/FCMs to presume that a CCP’s margin methodology, which is subject to supervision by the CFTC, is presumptively reasonable, unless the BD/FCM or its supervisor has a foundation on which it may determine that the CCP’s methodology is not appropriate in light of the risk or that there are better or more reasonable ways to address such risk. This could increase transparency for market participants in terms of being able to anticipate margin requirements generated by their cleared CDS portfolios, as CCPs generate the regulatory margin requirements.<sup>8</sup>

Finally, we reiterate the importance of transparency in margin models to our members and urge the SEC to require BD/FCMs to be transparent to their customers regarding their model’s design and function. As we have stated previously, financial end users must be able to independently verify the calculation of any IM amounts calculated through models.<sup>9</sup> Otherwise, financial end users will be confronted with a “black box” that will not allow them to predict, or understand, their margin requirements. A significant concern for our members, particularly during times of increased market uncertainty, is that they could be forced to post greater margin, without any notice, exposing them to greater risk.<sup>10</sup> Promoting transparency, albeit in a balanced manner to protect BD/FCM’s proprietary models, would increase accountability on the part of entities whose models are being used, and minimize the negative effects of inaccurate collateral calls. We welcome further discussions with the SEC on this point.

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<sup>8</sup> 85 Fed. Reg. 70657 at 70662.

<sup>9</sup> SIFMA AMG comment letter to the SEC on the Proposed Capital, Margin and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants at 16, filed with the SEC on February 22, 2013, available at: <https://www.sifma.org/wp-content/uploads/2017/05/sifma-amg-submits-comments-to-the-sec-on-capital-margin-and-segregation-requirements-for-sbsds-and-msbsps.pdf>.

<sup>10</sup> See joint letter from MFA, the American Council of Life Insurers, and AIMA to SEC Chairman White on request for action to address CDS portfolio margining concerns of buy-side market participants, filed with the SEC on December 27, 2013, available at: <https://www.sec.gov/comments/s7-13-12/s71312-4.pdf>.

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SIFMA AMG and MFA thank the SEC for the opportunity to provide comments on the 2020 Proposed Order. With the limited modifications as discussed above, we urge the SEC to make the exemptive order permanent to facilitate the portfolio margining of cleared CDS. Please do not hesitate to contact Jason Silverstein at (212) 313-1176 or Jennifer Han at (202) 730-2600 with any questions the SEC or its staff might have regarding this letter.

Respectfully submitted,

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