



January 19, 2016

Chairman Timothy G. Massad
Commissioner Sharon Y. Bowen
Commissioner J. Christopher Giancarlo
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

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

Chair Janet L. Yellen
Board of Governors of the Federal Reserve
System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Chairman and CEO Kenneth A. Spearman
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Director Melvin L. Watt
Federal Housing Finance Agency
Eighth Floor, 400 Seventh Street, SW
Washington, DC 20024

Chairman Martin J. Gruenberg
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Final Margin Rules for Uncleared Swaps Transactions¹

To Whom It May Concern:

The Asset Management Group (“AMG”)² of the Securities Industry and Financial Markets Association (“SIFMA”) writes to raise a time-sensitive issue regarding the application of the final margin rules for uncleared swaps transactions (“Final Margin Rules”) upon investment funds initially funded with seed capital by a sponsor and consolidated on the sponsor’s or the sponsor’s group’s financial statements (“seeded investment funds”).

¹ Department of the Treasury Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, 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, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants; Final Rule, 81 Fed. Reg. 636 (January 6, 2016).

² AMG’s members represent U.S. asset management firms whose combined assets under management exceed \$30 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds, undertakings for collective investments in transferable securities (“UCITS”) and private funds such as hedge funds and private equity funds.

The definitions of “affiliate” and “margin affiliate” adopted in the Final Margin Rules will negatively impact seeded investment funds.³ We believe that this negative impact, discussed below, was not fully considered by the Prudential Regulators or Commission,⁴ particularly given that the resulting impact is inconsistent with both the purpose of and policy behind the Final Margin Rules and the direction taken in other regulations, including the Volcker Rule.⁵

We request that the Prudential Regulators and Commission provide permanent relief to address this issue with temporary relief in the interim so that seeded investment funds are not disadvantageously treated as margin affiliates of their sponsors for the September 2016 phased-in compliance date under the Final Margin Rules and thereafter. Given the documentation requirements and system investments that unexpectedly will be needed for some seeded investment funds in the absence of relief, this matter requires urgent attention if any meaningful relief will be provided.

Seeded investment funds should not be consolidated for margin calculation purposes on the basis of accounting standards. The problematic application of the Final Margin Rules to seeded investment funds stems from the Final Margin Rules’ definitions of “affiliate” and “margin affiliate,” keystones for margin calculations under the Final Margin Rules, and which affect the threshold calculation of material swaps exposure (“MSE”) and the calculation and allocation of the initial margin threshold amount (“IMTA”). The Final Margin Rules use an accounting consolidation standard, defining as an “affiliate” and 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.⁶ MSE, in turn, is defined to mean the average daily aggregate notional amount of specified, uncleared swaps and forwards for the entity *and its*

³ AMG provided extensive comments on prior proposals regarding margin for uncleared swaps and expressed concerns relating to passive investors and seeded investment funds under the proposed requirements, *see, e.g.*, AMG’s 2014 letter to multiple regulators at 10-12, *available at*: <https://www.sifma.org/comment-letters/2014/sifma-amg-submits-comment-letter-to-multiple-regulators-regarding-margin-and-capital-requirements-for-covered-swap-entities/>. As discussed herein, these concerns were not addressed by the Final Margin Rules’ re-formulated definition of “affiliate” or “margin affiliate.”

⁴ The Prudential Regulators, as used herein, means the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Farm Credit Administration and the Federal Housing Finance Agency. The Commission, as used herein, means the Commodity Futures Trading Commission.

⁵ Dodd-Frank Wall Street Reform and Consumer Protection Act § 619, 12 U.S.C. § 1851.

⁶ 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.

margin affiliates.⁷ Likewise, ITMA is defined to mean aggregate credit exposure of \$50 million resulting from all uncleared swaps between a covered swap entity and its margin affiliates on the one hand, and a covered counterparty *and its margin affiliates* on the other.⁸

Seeded investment funds do not have uncleared swaps exposures that pose significant risks to swap counterparties or the financial system, and have a markedly different relationship with their sponsor than an ordinary corporate affiliate. A seeded investment fund will typically have more than 50% ownership from a fund sponsor and, as a result, will generally be consolidated onto the sponsor's financial statements and be the sponsor's margin affiliate under the Final Margin Rules. 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. While a sponsor of a seeded investment fund has influence over the fund beyond that of a passive, unaffiliated investor, a seeded investment fund is by no means the same as a corporate affiliate. For example, seeded investment funds that are registered as management companies under the Investment Company Act of 1940 (the "40 Act") are overseen by an independent board of directors/trustees and managed by a registered investment adviser that has fiduciary duties of care and loyalty to the fund and *all* investors in the fund. Similar features are present for unregistered funds relying on an exemption from registration under Section 3(c)(1) or 3(c)(7) of the '40 Act. Additionally, all seeded investment funds are distinct legal entities that are managed by an investment adviser pursuant to an investment advisory agreement that, among other things, requires the assets of the fund to be managed in accordance with specified investment guidelines, objectives and strategies and not capriciously at the desire of the fund sponsor. 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. Notwithstanding these characteristics, the Final Margin Rules provide no exclusion for seeded investment funds from consolidated margin calculations.⁹

⁷ 80 Fed. Reg. 74840, 74901; 81 Fed. Reg. 636, 697.

⁸ 80 Fed. Reg. 74840, 74901 ("Initial margin threshold amount"); 81 Fed. Reg. 636, 697 ("Initial margin threshold amount").

⁹ In this result, the Final Margin Rules differ from the recommendations set out in 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, *available at: <http://www.bis.org/bcbs/publ/d317.htm>* (March 2015). While the BCBS/IOSCO recommendations similarly measure initial margin threshold 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," "[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* Commentary at 2(ii) and Requirement 2 n.10. The Final Margin Rules' departure from the BCBS/IOSCO standard disadvantages seeded investment funds in the U.S.

Inclusion of seeded investment funds with the sponsor’s MSE and IMTA calculations will negatively impact seeded investment funds and is inconsistent with the purpose and policy of the Final Margin Rules. Given that a seeded investment fund will often be consolidated on the sponsor’s financial statements, MSE calculations of the seeded investment fund will include the sponsor along with any other margin affiliates of the sponsor and, if the threshold is exceeded, will require even the smallest seeded investment fund to post initial margin when, absent the application of the margin affiliate definition, it would not be required to do so. If the sponsor has a swap dealer affiliate or is in a family of companies that includes a financial company, a large corporate or insurance entity that uses swaps for hedging, this result will be a foregone conclusion.

This outcome is not consistent with the intended purposes of measuring uncleared swaps exposure on a consolidated basis. For example, the Final Margin Rules’ releases indicate that margin affiliates are included in calculations of MSE and IMTA as a simplified means to prevent companies from using shell companies and netting sets without economic basis to evade margin requirements.¹⁰ These concerns, however, are not implicated in the case of seeding new investment funds; seeded investment 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 adviser having fiduciary duties to the entity in accordance with a specified investment program. Further, seeded investment 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.

Requiring seeded investment funds to post initial margin along with the largest swap dealers and counterparties, potentially beginning as early as September 2016, is also illogical given that (i) seeded investment funds typically have small, uncleared swaps exposures that do not pose significant risks to swap counterparties or the financial system; (ii) the sponsor does not exercise corporate control over the investment fund, (iii) the seeding is temporary; and (iv) the sponsor’s ownership percentage will diminish as unaffiliated investors join the fund. While the Final Margin Rules’ releases indicate the view that the treatment of newly seeded investment funds is appropriate because the sponsor may own up to 100 percent of the fund,¹¹ as discussed above, the structural, fiduciary and contractual features of seeded investment funds provide crucial safeguards not addressed or recognized by the Final Margin Rules. Further, if in fact an entity uses seeded investment funds in an abusive, evasive manner, the Prudential Regulators or the Commission can use their anti-evasion authority to counter such activity.

Applying the margin affiliate definition to seeded investment funds will also cause the uncleared swaps activity of a seeded investment fund to be impacted by unrelated swaps activity of the sponsor and the sponsor’s other margin affiliates (including the sponsor’s other seeded investment funds) through both the MSE and IMTA calculations, and lead to problems for

¹⁰ 80 Fed. Reg. 74840, 74863; 81 Fed. Reg. 636, 651.

¹¹ 80 Fed. Reg. 74840, 74860; 81 Fed. Reg. 636, 647.

investment advisers managing seeded investment funds. For example, where the sponsor has multiple seeded investment funds, the uncleared swaps activity and the MSE calculations of one fund will impact the MSE calculations of the others in determining whether any must post initial margin, and the IMTA will need to be shared among the funds (notwithstanding their entirely separate investment activities) for any common swap dealer counterparty. Because the posting of initial margin causes funds to incur costs and, as such, impacts fund performance, the sharing of these calculations across funds leads to problems and complexities that ultimately will negatively impact unaffiliated investors. These complexities are only increased in cases where there are multiple investment advisers to seeded investment funds that are consolidated on the balance sheet of a single sponsor. Funds must be managed independently from each other and their sponsors. Yet the Final Margin Rules' calculations require that the uncleared swaps activity of seeded investment funds be managed and monitored on a consolidated basis, potentially requiring decisions that pit one seeded investment fund against others that are margin affiliates as well as against their sponsors and their sponsors' other margin affiliates (such as in allocations of the IMTA).

AMG requests a temporary exclusion of seeded investment funds from consolidated margin calculations followed by a permanent solution to exclude seeded investment funds. Because seeded investment funds' MSE calculations need to include the sponsor and its other margin affiliates, some seeded investment funds will unexpectedly be required to begin posting initial margin along with the largest swaps users in September 2016—ahead of virtually all other funds. Seeded investment funds will need to put into place new custodial arrangements and credit support documentation, including control agreements, which, while needed during the seeding period as a result of the margin affiliate definition, will not be required when their sponsors' ownership falls below 50% as unaffiliated investors join the funds. These steps were reasonably not anticipated by seeded investment funds, their sponsors and their investment advisers. As such, AMG asks as a matter of urgency that temporary relief be provided to exclude seeded investment funds from consolidated margin calculations for the September 2016 phased-in compliance date.

Once temporary relief has been provided, AMG requests that the Prudential Regulators and the Commission provide a permanent exclusion for seeded investment funds from consolidated margin calculations. When similar issues were considered under the Volcker Rule, the Prudential Regulators and Commission excluded seeded investment funds for an initial three-year seeding period and further clarified this exclusion through an FAQ released in July 2015.¹² Seeded investment funds should be similarly excluded under the Final Margin Rules.

For these reasons, we request that the Prudential Regulators and the Commission provide relief from the Final Margin Rules for Uncleared Swaps Transactions to exclude seeded investment funds from consolidated margin calculations.

¹² Volcker FAQ update re Seeded Funds (posted 7/16/2015), *available at*: www.federalreserve.gov/bankinfo/volcker-rule/faq.htm#16.

We appreciate your consideration of this matter. We stand ready to provide any additional information or assistance that the Prudential Regulators or the Commission might find useful. Should you have any questions, please do not hesitate to contact Tim Cameron at 202-962-7447 / tcameron@sifma.org or Laura Martin at 212-313-1176 / lmartin@sifma.org.

Respectfully submitted,



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



Laura Martin
Managing Director and Associate General
Counsel
Asset Management Group
Securities Industry and Financial Markets
Association

cc: Governor Daniel Tarullo
Scott Alvarez, General Counsel
Mr. Michael Gibson, Director, Division of Banking
Supervision and Regulation
Mr. Mark Van Der Weide, Deputy Director,
Division of Banking Supervision and Regulation
Mr. Felton Booker, Senior Advisor, Division of
Banking Supervision and Regulation
Board of Governors of the Federal Reserve System

Mr. Paul Nash, Senior Deputy Comptroller and Chief of Staff
Ms. Amy Friend, Senior Deputy Comptroller and Chief Counsel
Office of the Comptroller of the Currency

Mr. Bobby Bean, Associate Director, Capital Markets Branch
Federal Deposit Insurance Corporation

Mr. Jeffrey Bandman
Commodity Futures Trading Commission