

**December 9, 2019**

Office of the Comptroller of the Currency  
Federal Deposit Insurance Corporation  
Farm Credit Administration  
Board of Governors of the Federal Reserve  
Federal Housing Finance Agency

**Re: Margin and Capital Requirements for Covered Swap Entities – Office of the Comptroller of the Currency (RIN: 1557-AE69); Board of Governors of the Federal Reserve (RIN: 7100-AF62); Federal Deposit Insurance Corporation (RIN: 3064-AF08); Farm Credit Administration (RIN: 3052-AD38); Federal Housing Financing Agency (RIN: 2590-AB03)<sup>1</sup>**

Dear Sirs and Madams:

The Asset Management Group of the Securities Industry and Financial Markets Association (“AMG” or “SIFMA AMG”) and the American Council of Life Insurers (“ACLI” together, the “Associations”)<sup>2</sup> appreciate the opportunity to provide comments to the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve, Federal Deposit Insurance Corporation, Farm Credit Administration, and Federal Housing Financing Agency (the “Prudential Regulators”) on the Proposal. The Associations are supportive of the amendments in the Proposal that would incorporate the recent Basel Committee on Banking Supervision and the International Organization of Securities Commissions’ (“BCBS-IOSCO”) statements on documentation and extending the implementation of the remaining phases of the initial margin requirements for non-centrally cleared derivatives (“UMRs”). The Associations are also supportive of the proposed rules on relief for IBORs transitions and portfolio compression exercises. While the changes in the Proposal serve to codify helpful relief for the implementation of the UMR Rules, these changes alone will not remediate the substantial challenges faced by asset managers, their clients, and life insurers as they implement the UMR during the final phases of the implementation schedule, and therefore, we believe further changes are necessary to account for the scoping and implementation challenges faced by asset managers their clients, and life insurers.

The Associations appreciate the commitment of the Prudential Regulators to ensure a robust and workable uncleared margin framework. The Prudential Regulators’ current review of the margin framework is well-timed given the challenges that have arisen as asset managers, their clients, and life

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<sup>1</sup> Margin and Capital Requirements for Covered Swap Entities, 84 Fed. Reg. 59970 (November 7, 2019), available at <https://www.fdic.gov/news/board/2019/2019-09-17-notice-dis-b-fr.pdf> (the “Proposal”).

<sup>2</sup> See Appendix I for descriptions of SIFMA AMG and ACLI.

insurers have begun preparations for the final stages of the implementation schedule. In response to these challenges, both AMG and ACLI recently submitted letters to global regulators on the remaining stages of the initial margin phase-in, and have continued to provide feedback to the Prudential Regulators.<sup>3</sup> The Associations continue to have significant concerns with respect to the scoping of the UMR and implementation issues that are specific to asset managers. To solve for the various challenges posed by the UMR, in addition to the relief afforded in the Proposal, the Associations propose certain scoping and implementation solutions for which we believe will allow for a more orderly implementation of the UMR. A summary of these solutions is provided below.

#### Scoping Issues and Potential Solutions:

1. **Address Burdensome Daily Calculation of Initial Margin by Allowing Annual Calculation of Initial Margin and/or Six-Months Grace Period for Documentation:** Under the current regime, once an asset manager’s client has crossed the final two thresholds for initial margin phase-in, \$50 billion and \$8 billion notional, the asset manager and swap dealers must monitor and calculate the potential initial margin (“**IM**”) amounts daily even in circumstances where the account is not near the \$50 million threshold (“**IM Threshold**”). The types of market participants captured in these final phases, large in number compared to prior phases (around 700 entities and 7,000 relationships) and presenting collectively a small percentage of outstanding notional amounts (around 11% of the AANA across all phases), has resulted in a number of in-scope market participants that do not always exceed the \$50 million counterparty threshold.<sup>4</sup> As such, this daily obligation applied to market participants is overly burdensome, in particular those with smaller AANA calculations closer to \$8 billion. This challenge is exacerbated for a beneficial owner with multiple separately managed accounts through multiple asset managers (“**SMA**”), where an asset manager only has knowledge of the derivatives trading it engages in on behalf of an SMA client and does not have transparency into other derivative trading by the SMA client (either directly or through other asset managers). While the proposed guidance on documentation in the Proposal is helpful for some relationships, there remains many clients (both funds and SMAs) that would incur significant burdens and costs to daily monitor their accounts and may suffer trading disruptions, requirements to terminate or novate trades, negative performance, and more importantly, the inability to implement prudent risk and portfolio management if the IM Threshold is near or exceeds \$50 million. In order to mitigate these concerns, the Associations are offering the following proposed solutions:

- Permit the calculations of the \$50 million IM threshold to be done annually, rather than daily, using the same measurement period that is used for performing AANA calculations.
- Provide at least a 6-months grace period for firms, following notice from the applicable swap dealer that aggregate IM [for a client] required to be exchanged under the regulations equals or exceeds the IM threshold, to complete the necessary documentation and system set-ups to be compliant with the UMR.

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<sup>3</sup> See SIFMA AMG Comment Letter, Margin Requirements for Non-Centrally Cleared Derivatives – Remaining Stages of Initial Margin Phase-In, September 13, 2019, available at <https://www.sifma.org/wp-content/uploads/2019/09/SIFMA-AMG-Letter-on-the-Margin-Requirements-for-Non-Centrally-Cleared-Derivatives-Final-9-13-19.pdf> (the “**AMG Letter**”).

<sup>4</sup> Richard Haynes, Madison Lau, and Bruce Tuckman, *Initial Margin Phase 5* (October 24, 2018), available at [https://www.cftc.gov/sites/default/files/About/Economic%20Analysis/Initial%20Margin%20Phase%205%20v5\\_ada.pdf](https://www.cftc.gov/sites/default/files/About/Economic%20Analysis/Initial%20Margin%20Phase%205%20v5_ada.pdf).

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

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

3. **Scoping of Seeded Funds:** Current US UMR rules would require the consolidation of seeded funds based on a GAAP test which is not warranted given the limited and passive nature of the relationship between seeded funds and their sponsors. Such consolidation is not required for UCITS-regulated funds under the EU's adoption of the UMR, which may create an opportunity for regulatory arbitrage and competitively disadvantage U.S. markets. The Associations continue to urge regulators to not require a seeded fund to aggregate its notional exposures with those of its parent or other commonly consolidated entities for purposes of calculating is AANA. To accomplish this exclusion, we recommend that the Prudential Regulators consider the following language which would serve as a carve-out for seeded funds:

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

Such an interpretation would be consistent with BCBS-IOSCO<sup>5</sup> standards and the Prudential Regulators' recognition of seeded funds in the Volcker Rule.<sup>6</sup>

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

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

#### Implementation Issues and Potential Solutions:

1. **Use of Money Market Funds ("MMFs"):** The current definition of forms of eligible margin contains restrictive language that would broadly disqualify many (if not most) MMF's currently used by asset managers, specifically, the limitation that "the [money market] fund's assets may not be transferred through securities lending, securities borrowing, repurchase agreements, reverse repurchase agreements or other similar means"<sup>7</sup>. As further noted in the AMG Letter, we believe

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<sup>5</sup> BCBS-IOSCO Margin Requirements for Non-Centrally Cleared Derivatives (March 2015), available at <https://www.bis.org/bcbs/publ/d317.pdf>. (See Footnote #10, stating "Investment funds that are managed by an investment advisor are considered distinct entities that are treated separately when applying the threshold as long as the funds are distinct legal entities that are not collateralised by or are otherwise guaranteed or supported by other investment funds or the investment advisor in the event of fund insolvency or bankruptcy.")

<sup>6</sup> See the AMG Letter at 7.

<sup>7</sup> 12 CFR 237.6 (CFTC eligible collateral); 12 CFR 237.7 (CFTC segregation of collateral); 12 CFR 45.6 (Comptroller of Currency eligible collateral); 12 CFR 45.7 (Comptroller of Currency segregation of collateral); 12 CFR 237.6 (Federal Reserve eligible collateral); 12 CFR 237.7 (Federal Reserve segregation of collateral); 12 CFR 349.6 (FDIC eligible collateral) 12 CFR § 349.7 (FDIC segregation of collateral); 12 CFR 624.6 (FCA eligible collateral); 12 CFR 624.7 (FCA segregation of collateral); 12 CFR 1221.6 (FHFA eligible collateral); 12 CFR 1221.7 (FHFA segregation of collateral).

this restriction to be unwarranted and request it be removed from the relevant section noted herein.

2. **Minimum Transfer Amounts (“MTA”) for SMAs:** the current framework provides operational and documentation challenges that will continue to compound as the implementation of regulatory IM with SMAs captures increasingly more counterparties. We request that the Prudential Regulators adopt the approach outlined in the CFTC’s DSIO No-Action Letter 17-12 that allows for asset managers to apply no greater than a \$50,000 MTA to each separate SMA it manages.

The Associations are appreciative of the agencies’ continued commitment to facilitating a smooth implementation of the UMR and in addition to the proposed solutions above, is providing specific feedback to the Proposal below.

### **Specific Comments on the Proposal:**

#### **I. Additional Compliance Date for the Initial Margin Requirements**

The Associations are supportive of the Prudential Regulators’ proposal to both extend the compliance schedule of the UMR by one year and split the final phase in two. In doing so, the Prudential Regulators acknowledged industry concerns regarding operational complexities associated with IM calculation and third-party segregation.<sup>8</sup> While the Associations agree with these concerns, the proposed changes only take a step towards alleviating issues in the near term. To that end, we believe there are substantial implementation issues that would not be resolved by an extension of the compliance date.

One example, as outlined in the AMG Letter, is in the context of a beneficial owner with SMAs. In this scenario, only the beneficial owner will have knowledge of the total notional amount of derivatives at the client’s legal entity level. Thus, asset managers must solicit each client (that it trades derivatives on behalf of) to determine whether their total notional amount exceeds the UMR notional threshold. This knowledge gap, between an asset manager and its SMA clients, is a distinct issue from those faced by the entities brought into scope by the first three phases, and will likely require more than an implementation schedule extension to alleviate.

Accordingly, while the Associations are supportive of the Proposal’s changes to the implementation schedule of the UMR, we respectfully request the Prudential Regulators consider the suggested solutions above.

#### **II. Documentation Requirements**

The Associations’ members are supportive of the Prudential Regulators’ proposal to amend the UMR to expressly state that a covered swap entity is not required to execute initial margin trading documentation with a counterparty prior to the time that it is required to collect or post initial margin. This would be consistent with consistent with the March 5, 2019 BCB-IOSCO statement and CFTC

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<sup>8</sup> Prudential Proposal at 59977.

Letter No. 19-16, published on July 9, 2019, that provides guidance on the documentation requirement for initial margin.

**III. Proposed Rule on Interbank Offered Rates; Portfolio Compression Exercises, and Other Life Cycle Events**

The Associations are generally supportive of the agencies’ proposal to amend the Swap Margin Rule to preserve the legacy status of a non-cleared swap after a covered swap entity replaces certain reference rates, and swaps that are subject to portfolio compression exercises, and other life cycle events.

While the Associations’ members do not have specific additions to the proposed list of Interbank Offered Rates (“IBORs”) outlined in the Proposal, we’re appreciative of the agencies’ recognition of certain reference rates, as well as, the agencies’ proposal to also allow for a more forward-looking standard “designed to encourage covered swaps entities to resolve critical uncertainties before an interest rate benchmark is discontinued, or loses its market relevance. . .”<sup>9</sup> By providing for a flexible standard in addition to including specific reference rates, market participants would be afforded the ability to mitigate issues relating to problematic reference rates prior to any market disruptions.

**IV. Non-Cleared Swaps Between Covered Swaps Entities and an Affiliate**

The Associations are supportive of the proposal to exempt transactions between CSEs and an affiliate for the initial margin requirements.

We appreciate your consideration of this letter and look forward to discussions that will address the issues raised. Please do not hesitate to contact Jason Silverstein, at [jsilverstein@sifma.org](mailto:jsilverstein@sifma.org) or at +1-212-313-1176, or Carl Wilkerson, at [carlwilkerson@acli.com](mailto:carlwilkerson@acli.com), or at +1-202-624-2118.

Sincerely,

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

Carl Wilkerson  
Vice President & Chief Counsel, Securities  
American Council of Life Insurers

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<sup>9</sup> Prudential Proposal at 59974.

CC: U.S. Commodity Futures Trading Commission  
U.S. Securities and Exchange Commission  
Secretariat of the Basel Committee on Banking Supervision Bank for International Settlements  
Secretariat of the International Organization of Securities Commissions  
Board of Governors of the Federal Reserve System  
European Banking Authority  
European Central Bank  
European Commission  
European Securities and Markets Authority  
Australian Prudential Regulation Authority  
Brazil National Monetary Council  
Canada Office of the Superintendent of Financial Institutions  
Central Bank of Brazil  
Central Bank of Ireland  
Hong Kong Monetary Authority  
Japan Financial Services Agency  
Luxembourg Commission de Surveillance du Secteur Financier  
Monetary Authority of Singapore  
Korean Financial Supervisory Service  
Swiss Financial Market Supervisory Authority  
South African Prudential Authority  
South African Financial Sector Conduct Authority

## Appendix I

### Descriptions of the Associations

**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.

**ACLI** is a national trade association representing 280 life insurers that hold over 95 percent of the industry's total assets. Our members serve 75 million American families that rely on life insurers' products for financial and retirement security. ACLI's members offer life insurance, annuities, retirement plans, long-term care, disability income insurance, and reinsurance.



**Appendix II**

**AMG Letter**



## asset management group

September 13, 2019

Secretariat of the Basel Committee on Banking Supervision  
Bank for International Settlements  
Secretariat of the International Organization of Securities Commissions  
Board of Governors of the Federal Reserve System  
European Banking Authority  
European Central Bank  
European Commission  
European Securities and Markets Authority  
Farm Credit Administration  
Federal Deposit Insurance Corporation  
Federal Housing Finance Agency  
Financial Conduct Authority  
Office of the Comptroller of the Currency  
U.S. Commodity Futures Trading Commission  
U.S. Department of the Treasury

U.S. Securities and Exchange Commission  
Australian Prudential Regulation Authority  
Brazil National Monetary Council  
Canada Office of the Superintendent of Financial Institutions  
Central Bank of Brazil  
Central Bank of Ireland  
Hong Kong Monetary Authority  
Japan Financial Services Agency  
Luxembourg Commission de Surveillance du Secteur Financier  
Monetary Authority of Singapore  
Korean Financial Supervisory Service  
Swiss Financial Market Supervisory Authority  
South African Prudential Authority  
South African Financial Sector Conduct Authority

**Re: Margin Requirements for Non-Centrally Cleared Derivatives – Remaining Stages of Initial Margin Phase-In**

Dear Sirs and Madams:

The Asset Management Group of the Securities Industry and Financial Markets Association (“**AMG**”)<sup>1</sup> is writing in regards to several scoping and implementation issues that asset managers and their clients are facing in the remaining phases of the implementation of initial margin (“**IM**”) requirements for non-centrally cleared derivatives (commonly referred to as the “**Uncleared Margin Rules**” or “**UMRs**”).

We support the recent July 23, 2019 joint statement of the Basel Committee on Banking Supervision (“**BCBS**”) and the International Organization of Securities Commissions (“**IOSCO**”) (the “**July 23, 2019 Statement**”) recommending extending implementation of the remaining phases of the UMRs (by splitting Phase V into two phases). We encourage global regulators to adopt the July 23, 2019 Statement for regulatory certainty and clarity.<sup>2</sup> In particular, and consistent with the July 23, 2019 Statement, an intermediary phase-in

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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 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.

<sup>2</sup> We applaud the Farm Credit Administration, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the Office of the Comptroller of the Currency (U.S. Department of the Treasury), the Board of Governors of the Federal Reserve System

period between Phase IV and Phase V set at an amount above EUR/USD 50 billion<sup>3</sup> would allow market participants and regulators to assess and hopefully address difficulties in implementation prior to the rush of counterparties coming within scope at the EUR/USD 8 billion threshold,<sup>4</sup> and would allow for the tapered development of market infrastructure necessary for successful compliance.

We also support the March 5, 2019 joint statement of BCBS/IOSCO (the “**March 5, 2019 Statement**”)<sup>5</sup> clarifying that “the [UMR] framework does not specify documentation, custodial or operational requirements if the bilateral initial margin amount does not exceed the framework’s [EUR/USD] 50 million IM threshold,” and we appreciate that this clarification was effectively adopted in an Advisory issued on July 9, 2019 by the Division of Swap Dealer and Intermediary Oversight (“**DSIO**”) of the Commodity Futures Trading Commission (“**CFTC**”) (the “**Advisory**”). As you know, a number of buy-side entities will become subject to the current UMRs in Phases IV and V solely as a result of their aggregate average notional amount (“**AANA**”) exposures, because many of these entities do not necessarily present systemic risk, and even though a significant portion of the AANA may be made up of transactions not subject to margin obligations, such as physically settled FX transactions. In order to help ensure that the UMRs do not impose undue burdens on these buy-side entities and their sell-side counterparties, we urge global regulators to promptly adopt or publicly support the clarification provided in the March 5, 2019 Statement and the Advisory.<sup>6</sup>

While global regulatory adoption of both the March 5, 2019 Statement and the July 23, 2019 Statement would provide some much-needed certainty to the industry, those statements do not fully resolve other important scoping and implementation challenges presented by the UMRs. The time provided by the intermediary phase-in period recommended by the July 23, 2019 Statement will allow additional time that should be used by regulators to address the fundamental scoping and implementation issues discussed herein.<sup>7</sup> For the reasons described further in this letter, we respectfully request that regulators take the following actions:

### Scoping

- *In the context of a beneficial owner with multiple separately managed accounts through multiple asset managers (each account, an “**SMA**”), permit the calculations of the EUR/USD 50 million IM threshold (“**IM Threshold**”) to be done annually, rather than daily, using the same measurement period that is used for performing the AANA calculations. As further described herein, approaching the IM Threshold calculation in this way allows it to be an effective scoping tool for the UMRs; alternative*

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(together, the “**Prudential Regulators**”), the Australian Prudential Regulation Authority, the Hong Kong Monetary Authority, the Monetary Authority of Singapore and the South Korean Financial Supervisory Service for expressing support for BCBS/IOSCO’s push-out approach and for their efforts to develop rules extending the implementation timeline.

<sup>3</sup> We recognize that not all regulators will use this number or its equivalent, but the EUR/USD figures will be used throughout for reference because it most closely reflects the figures in the March 2019 Statement.

<sup>4</sup> In addition, we believe that the EUR/USD 8 billion threshold should be raised, as discussed in Part I, Section (b) of this letter.

<sup>5</sup> BCBS/IOSCO Statement on the Final Implementation Phases of the Margin Requirements for Non-centrally Cleared Derivatives, dated March 5, 2019, available at <https://www.bis.org/press/p190305a.htm>.

<sup>6</sup> We commend the Prudential Regulators, the Australian Prudential Regulation Authority, the Canada Office of the Superintendent of Financial Institutions and the Hong Kong Monetary Authority for also supporting the March 5, 2019 Statement.

<sup>7</sup> We recognize that the Securities and Exchange Commission’s (“**SEC**”) final uncleared margin rules for security-based swaps are not yet effective; however, as those rules come into effect, largely the same concerns will apply to security-based swap dealers, and adjustments in regulations should apply similarly to security-based swap dealers to the extent any such adjustments are made. *See* 84 Fed. Reg. 43872 (August 22, 2019) (SEC’s uncleared margin rules regarding Security-Based Swap Dealers and Major Security-Based Swap Participants).

approaches are unduly burdensome from an operational and documentation perspective, create uncertainty and may result in unworkable deadlines and trading disruptions.<sup>8</sup>

- *Provide an exemption, to the extent not already available, from consolidating seeded investment funds with their sponsors for purposes of AANA calculations.* Consolidation is not warranted given the limited and passive nature of the relationship between seeded funds and their sponsors, as described in this letter; moreover, such consolidation is not required for UCITS-regulated funds under the EU's adoption of the UMRs, which may create an opportunity for regulatory arbitrage and competitively disadvantage U.S. and other markets.
- *Provide an exemption for physically settled foreign exchange ("FX") swaps and forwards from AANA calculations.* Including physically settled FX swaps and forwards is not warranted because they are short-dated and highly liquid transactions that present low long-term or systemic risk and do not require the exchange of IM under the rule.
- *Provide an exemption for single-stock equity options and index options from margin requirements.* The EU's equity option derogation is set to expire in January 2020, but the reasons for such derogation or extension still exist, as US regulations do not apply UMRs to equity options, which will result in market fragmentation and regulatory arbitrage when the derogation expires.<sup>9</sup> Other jurisdictions have afforded similar flexibility with respect to security-index options and security options. Where these exemptions are time-delimited, we urge regulators in all relevant jurisdictions to make such exemptions permanent.

### **Implementation**

- *To the extent the IM Thresholds could not be calculated using the standard AANA measurement period, provide a grace period for SMAs following notice from the applicable swap dealer that aggregate IM is near or exceeds the IM Threshold during which the SMA, through its respective asset manager, must complete the necessary documentation and system set-ups.* An expectation of immediate action would be unreasonable considering that asset managers lack the transparency to predict when a client's aggregate IM (across all of its asset managers) with a swap dealer and its affiliates is at or near the IM Threshold. Without such a grace period, swap dealers may decide to halt trading with some or all of the asset managers for an SMA without much advanced notice until they comply with the new UMRs. This could negatively impact managers' performance and may force them to novate or early terminate existing transactions, thus causing clients to suffer unnecessary costs or losses in their portfolios. Additionally, once the aggregate IM is near or exceeds the IM Threshold, there may be complications in determining how to sub-allocate the IM Threshold across asset managers and a swap dealer (and its affiliates, if any) for purposes of determining how much IM should be collected from each SMA of a beneficial owner. Similar to minimum transfer amounts ("MTAs") as discussed below, sharing or allocating IM Thresholds dynamically would be challenging and impractical from an operational and documentation perspective, potentially requiring multiple amendments to reallocate sub-allocations of the IM Thresholds as the number of asset managers and/or volume of trading activities change.

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<sup>8</sup> As discussed briefly in Part I of this letter, the failure to adopt the proposed annual approach to calculating the IM Threshold would make it even more critical to implement other scoping adjustments, such as raising the AANA thresholds for the remaining UMR phases and removing deliverable foreign exchange swaps and forwards from the AANA calculation.

<sup>9</sup> Commission Delegated Regulation (EU) 2016/2251(43), October 4, 2016.

- *Expand the list of eligible collateral, in particular, by removing the unduly restrictive conditions to the use of money market funds (“MMFs”).* The current restrictions on the use of MMFs broadly disqualify many (if not most) MMFs, which would result in economic and operational inefficiencies and create unnecessary burdens on asset managers and their clients.
- *Adopt relief similar to that provided in CFTC No-Action Letter 17-12 to permit asset managers to adopt a fixed sub-MTA at each SMA level rather than having to actively share the aggregate MTA per each SMA owner with each swap dealer.* With the implementation of regulatory IM, there is an even more pressing need to ensure that allocations of MTA, which represents a combined amount of required IM and required variation margin, are handled effectively and efficiently; the flat allocation approach in CFTC Letter 17-12<sup>10</sup> ensures that the regulatory purpose of MTAs is served while minimizing operational challenges and documentation burdens for asset managers.
- *Remove back-testing and internal governance process requirements for non-dealers’ use of globally accepted IM models.* As summarized in a recent letter to EU regulators,<sup>11</sup> non-dealers coming into scope during Phases IV and V should not be subject to internal back-testing requirements and should not be required to go through the initial approval process when using globally approved IM models such as ISDA SIMM.

We discuss these issues in more detail below. We recognize that there are differences among various jurisdictions’ rules, and therefore the issues in this letter may be more or less relevant in one jurisdiction than another. Ultimately, we have advocated for, and continue to support, a level global regulatory playing field. Accordingly, our views on the issues identified herein are directed towards the establishment of a global standard and minimization of cross-border inconsistencies.

## I. SCOPING ISSUES

### (a) The IM Threshold Can Serve as an Effective Scoping Tool if it is Calculated Annually Using the Same Time Period as the AANA Calculation.

In former CFTC Chairman Giancarlo’s April 29, 2019, letter to the Federal Reserve Board of Directors,<sup>12</sup> the then-Chairman acknowledged that in the absence of certain relief under the UMRs (e.g., raising the AANA threshold from \$8 billion to \$50 billion), the IM Threshold becomes an even more important scoping tool for determining which entities should be subject to regulatory IM requirements, including documentation, custodial, and operational requirements. Specifically, the former Chairman set forth his view that “[e]ntities with notional amounts greater than \$8 billion but calculated margin less than \$50 million [i.e., calculated margin that does not exceed the IM Threshold]” should be “spared the expense of preparing to exchange margin.” We wholeheartedly support the former Chairman’s balanced approach.

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<sup>10</sup> CFTC Letter No. 17-12 (dated, February 13, 2017) available at <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/17-12.pdf>.

<sup>11</sup> See International Swaps and Derivatives Association (“ISDA”), Association of the Luxembourg Fund Industry (“ALFI”) and SIFMA letter to the European Securities and Markets Authority (“ESMA”), European Banking Authority (“EBA”) and European Insurance and Occupational Pensions Authority (“EIOPA”), March 17, 2019 at [https://www.isda.org/a/Y3tME/2019.05.17\\_EU-Letter\\_IM-Models\\_FINAL.pdf](https://www.isda.org/a/Y3tME/2019.05.17_EU-Letter_IM-Models_FINAL.pdf).

<sup>12</sup> CFTC Chairman Giancarlo’s Letter to Federal Reserve Board Vice Chairman Randal K. Quarles on Phase Five Implementation, dated May 2, 2019, available at <https://www.cftc.gov/PressRoom/PressReleases/7922-19>.

Precisely how often the IM Threshold should be calculated is not, however, described in the former Chairman’s letter, in the Advisory, or under the UMRs. For instance, in adopting the UMRs, U.S. regulators did not explicitly identify the *frequency* of the IM threshold calculation, instead focusing on its *methodology*: “The \$50 million threshold is measured as the amount of initial margin for the relevant portfolio of non-cleared swaps and non-cleared security based swaps, pursuant to either the internal model or standardized initial margin table used by the covered swap entity [and its consolidated affiliates].”<sup>13</sup> As a result, there is some latent ambiguity regarding the frequency with which such calculations should be made.

If the IM Thresholds are required to be calculated daily on an aggregate basis, a host of complications and challenges may arise, particularly in the context of SMAs. An SMA client may have multiple strategies executed through separate asset managers. The SMA approach achieves a diversity of investment perspectives/expertise and asset allocations for the invested assets and mitigates concentration risks. In these SMA arrangements, each asset manager for a SMA client generally trades under agreements it negotiates on behalf of its SMA client, maintains separate assets under management for its strategy and has no transparency nor control as to the derivatives activities executed through other asset managers nor to the client’s (and the client’s consolidated affiliates’) aggregate exposures across all of its derivatives positions. While an individual swap dealer may not have transparency to the SMA client’s AANA across all swap dealers, it, however, will have visibility across that SMA client’s trades through all asset managers with the swap dealer and its affiliates. Additionally, under certain UMRs, it is the covered swap entity (i.e., the swap dealer) who is expected to calculate the amounts of IM that are required to be exchanged between itself and its counterparties and, solely with respect to its counterparties whose AANAs exceed the threshold for the relevant year, to monitor whether the aggregate IM requirements would exceed the IM Threshold.

If the IM Threshold has to be calculated on a daily basis, then the swap dealer in this scenario would be calculating at least *two* separate margin amounts every day:

- (1) per each asset manager for the same SMA client (and its consolidated affiliates), the margin requirement to be exchanged based on existing margin methodology,<sup>14</sup> and
- (2) the aggregate simulated IM requirements for the same SMA client (and its consolidated affiliates), using the swap dealer’s internal model, SIMM, or standardized initial margin table, in order to see how close the simulated IM is (across all asset managers trading on behalf of the SMA client (and its consolidated affiliates) with the dealer and its affiliates) to the IM Threshold.<sup>15</sup>

Running a minimum of two types of calculations (potentially on a real-time basis) per day per SMA client—one pursuant to existing margin methodology and the other a simulated calculation *per each asset manager* to check against the IM Threshold and then aggregating those calculations across managers for the same SMA client (and its consolidated affiliates)—poses obvious operational costs and undue burdens on both the sell-side and the buy-side. As the Prudential Regulators have observed, it could create a “significant operational burden” to have to calculate “initial margin collection amounts on a *daily basis* even though no initial margin

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<sup>13</sup> See 80 Fed. Reg. 74840, 74864 (Nov. 30, 2015) (Prudential Regulators’ final uncleared margin rules); see also 81 Fed. Reg. 636, 653 (Jan. 6, 2016) (CFTC’s final uncleared margin rules).

<sup>14</sup> This would be a net requirement, assuming that the asset managers would not split old trades from new trades or require variation margin to be calculated separate from voluntary IM. If the asset manager did split its legacy book from new transactions, it could further exacerbate the number of margin calls and calculations the swap dealer would have to perform on a daily basis.

<sup>15</sup> 12 C.F.R. § 23.154 (CFTC rule re IM models); 12 C.F.R. 45.8 (Comptroller of Currency rule re IM models); 12 C.F.R. 237.8 (Federal Reserve rule re IM models); 12 C.F.R. 349.8 (FDIC rule re IM models); 12 C.F.R. 1221.8 (FIFA rule re IM models).

would be expected to be collected.”<sup>16</sup> Furthermore, if, in the course of daily calculation and monitoring, the swap dealer determines that the IM Threshold is exceeded or close to being exceeded, then the SMA client’s asset managers must immediately work with the same SMA client, SMA client’s IM custodian, and the swap dealer (and any affiliates) and the swap dealer’s tri-party agent to get all of the documentation and accounts in place by the relevant regulatory IM deadlines. Swap dealers may also selectively choose to prioritize the legal and operational set-up with a subset of the SMA client’s asset managers, therefore effectively shutting down trading with the smaller managers or with managers doing less trading on a temporary or permanent basis. Practically speaking, however, regardless of the number of asset managers, it may be impossible to successfully accomplish this race against the clock as each manager and swap dealer simultaneously compete for the same custodian’s and tri-party agent’s time and resources. The process of negotiating and finalizing UMR compliant documentation and completing the operational set-up is lengthy and complex, frequently taking market participants up to a year or more to complete.

In light of the problems with a daily calculation of the IM Threshold, AMG urges regulators to confirm that the following proposal is acceptable: the IM Threshold would be calculated *annually*, using the same calculation periods used to determine whether AANA thresholds are exceeded. In adopting the calculation approach for the AANA threshold, the U.S. regulators explained that the specified time period (i.e., June, July, and August of the previous year) “is appropriate to gather a more comprehensive assessment of the financial end user’s participation in the swaps market, and to address the possibility that a market participant might ‘window dress’ its exposure...”<sup>17</sup> The regulatory comfort with using a three-month period once a year to measure AANA should also apply to using the same approach for calculating the IM Threshold. Both the AANA threshold and the IM Threshold function as scoping tools and, together, they would determine and provide much needed certainty as to whether an entity is in scope for regulatory IM for the period beginning September of the relevant year (or, after the final implementation phase-in, for the period beginning January of the relevant year).

Once an asset manager(s) for an SMA client receives notice from the applicable swap dealer that the SMA client’s simulated IM Threshold and AANA threshold were both exceeded during the calculation period, they would proceed to put in place required documentation for regulatory IM. If the thresholds were not exceeded, then the parties would know with certainty that the SMA client would not be subject to regulatory IM requirements at least until the next annual calculation period. This approach would remove the costs and complexities of swap dealers having to do simulated IM calculations on an ongoing basis throughout the year and, for asset managers’ SMAs, it would eliminate the additional complexities around potentially negotiating (and renegotiating) the sub-allocations of IM Thresholds and monitoring IM levels across multiple asset managers<sup>18</sup> and unnecessary fire-drills to ensure the documentation and operational set-ups are completed by the time the aggregate regulatory IM across all asset managers is at or near \$50 million.

An added advantage of this approach is that, unlike AANA thresholds where only underlying clients with differing levels of sophistication have full transparency into their aggregate notional exposures, the IM Threshold can be calculated on an annual basis accurately and relatively simply by swap dealers. Additionally, the swap dealers could calculate the IM Thresholds for the relevant AANA calculation periods and pre-determine the narrower client base who may potentially be in scope of the regulatory IM requirements well in

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<sup>16</sup> See 80 Fed. Reg. 57366 (Sept. 24, 2014) (Prudential Regulator’s Proposed Margin and Capital Requirements for Covered Swaps Entities).

<sup>17</sup> See 80 Fed. Reg. 74840, 74857 (Nov. 30, 2015).

<sup>18</sup> Any approach involving a “flat” sub-allocation of the IM Threshold would also be problematic. Under that approach, if an SMA exceeds its assigned sub-allocation (representing a portion of the \$50 million unmargined credit exposure), the SMA would potentially be subject to regulatory IM requirements even though it is unlikely to present systemic risk and, on an aggregate basis, the SMA client might not have exceeded the IM Threshold.

advance of receiving confirmation whether such clients have exceeded the AANA thresholds. The IM Threshold calculations could essentially drive where AANA calculations are necessary, greatly increasing precision, reducing work needed to identify in scope accounts, and providing much needed predictability for all parties.

**(b) Failure to Adopt an Annual Approach to Calculating the IM Threshold Would Make it Even More Critical to Implement Other Scoping Adjustments.**

If the proposal set forth above for annual calculation of the IM Threshold is not adopted, then it is unlikely that the IM Threshold would be a workable and effective scoping tool. It would then be even more critical to raise the current gross notional threshold of EUR/USD 8 billion for Phase V, in addition to implementing an intermediary phase-in as recommended by the July 23, 2019 Statement.<sup>19</sup> The gross notional threshold of EUR/USD 8 billion should be adjusted because most of the counterparties that will come into scope do not contribute materially to systemic risk but will incur the undue costs of compliance.<sup>20</sup>

**(c) Seeded Funds Should Not Be Consolidated with Their Sponsors for Scoping Purposes.**

The AMG continues to urge regulators to not require a seeded fund to aggregate its notional exposures with those of its parent or other commonly consolidated entities for purposes of calculating its AANA.<sup>21</sup> A seeded investment fund is a fund which has received a large portion of its starting capital from a larger fund (a “sponsor”). The relationship between a sponsor and a seeded fund is not analogous to the relationship between a parent company and its subsidiaries. While the sponsor may retain a passive, equity interest in the seeded fund, neither it nor its commonly consolidated entities controls or has transparency into the management or trading of the fund. The seeded fund retains independent management and investment discretion and has independent fiduciary duties to the other investors in the fund (if any). Additionally, the sponsor’s exposure to the seeded fund is capped at its investment, similar to any other passive investment. In the Volcker Rule, the Prudential Regulators recognized that it is common practice to seed funds (in particular, retail funds) in order to build a track record in performance and attract third party investors.<sup>22</sup> Seeded funds typically do not have uncleared swaps exposures that pose significant risks to swap counterparties or the financial system and most will never exchange IM under the UMRs (absent the consolidation requirements) because their swaps exposures will be below the IM Threshold.

It is also worth noting that the EU adoption of the UMRs do not require consolidation for UCITS-regulated funds. This principle should be expanded in the EU to apply to all seeded funds regardless of whether they are EU-regulated and consistently adopted in other jurisdictions. Absent any changes to the AANA consolidation requirements for seeded funds under the existing UMRs, it may become prohibitively expensive for newly seeded funds to use derivatives or FX because of the mandatory IM requirements that they may be subject to and the resulting substantial costs on returns for investors. This would not be due to the fund’s individual swap activity presenting any systemic risk, but solely as a result of the UMR requirement to aggregate

<sup>19</sup> Managed Funds Association, October 25, 2018 letter to BCBS and IOSCO <https://www.managedfunds.org/wp-content/uploads/2018/11/MFA-Letter-UMR-Implementation-Challenges-for-Final-Stages-of-IM-Phase-in.pdf>

<sup>20</sup> See CFTC Analysis, *Initial Margin Phase 5*, October 24, 2018. Can be found at: [https://www.cftc.gov/sites/default/files/About/Economic%20Analysis/Initial%20Margin%20Phase%205%20v5\\_ada.pdf](https://www.cftc.gov/sites/default/files/About/Economic%20Analysis/Initial%20Margin%20Phase%205%20v5_ada.pdf). (referred to hereafter as “CFTC Analysis”). See also Margin Requirements for Non-Centrally Cleared Derivatives – Final Stages of Initial Margin Phase-In, at: <https://www.isda.org/a/5evEE/Initial-Margin-Phase-In-Implementation-Joint-Trade-Association-Comments.pdf>. (referred to hereafter as “ISDA Data”).

<sup>21</sup> See AMG letter to U.S. regulators, March 24, 2016, at <https://www.sifma.org/wp-content/uploads/2017/05/sifma-amg-submits-supplemental-comments-to-multiple-regulators-regarding-request-for-relief-on-final-margin-rules-for-uncleared-swaps-transactions.pdf>.

<sup>22</sup> 12 C.F.R. §248.12(a)(1); see also <https://www.federalreserve.gov/supervisionreg/faq.htm#16>.



its AANA calculations with a sponsor or commonly consolidated entities that may have material swaps exposures, despite those entities having neither transparency as to, nor control over, the fund's trading. In addition, given the disparity between the EU's approach and other jurisdictional requirements, EU regulated funds may choose to only trade with EU dealers and thus, this may result in a shift in liquidity and a competitive disadvantage for US and other markets as some market participants take advantage of the regulatory arbitrage opportunities.

**(d) FX Swaps and Forwards Should Be Excluded From AANA Calculations.**

Physically settled foreign exchange ("FX") swaps and forwards should be removed from calculations of AANA because these products do not, under the rules, independently require IM exchange. AMG recommends this exemption for the same reason that regulators do not require IM to be exchanged under the UMRs. FX swaps and forwards are short-dated and highly liquid transactions that present low long-term or systemic risks. According to the ISDA Data and the CFTC Analysis, approximately 30% of counterparties and relationships will be brought into scope in Phases IV & V solely because of their FX swaps and forwards activity even though their material swaps exposures do not pose a significant risk to the financial system.

It is customary in the FX market for counterparties to extend the settlement date of their trades through a mechanism called a "roll". Rolls are effected by closing out an existing trade and then reopening a new position with the new settlement date. Accounts that roll physically settled FX swaps and forwards over month-ends may account for the large number of entities that are brought into scope in the ISDA Data that do not trade marginable securities. These entities are only brought into scope because of their FX swaps and forwards activity since the value of each nominally separate trade may not be netted in the AANA calculation. As a result, gross currency positions rolled over a month-end would be included three times in the AANA calculation: once for each of the original position, the close and reopen, which artificially inflates AANA.

It is inconsistent for the UMRs to exclude physically settled FX swaps and forwards from the calculation of IM but include them in the calculation of AANA. Derivatives that do not require the exchange of IM under the rules should not be considered when determining whether a counterparty is in scope to exchange margin.

**(e) The EU Equity Option Derogation (and Other Similar Exemptions) Should Be Extended Indefinitely.**

Single stock equity options and stock index options are not currently considered in the calculation of IM under US, EU, Singapore, Hong Kong and Korean UMRs, but equity options will become subject to the IM requirements under those UMRs in early 2020.<sup>23</sup> Thereafter, different rules will apply between US and other markets, creating opportunities for regulatory arbitrage. EU, Singapore, Hong Kong and Korean UMRs should be amended to exempt equity options from IM and variation margin requirements prior to January 2020. The stated reason for the derogation in the EU UMRs still applies to UMRs across all jurisdictions: "to avoid market fragmentation and ensure a level playing field" for local counterparties and to provide a period of time to monitor regulatory developments in other jurisdictions to "ensur[e] that appropriate requirements are

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<sup>23</sup> For EU UMRs, see Regulation No. 2016/2251 of October 4, 2016 Supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council of July 4, 2012 on OTC Derivatives, Central Counterparties and Trade Repositories with Regard to Regulatory Technical Standards for Risk-Mitigation Techniques for OTC Derivative Contracts Not Cleared by a Central Counterparty (as corrected by Commission Delegated Regulation (EU) 2017/323 of January 20, 2017)(the "Margin RTS").

in place in the [local jurisdiction] to mitigate counterparty credit risk in respect of [equity options] whilst avoiding scope for regulatory arbitrage.”<sup>24</sup>

## II. IMPLEMENTATION ISSUES

### (a) **Once the IM Threshold is Close to Being Exceeded or is Exceeded, Grant Time Relief as Needed for Compliance with Regulatory IM Requirements and Develop a Feasible Approach for Allocating the IM Threshold.**

To the extent that the IM Thresholds could not be calculated using the same AANA measurement period, then at least a six-month “moratorium” period that begins when an asset manager receives notice from a swap dealer that the IM Threshold is exceeded should be granted to allow sufficient time for SMAs through their asset managers to complete the necessary documentation and system set-ups. Asset managers are not positioned to undertake immediate action on behalf of SMAs given that they lack transparency to predict when the SMA client’s aggregate IM (across all of its asset managers) with a swap dealer and its affiliates is at or near the IM Threshold. Additionally, swap dealers may unilaterally, and without much advanced notice, decide to halt trading with some or all asset managers for SMAs until they are in compliance with the regulatory IM requirements. Although the moratorium period would be helpful to achieve compliance within a reasonable timeframe, it would not address the problem, as discussed in Part I above, that swap dealers would still need to track hypothetical IM Thresholds daily for all SMA counterparties, even before they were otherwise required to post IM.

In addition, the lack of visibility that makes it practically impossible for asset managers and their SMA clients to calculate the IM Threshold also renders it practically impossible for asset managers to allocate among themselves the IM Threshold for a given SMA client. Again, only the dealers will have the necessary visibility to do so; but, again, they will be faced with serious operational challenges: IM positions, as well as the identity of asset managers a client may employ, may change, thereby potentially affecting how allocations should be made. Currently, we are unaware of any feasible solution to this problem and accordingly we ask that regulators work with market participants to formulate one.

### (b) **Barriers to the Use of Money Market Funds as Eligible Collateral Should Be Eliminated.**

We urge global regulators to eliminate the restrictions and conditions in the various UMRs on the use of money market funds as eligible IM collateral.<sup>25</sup> As acknowledged by global regulators, the vast majority of asset managers and end-user clients historically have used cash as margin for derivatives transactions. This was in large part due to cash being fungible and easily transferrable, and not subject to any margin haircuts. As buy-side market participants have steadily increased the use of tri-party IM segregation arrangements (for both voluntary and mandatory IM) and margin transfer deadlines continue to contract from a regulatory perspective, there has been a growing proliferation of the use of money market funds as a secure and efficient alternative to cash margin. Many client custodians offer money market sweep programs that allow asset managers and end-user clients the continued operational ease of pledging cash into the tri-party accounts and then instructing custodians to sweep such cash into money market fund shares that are pledged as collateral to swap

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<sup>24</sup> The Margin RTS, paragraph (43).

<sup>25</sup> See AMG joint letter to U.S. regulators, August 1, 2019, at <https://www.sifma.org/wp-content/uploads/2019/08/ISDA-Letter-to-US-Regulators-Cash-and-Money-Market-Funds-as-Initial-Margin-8.1.19.pdf>.

counterparties. The eligible money market funds invest predominantly in treasuries and other high quality, short-term government securities. These money market sweep arrangements afford the buy side the ability to efficiently meet margin calls in compressed timeframes without having personnel constantly buying or selling treasuries or other non-cash assets or dealing with odd lot sizes and other settlement issues. Additionally, asset managers and end-user clients can effectively mitigate insolvency risks to the custodians (as non-cash collateral would not be consolidated with the custodian from a supplemental leverage ratio and bankruptcy perspective) and potential negative interest rate charges. Without the ability to broadly use money market funds as eligible IM collateral, asset managers may be forced to liquidate investments and constantly buy and sell other eligible forms of non-cash assets that may be sub-optimal for, or inconsistent with, the client's portfolio strategy and thus could result also in unnecessary costs and operational burdens, negative performance and/or tracking errors.

While the U.S. margin regulations do allow for the use of redeemable securities in a pooled investment fund that holds only U.S. Treasuries (or securities unconditionally guaranteed by the U.S. Treasury) and cash funds denominated in U.S. dollars, this form of eligible collateral is subject to the undue limitation that "*the fund's assets may not be transferred through securities lending, securities borrowing, repurchase agreements, reverse repurchase agreements or other similar means*".<sup>26</sup> To the AMG's knowledge, a significant percentage of all U.S. money market funds engage in some form of these activities in order to mitigate a money market fund's insolvency exposure to its custodian and any consolidation issues with respect to any cash held at the custodian as well as to avoid any cash drag on performance. As a result, this limitation severely reduces the number of eligible money market funds that could be used under the UMRs. AMG finds the imposition of this limitation to be unwarranted and inconsistent with other regulations where regulators have recognized government money market funds as safe, high quality investments, such as CFTC Regulation 1.25 (which governs the investment of customer money by futures commission merchants ("FCMs") without similar restrictions).<sup>27</sup>

Although the EU margin regime, as described in the Margin RTS, includes as eligible collateral cash in the form of a claim for the repayment of money, such as money market deposits<sup>28</sup>, it imposes unnecessary

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<sup>26</sup> 12 CFR 237.6 (CFTC eligible collateral); 12 CFR 237.7 (CFTC segregation of collateral); 12 CFR 45.6 (Comptroller of Currency eligible collateral); 12 CFR 45.7 (Comptroller of Currency segregation of collateral); 12 CFR 237.6 (Federal Reserve eligible collateral); 12 CFR 237.7 (Federal Reserve segregation of collateral); 12 CFR 349.6 (FDIC eligible collateral) 12 CFR § 349.7 (FDIC segregation of collateral); 12 CFR 624.6 (FCA eligible collateral); 12 CFR 624.7 (FCA segregation of collateral); 12 CFR 1221.6 (FIFA eligible collateral); 12 CFR 1221.7 (FIFA segregation of collateral).

<sup>27</sup> Pursuant to Regulation 1.25(c), a money market fund is a permissible investment for customer funds by an FCM so long as it meets certain non-problematic requirements and does not voluntarily elect to be subject to liquidity fees or redemption restrictions (See CFTC Letter No. 16-68 (No Action) Aug 8, 2016). Moreover, Regulation 1.25 specifically permits, subject to certain requirements, FCMs to buy and sell otherwise permitted investments pursuant to repurchase and reverse repurchase agreements.

<sup>28</sup> The CFTC has published "comparability determinations" for margin regulations of the EU and Japan (78 FR 78923 and 78 FR 78878 (EU comparability determination); and 78 FR 78890 and 78 FR 78910 (Japan comparability determination)). These determinations mean that certain U.S. market participants facing European or Japanese counterparties in uncleared swaps should be able to comply with the margin rules of those jurisdictions rather than the CFTC's margin regulations. Similarly, in October 2017, the European Commission adopted an implementing decision that the CFTC margin requirements should be considered equivalent to those provided for under Article 11(3) of Regulation (EU) No 648/2012. This means that counterparties within the scope of the EU margin requirements can fulfil their obligations by complying with the CFTC's margin regulations, where at least one party to the transaction is established in the U.S. and registered with the CFTC as a swap dealer or major swap participant and is subject to the CFTC's margin requirements. While these comparability determinations are helpful, they are of limited utility to asset managers. First, they are effective only with respect to swap dealers or major swap participants that are subject to the jurisdiction of the CFTC and not with respect to the market participants under the regulatory jurisdiction of the Prudential Regulators which asset managers' clients face. Second, asset managers' clients may still be subject to the duplicative and/or conflicting margin rules of multiple jurisdictions, depending on the jurisdictions of each client and swap dealer and other factors, such as a client's principal place of business or where a swap dealer has arranged, negotiated or executed such transactions.

barriers to the use of money market funds as IM<sup>29</sup>, such as (a) the concentration limits applicable to shares or units in UCITS under Article 8(1)(a) of the Margin RTS and (b) the requirement under Annex II of the Margin RTS that the haircut applicable to an interest in a UCIT is the weighted average of the haircuts that would apply to the assets in which the underlying money market fund is invested. Such concentration limits unjustifiably undermine and curtail the effective use of money market fund sweeps as market participants would have to actively monitor such limits and/or potentially use other forms of eligible margin. Similarly, absent the ability for market participants to actively monitor the investments of the underlying money market funds and dynamically amend the associated haircuts in their credit support documents and in their collateral management systems per each money market fund's investments, the haircut requirement is practically unworkable.

**(c) Asset Managers Should Be Permitted to Allocate Partial MTAs at the SMA Level.**

AMG urges regulators to globally adopt the approach outlined in the CFTC's DSIO No-Action Letter 17-12 that allows for asset managers to apply no greater than a USD 50,000 MTA to each separate SMA it manages. This approach offers a workable solution to the operational and documentation burdens that asset managers otherwise have faced since March of 2017 in having to negotiate separate sub-allocations of the EUR/USD 500,000 MTA with each swap dealer *for each SMA (and subsequent amendments thereto)* despite the fact that each manager neither has any control nor transparency as to the number of other asset managers trading with the same dealer for the same SMA client. If such relief is not adopted globally, the operational and documentation challenges will continue to compound as the implementation of regulatory IM with SMAs captures increasingly more counterparties given that the MTA must be further split between regulatory IM and regulatory variation margin per each SMA, asset manager and swap dealer combination.

**(d) Non-Dealers Using ISDA SIMM and Other Globally Approved Models Should Be Exempt from Back-Testing and Model Governance Rules.**

With respect to AMG's request that regulators consider exempting parties using ISDA SIMM and other globally approved models, we refer to the March 17, 2019 letter referred to above.<sup>30</sup> Non-dealers coming into scope during Phases IV and V should not be subject to internal back-testing requirements, and should not be required to comply with the initial margin model approval process when using globally approved IM models such as the ISDA SIMM.

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<sup>29</sup> See AMG Comment Letter, SIFMA AMG's Feedback on European Commission's EMIR Proposal, July 18, 2017, <https://www.sifma.org/wp-content/uploads/2017/07/SIFMA-AMG-Provides-Comments-on-European-Commission-Proposal-to-Amend-EMIR.pdf>.

<sup>30</sup> See ISDA, ALFI and SIFMA letter to ESMA, EBA and EIOPA, March 17, 2019 at [https://www.isda.org/a/Y3tME/2019.05.17\\_EU-Letter\\_IM-Models\\_FINAL.pdf](https://www.isda.org/a/Y3tME/2019.05.17_EU-Letter_IM-Models_FINAL.pdf).

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

Sincerely,

A handwritten signature in black ink, appearing to be 'TC', with a long horizontal line extending to the right.

Tim Cameron, Esq.  
Asset Management Group – Head  
Securities Industry and Financial Markets  
Association

A handwritten signature in black ink, appearing to be 'Jason Silverstein', written in a cursive style.

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

**Appendix III**

**ACLI Letter**



*Carl B. Wilkerson*  
*Vice President & Chief Counsel, Securities*

September 23, 2019

Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, NW  
Washington, DC 20551

Office of the Comptroller of the Currency  
250 E Street, SW  
Mail Stop 2-3  
Washington, DC 20219

Federal Housing Finance Agency  
Eighth Floor, 400 Seventh Street, SW  
Washington, DC 20024

Farm Credit Administration  
1501 Farm Credit Drive  
McLean, VA 22102-5090

Federal Deposit Insurance Corporation  
550 17th Street, NW  
Washington, DC 20429

Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington DC 20581

**Re: The Final Margin Rules for Uncleared Swaps Transactions<sup>1</sup> with respect to Seeded Investment Funds**

The American Council of Life Insurers (“ACLI”)<sup>2</sup> writes to request relief from the application of the final margin rules for uncleared swaps transactions (“Final Margin Rules”) with respect to initial margin (“IM”) upon investment funds initially funded with seed capital by a fund sponsor or affiliate and consolidated on the sponsor’s (or the sponsor’s group’s) financial statements (“seeded funds”) during the three year seeding period following a seeded investment fund’s launch (the “seeding period”).

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<sup>1</sup> Department of the Treasury Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System (the “Federal Reserve”), Federal Deposit Insurance Corporation, Farm Credit Administration and Federal Housing Finance Agency Margin and Capital Requirements for Covered Swap Entities; Final Rule, 80 Fed. Reg. 74840 (Nov. 30, 2015). Commodity Futures Trading Commission (the “Commission”), Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants; Final Rule, 81 Fed. Reg. 636 (January 6, 2016).

<sup>2</sup> The American Council of Life Insurers (ACLI) is a national trade association with 280 member companies that represent 95 percent of industry assets, 92 percent of life insurance premiums, and 97 percent of annuity considerations in the United States. Our members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance that 75 million American families rely on for financial and retirement security.

Specifically, we ask that the Prudential Regulators and Commission take the following actions in order to provide relief to seeded funds with respect to the application of the Final Margin Rules to funds seeded in good faith:

1. Provide publicly announced compliance/examination guidance to their supervisory staff that they should deprioritize compliance with and enforcement of the Final Margin Rules with respect to seeded funds until such time as the Prudential Regulators and Commission can engage in limited rulemaking to provide relief on this topic.<sup>3</sup>
2. Engage in limited rule making exercise to exclude seeded investment funds from the definition of a consolidated group by incorporating the following language into the Final Margin Rules:

Investment funds that are managed by an investment advisor are considered distinct entities that are treated separately when applying the threshold (as long as the funds are distinct legal entities that are not collateralized by or are otherwise guaranteed or supported by other investment funds or the investment advisor in the event of fund insolvency or bankruptcy) and shall not be considered to be an “affiliate” or “margin affiliate” of any other entity for a period of three years after such investment fund commences trading.<sup>4</sup>

This language is drawn directly from the BCBS/IOSCO final statement on margin requirements for non-centrally cleared derivatives and is consistent with the approach taken by regulators in other jurisdictions, including the EU, Japan and Canada, with the exception that the BCBS/IOSCO language and foreign regulators have not included any time limitation on the exclusion.

The Final Margin Rules require financial entities within a corporate group that are consolidated from an accounting perspective, where the corporate group has material swaps exposure (“MSE”) to post and collect IM as long as the swap activities of the consolidated group remain above the MSE threshold. This group approach has the logical and appropriate result of capturing entities within a corporate group whose uncleared swap activity alone does not meet the MSE threshold but whose relationship to one or more large users of uncleared swaps might pose a systemic risk to the financial system. It prevents a financial entity from dividing up its uncleared swap activities among several affiliated entities under common control to evade the Final Margin Rules. However, the consolidation rule requires seeded funds that are sponsored by entities with MSE to post and collect IM during the temporary phase in which the funds are consolidated with their sponsors even though a variety of safeguards exists to limit the sponsor’s control of these funds.

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<sup>3</sup> This approach would be consistent with the approach taken by the Prudential Regulators and the Commission with respect to the delay of the compliance with the variation margin requirements of the Final Margin Rules in 2017. See Fed Supervisory Letter SR 17-3 (February 22, 2017), OCC Bulletin 2017-2 (February 23, 2017) and CFTC Staff letter 17-11 (February 13, 2017).

<sup>4</sup> This approach would be consistent with the rule adopted by the Prudential Regulators and the Commission to amend the definition of “eligible master netting agreement” in the Final Margin Rules in order to bring the Final Margin Rules into compliance with the QFC Rules adopted by the Prudential regulators with respect to certain qualified financial contracts entered into by global systemically important banking institutions. See 83 Fed. Reg. 50805-50813 (October 10, 2018) and 83 Fed. Reg. 60343-60347 (November 26, 2018).



As discussed below, the ACLI is requesting relief from the requirement of seeded funds that are sponsored by entities with MSE from having to post and collect IM during the seeding period given that:

1. There are multiple contractual, structural, fiduciary and regulatory safeguards to prevent the use of seeded funds by a sponsor to avoid or evade the requirements of the Final Margin Rules with respect to the sponsor's own obligations.
2. Seeded funds that do not separately exceed the MSE threshold do not pose systemic risk to the financial system during the seeding period.
3. Seeded funds, as financial entities, are required to post variation under the Final Margin Rules.
4. Such relief would harmonize the Final Margin Rules with the intent of the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions ("BCBS/IOSCO") "Margin requirements for non-centrally cleared derivatives" (the "framework") and provide US fund sponsors with a level playing field vis-a-vis their global counterparts.
5. Such relief would be consistent with the Federal Reserve's treatment of seeded Funds under the Volcker Rule.
6. Requiring seeded funds to post IM during the seeding period poses a significant operational challenge to both fund sponsors and their trading counterparties, with little benefit in terms of systemic risk reduction.

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**1. There are multiple contractual, structural, fiduciary and regulatory safeguards to prevent the use of seeded funds by a sponsor to avoid or evade the requirements of the Final Margin Rules with respect to the sponsors own obligations.**

When the Final Margin Rules were adopted, the rules release (the "Release") addressed commenters' concerns regarding the definition of "affiliate" by adopting an accounting consolidation standard rather than a control standard.<sup>5</sup> The Prudential Regulators declined to exclude seeded funds in the adopting

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<sup>5</sup> The Final Margin Rules use an accounting consolidation standard, defining as an "affiliate" and as a "margin affiliate" any company that consolidates with another company on the other company's financial statements, or that is consolidated with the other company on the financial statements of a third company, under applicable accounting standards 80 Fed. Reg. 74840, 74899 ("Affiliate"); 81 Fed. Reg. 636, 697 ("Margin affiliate"). The term "margin affiliate" used in this letter refers to both definitions.

rules release because in their view managers could use these vehicles to evade the purposes and intent of the Final Margin Rules.<sup>6</sup>

The Release indicates that margin affiliates are included in calculations of MSE and the initial margin threshold amount ("IMTA") as a simplified means to prevent companies from using shell companies and netting sets without economic basis to evade margin requirements.<sup>7</sup> As discussed below, the structural, fiduciary and contractual features of seeded funds provide crucial safeguards not addressed or recognized by the Final Margin Rules that would prevent fund sponsors and/or fund managers from using seeded funds to evade their own obligations with respect to IM. Further, additional regulatory safeguards are in place to address an entity that uses seeded funds in an abusive, evasive manner, allowing the Prudential Regulators or the Commission to rely on their anti-evasion authority to prevent such activity.

For several reasons, seeded funds should not raise anti-evasion concerns. Seeded funds are created for a bona fide business and economic purpose, are typically overseen by an independent board (or equivalent) and are always managed by an investment advisor having fiduciary duties to the entity in accordance with a specified investment program. Further, seeded funds are distinct legal entities and, unlike arrangements often present among corporate affiliates, are not collateralized by or otherwise supported by the fund sponsor (apart from the fund sponsor's initial contribution of seed capital) or any other entity (apart from such entity's initial contribution of seed capital).

Additionally, all seeded funds are distinct legal entities that are managed by an investment manager pursuant to an investment management agreement that, among other things, requires the assets of the fund to be managed in accordance with predetermined, specified investment guidelines, objectives and strategies and not capriciously at the desire of the fund sponsor or manager. To suggest that a fund under such circumstances should be treated like any other corporate affiliate is inconsistent with these overriding structural, fiduciary and contractual safeguards.

While a sponsor to a seeded fund has influence on the fund beyond that of a passive, unaffiliated investor, a seeded fund is not the same as a corporate affiliate. For example, seeded funds that are registered as management companies under the Investment Company Act of 1940 (the "ICA") (e.g., mutual funds) are overseen by an independent board of directors/trustees and managed by a registered investment advisor that has fiduciary duties of care and loyalty to the fund and *all* investors in the fund. Similar features are present for unregistered funds (e.g., hedge funds and private equity funds) relying on an exemption from registration under Section 3(c)(1) or 3(c)(7) of the ICA.

Further, most seeded funds rely on one of two de minimis usage exemptions from registration as a commodity pool under the U.S. Commodity Exchange Act – Rule 4.5 with respect to registered investment funds and Rule 4.13(a)(3) with respect to unregistered investment funds.<sup>8</sup> To the extent

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<sup>6</sup> 80 Fed. Reg. 74840, 74860; 81 Fed. Reg. 636, 647.

<sup>7</sup> 80 Fed. Reg. 74840, 74863; 81 Fed. Reg. 636, 651.

<sup>8</sup> For benefit of the Prudential Regulators – a commodity pool that relies on either Rule 4.5 or Rule 4.13(a)(3) must satisfy one of the following de minimis tests:

- 5% test: the aggregate initial margin and premiums required to establish commodity interest positions do not exceed 5% of the liquidation value of the Fund's portfolio, after taking into account

that a seeded fund's use of derivative products exceeds the de minimis thresholds set forth in these two rules, the fund must register with the Commission as a commodity pool and report additional information to the Commission with respect to the relevant pool's use of commodity interests (thus giving the Commission even greater ability to ensure that the seeded fund is not being used to evade the requirements of the Final Margin Rules).

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## **2. Seeded funds do not pose systemic risk to the financial system during the seeding period.**

Investment funds at the seeding phase tend to be small and, as a result, do not typically have uncleared swaps exposure that would present significant risk to a swap counterparty or the financial system. Despite not being guaranteed by their plan sponsor, such funds are treated as having MSE as if they did pose a systemic risk to the financial system.<sup>9</sup> It is also worth pointing out that funds seeded by sponsors that do not belong to corporate groups with MSE but that otherwise are of similar size and pursue similar strategies during the seeding period would not be subject to these IM posting requirements.

As an odd result, when such funds grow larger and have more of a market impact, the sponsor's percentage ownership in them drops; they cease to be margin affiliates; and they no longer have to post IM unless their individual notional amount of uncleared derivatives crosses the MSE threshold.

Sampling the members of the ACLI, the majority of entities that responded were concerned about this issue. Even if it did not directly impact them at the current time, they acknowledged the chilling effect the Final Margin Rules would have on their future product offerings in terms of drag to performance and operational costs. Using a small sampling of insurance companies, consolidated families of insurance companies averaged 8 in scope seeded funds, with an average AUM of \$96mm and an average notional exposure of \$32mm.

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## **3. Seeded funds already post variation under the Final Margin Rules.**

Seeded funds remain subject to the variation margin requirements of the Final Margin Rules and will still be required to post at a minimum the required regulatory collateral on a daily basis, thus mitigating any risk such funds might pose to the overall financial system.

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unrealized profits and losses on such positions. (4.5 accounts may exclude "bone fide hedging" transactions.)

- **Net notional value test:** the aggregate net notional value of commodity interest positions, determined at the time the most recent position was established, does not exceed 100% of the liquidation value of the Fund's portfolio, after taking into account unrealized profits and losses on such positions.

<sup>9</sup> Dollar amounts for IM posted by any individual investment fund will vary based on strategy, use of derivatives and the size of the fund. However, it is expected that most of such funds will post IM in amounts below \$1 million – and in many cases below \$100,000 – at any given time.

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**4. The Requested Relief would harmonize the Final Margin Rules with the intent of the BCBS/IOSCO Framework and provide US fund sponsors with a level playing field vis-a-vis their global counterparts.**

The Final Margin Rules differ from the recommendations set out in the BCBS/IOSCO's Framework. While the BCBS/IOSCO recommends that the IMTA be measured on a consolidated group basis to "prevent the proliferation of affiliates and other legal entities within larger entities for the sole purpose of circumventing the margin requirements" (see Commentary at 2(ii)), BCBS/IOSCO excludes all investment funds noting that, "[i]nvestment funds that are managed by an investment advisor are considered distinct entities that are treated separately when applying the threshold as long as the funds are distinct legal entities that are not collateralised by or are otherwise guaranteed or supported by other investment funds or the investment advisor in the event of fund insolvency or bankruptcy." (See Requirement 2 at FN 10). By not excluding seeded funds under the rules applied in the U.S., funds seeded by U.S. sponsors are disadvantaged as compared to their non-U.S. equivalents.

Financial Regulators in Europe, Canada, Japan, Hong Kong and Australia have adopted BCBS/IOSCO's Framework with respect to all investment funds that are not collateralized, supported or otherwise guaranteed by the sponsor with MSE.<sup>10</sup> For example, on October 4, 2016, the Joint Committee of the European Supervisory Authority published a regulatory technical standard in which they adopted the BCBS-IOSCO Framework stating:

While the thresholds should always be calculated at group level, investment funds should be treated as a special case as they can be managed by a single investment manager and captured as a single group. Where the funds are distinct pools of assets and they are not collateralised, guaranteed or supported by other investment funds or the investment manager itself, they are relatively risk remote from the rest of the group. Such investment funds should therefore be treated as separate entities when calculating the thresholds. This approach is consistent with the BCBS-IOSCO framework.<sup>11</sup>

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<sup>10</sup> See *Margin Requirements for Non-Centrally Cleared Derivatives* by the Office of the Superintendent of Financial Institutions of Canada effective as of June 2017. <http://www.osfi-bsif.gc.ca/Eng/Docs/e22.pdf>. The JFSA published the final Japanese margin rules on March 31, 2016 by way of amendments to the Cabinet Office Ordinance concerning Financial Instruments Business, etc. as one of the subordinate regulations of the Financial Instruments and Exchange Act. The Australian Prudential Regulation Authority (APRA) adopted the BCBS-IOSCO Framework through the Banking, Insurance, Life Insurance and Superannuation (prudential standard) determination No. 1 of 2017 Standard CPS 226 Margining and risk mitigation for non-centrally cleared derivatives.

<sup>11</sup> Paragraph 13 of COMMISSION DELEGATED REGULATION (EU) 2016/2251 of 4 October 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty. 2016 O.J. L340/11 <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R2251&qid=1566229674235&from=EN>

This European guidance was published after the Final Margin Rules were adopted and so did not give the Prudential Regulators or the Commission time to consider this point for harmonization.

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**5. The Requested Relief would be consistent with the Federal Reserve’s treatment of seeded funds under the Volcker Rule.**

The request relief is consistent with the treatment of seeded funds under the Volcker Rule. In answers to frequently asked questions published on July 16, 2015, the Federal Reserve elected to exclude seeded funds from the requirements of the Volcker Rule during a three year seeding period.<sup>12</sup> Our suggested adjustments would level the playing field between banks and life insurance and asset management firms by providing all three types of business the opportunity to seed funds without confronting a host of complex regulatory challenges.

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**6. The operational burden of requiring seeded funds to post IM during the seeding period poses a challenge to both fund sponsors and their trading counterparties.**

Under the Final Margin Rules, seeded funds will need to negotiate and complete complex margin documentation and develop compliance infrastructure to handle the posting and receiving of IM at a cost not commensurate with their risk to the financial system. Because of their small size, such funds may be less able to complete the required documentation and infrastructure as counterparties and custodians address similar documentation across their client base – faced with a bottleneck, such counterparties and custodians are likely to prioritize larger AUM clients.

Unlike larger entities that are not consolidated, seeded funds may not be able to take advantage of the IMTA, or such relief may be limited, because of potential fiduciary conflicts as between the fund, the investment advisor, the ultimate parent and other affiliates of the parent. This may be particularly acute for life insurance companies with fiduciary duties to mutualized policyholders or shareholders. For example: determining an equitable division of the IMTA relief between the ultimate parent’s hedging activity and the seeded fund’s derivatives activity (in a list of funds that will constantly change) may be difficult to determine (or monitor) as the parent owes fiduciary duties to one group, while the fund investment advisor may owe them to different groups of investors in its various seeded funds. During this time period, investors in the seeded funds may be effectively bearing costs of IM because of uncleared OTC derivatives activity in entities and funds they did not invest in (without corresponding benefits).

It is worth emphasizing that the operational complexities of complying with the Final Margin Rules will present an ongoing set of challenges rather than just an initial hurdle at the appropriate phase-in date for these rules. As seeded funds gather outside investors or are wound down and cease to be consolidated with their sponsors and new funds are seeded, reallocations of the shared IMTA will need to be renegotiated.

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<sup>12</sup> See Question 16 of Volcker Rule - Frequently Asked Questions. Available at: <https://www.federalreserve.gov/supervisionreg/faq.htm#5>

Exacerbating these technical challenges, many companies that are consolidated for financial purposes remain distinct operationally. As a result, they may not have the ability to easily share the exposure information required to manage the IMTA. Even if they are able to share in the IMTA, the constant burden of having to renegotiate documentation to support the allocation of the IMTA between an ever-changing group of seeded funds will impose burdens on both the seeded funds and their trading counterparties.

Further, MSE calculations under the Final Margin Rules are required to be performed during June, July and August for implementation in January. If an insurance company sponsored a new fund today, it would look to whether the Affiliate group had MSE during such time frame. Although the entity did not exist, a fund would be immediately in scope for trading IM and would not have an opportunity to fall out of scope until the second following January, more than 15 months later. This is despite the fact that the fund in question may have only been consolidated for a short period.

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In conclusion, the ACLI along with other industry bodies such as SIFMA AMG first brought the issue of seeded funds to the attention of the Prudential Regulators and the Commission as a part of a number of issues raised with respect to the Final Margin Rules.<sup>13</sup> We are revisiting this issue now to ensure that the Prudential Regulators and Commission are fully aware of the multiple contractual, structural, fiduciary and regulatory safeguards to prevent the use of seeded funds by a sponsor to avoid or evade the requirements of the Final Margin Rules. Additionally, with respect to the sponsor's own obligations and to emphasize the regulatory developments globally with respect to this issue so that the Prudential Regulators and Commission might take advantage of this opportunity for harmonization.

The ACLI has been supportive of the regulatory initiative to increase systemic financial stability by requiring the posting and collection of margin for uncleared swaps. Indeed, most of our members have been required by state insurance law to exchange variation margin with their counterparties long before the Final Margin Rules came into place.

The relief we seek would align U.S. regulations on this issue more closely with the analogous regulations of the E.U. and other international regulators. More practically, it will provide some additional relief in lessening the significant work to be done by banks, insurers and asset managers to implement the final phases of the Final Margin Rules. Indeed, BCBS/IOSCO recognized the daunting task before the industry in adding a Phase 6 to the rule and clarifying that documentation need not be in place before relevant parties near the IMTA.

As ACLI members prepare to meet the requirements under Phase 5 of the Final Margin Rules, we ask that the Prudential Regulators reconsider a minor aspect of the Final Margin Rules that we believe will place an undue operational burden on insurance companies that provide seed capital to investment funds, with little benefit in reduced systemic risk.

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<sup>13</sup> See ACLI Submission on Prudential Regulators' Reproposed Rule on Margin and Capital Requirements for Covered Swap Entities (November 24, 2014) and ACLI Submission on CFTC Request for Supplemental Comment on Proposed Rule Governing Margin and Collateral for Uncleared Swap Transactions (September 14, 2012).

We greatly appreciate your attention to this issue. If any questions develop, please let me know.

Sincerely,

*Carl B. Wilkerson*

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