

September 14, 2015

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
3 Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: **Comment Letter on Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Proposed Rule on the Cross-Border Application of the Margin Requirements (RIN 3038-AC97)**

Dear Mr. Kirkpatrick:

The Asset Management Group (“AMG”) of the Securities Industry and Financial Markets Association (“SIFMA”)¹ welcomes the opportunity to provide the Commodity Futures Trading Commission (the “Commission”) with comments regarding the Commission’s proposed rules (the “Proposal”)² on the cross-border application of its uncleared swap margin requirements for swap dealers and major swap participants that do not have a Prudential Regulator (“CSEs”).³

AMG’s members believe strongly in the importance of robust counterparty protection in the swaps marketplace. In our previous letters on this topic to the

¹ 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 (“ERISA”) pension funds, and private funds such as hedge funds and private equity funds. For more information, visit <http://www.sifma.org/committees/asset-management-group/asset-management-group-%28amg%29/overview/>.

² Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements; Proposed Rule, 80 Fed. Reg. 41,376 (July 14, 2015) [hereinafter “Proposal”].

³ In this letter, “Prudential Regulator” refers to the Board of Governors of the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Authority.

Commission, we have advocated for bilateral margin exchange and other elements that we believe can better protect our clients and the United States financial system.⁴ However, we believe that it is critical that any regime put into place build upon, and not undermine, the significant market-driven developments that have led to an effective margining regime for the buy-side, across national boundaries, for many years. For example, it is critical that any margin proposal developed by the Commission not complicate close-out netting between counterparties, which undoubtedly reduces systemic and legal risk in the swap market, as evidenced by the effectiveness of such netting provisions during the recent financial crisis.

Unfortunately, we believe that the Commission's Proposal would unintentionally prove a significant roadblock to the continued realization of existing benefits of market protections and would introduce material operational and settlement risks to a regime whose sole purpose is the mitigation of risk. The Proposal's complex array of rules defining the applicability of the Commission's margin requirements and the limited availability of substituted compliance would cause uncertainty in determining which rules would apply to a specific CSE-counterparty pair. This could result in market participants fragmenting their trading, which could complicate close-out netting and lead to margin disputes and other operational risks. The rules covering substituted compliance are also highly complex, increasing uncertainty around the proper application of margin rules and, therefore, increasing rather than decreasing systemic risk.

The challenges raised by such complexity are particularly acute for asset managers, who frequently enter into block trades on behalf of dozens or even hundreds of underlying clients. The Commission's Proposal would subject the different underlying clients to different margin treatment, which would make pricing and executing block transactions significantly more difficult. Layering such complexity on top of substantive margin rules that impose significant operational and implementation burdens, including re-documenting master trade agreements, as well as determining material swap entity thresholds, initial margin models and types of eligible collateral, may lead to heightened systemic risk, thereby contradicting the underlying purpose of margin as a risk-mitigation tool. In sum, the Proposal risks destroying the market-developed protections that have allowed for the efficient and safe functioning of global markets.

Instead, we urge the Commission to adopt an approach that will allow dealers and buy-side participants to comply with a single set of margin requirements for all of their

⁴ See, e.g., Letter from Timothy W. Cameron, Managing Director, Asset Management Group, SIFMA to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, et al., Comment Letter on Proposed Rules Related to Margin for Uncleared Swaps (July 11, 2011), available at: <http://www.sifma.org/issues/item.aspx?id=8589934662> [hereinafter "2011 Substantive Margin Requirements Letter"]; Letter from Timothy W. Cameron, Managing Director, Asset Management Group, SIFMA et al. to Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission, et al., Comment Letter on the Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (RIN 3038-AC977) (Nov. 24, 2014), available at: <http://www.sifma.org/issues/item.aspx?id=8589952198> [hereinafter "2014 Substantive Margin Requirements Letter"].

uncleared swaps with each other, regardless of the trading or booking location of those uncleared swaps, as long as that set of margin requirements is consistent with the international standards of the BCBS/IOSCO Framework.⁵ Through the BCBS/IOSCO process, the Commission has coordinated with the Prudential Regulators, the Securities and Exchange Commission (“SEC”) and foreign regulators to develop a framework that, we believe, is generally appropriate to decrease systemic risk through the posting and collection of uncleared swap margin.⁶ The Commission’s substantive uncleared swap margin rules closely adhere to the BCBS/IOSCO Framework and, therefore, an approach that permits a CSE and its counterparties to comply with a single set of margin requirements consistent with the Framework would achieve the key goals of the Dodd-Frank Act and the Commission’s underlying margin rules. Such an approach would also decrease complexity and resulting operational and settlement risks, including those that would be introduced by the differences between the Commission’s Proposal and its Cross-Border Guidance.⁷ Under such an approach, for example, asset managers should be able to execute a block transaction knowing that all clients will be subject to the same margin requirements, which will simplify trading and minimize operational risk.

We have organized this letter into our three primary observations on the Proposal. We begin by describing issues related to the complexity of the Proposal, and provide detailed recommendations on how problems resulting from this complexity can be avoided. We then describe the problems that arise from the differences between the Proposal and the Commission’s Cross-Border Guidance, and provide related recommendations. Finally, we describe the need for an appropriate implementation period. A summary of the observations and recommendations follow, and further detail is provided in the remainder of this letter.

- **Observation 1:** The Proposal includes highly complex rules that define the application of the Commission’s substantive swap requirements and the availability of substituted compliance. These rules do not recognize the fact that global asset managers often trade in blocks for multiple clients with similar trading strategies. The application of different substantive rules to such transactions will result in a system that is fragmented and more prone to systemic risk.

⁵ Specifically, we refer here to the consensus reached through the development of the Basel Commission on Banking Supervision (the “Basel Commission”) and the Board of the International Organization of Securities Commissions’ (“IOSCO”) (together with the Basel Commission, “BCBS/IOSCO”) September 2013 framework “Margin requirements for non-centrally cleared derivatives,” updated in March 2015 (the “BCBS/IOSCO Framework”).

⁶ Our general comments on the BCBS/IOSCO Framework can be found in the 2011 Substantive Margin Requirements Letter and in the 2014 Substantive Margin Requirements Letter.

⁷ Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013) [hereinafter “Cross-Border Guidance”].

- **Recommendation 1A:** The Commission should allow market participants to comply with a single set of substantive margin requirements for all uncleared swaps between them, as long as those rules are consistent with the BCBS/IOSCO Framework. Asset managers should be able to comply with a single set of margin rules consistent with the BCBS/IOSCO Framework for block trades with a single CSE.
- **Recommendation 1B:** In determining which regimes are eligible for such substituted compliance, the Commission should look to general compliance with the BCBS/IOSCO Framework and should not engage in an element-by-element comparison with the Commission's substantive margin rules.
- **Recommendation 1C:** Regardless of the approach to substituted compliance taken by the Commission, the importance of bilateral margining should be recognized. Specifically, CSEs should be eligible to post margin under the rules of a comparable jurisdiction in every case in which they are eligible to collect margin under the rules of that jurisdiction.
- **Observation 2:** The Proposal differs in several important ways from the Commission's Cross-Border Guidance. Perhaps most importantly, the Proposal requires new and different characterizations of market participants. While some of these changes are appropriate, they will only be beneficial if applied uniformly and consistently across the Commission's cross-border regulatory regime. Otherwise, the existence of multiple cross-border approaches, layered on top of a general cross-border regime and set of substantive margin requirements that are already exceedingly complex, will substantially increase operational and settlement risks and will impose significant and unnecessary burdens on buy-side market participants.
 - **Recommendation 2A:** We agree with the removal of the majority ownership prong and prefatory language to the Commission's "U.S. person" definition but recommend that the Commission implement a consistent "U.S. person" definition for all Commission swap regulations and guidance. We also believe that the Commission should clarify, consistent with the language in the Cross-Border Guidance, that a collective investment vehicle publicly offered only to non-U.S. persons, and not offered to U.S. persons, is not a U.S. person.
 - **Recommendation 2B:** We recommend that the Commission explicitly state that a CSE and its counterparty may reasonably rely on representations absent indications to the contrary, consistent with the Commission's external business conduct rules.
 - **Recommendation 2C:** We agree with the Proposal's narrower definition of "guarantee" but believe a consistent definition of this key term should apply across all of the Commission's swap regulations and guidance.

- **Observation 3:** The implementation of a new swap margin regime requires significant new operational and technological systems, as well as new documentation between counterparties that will be highly negotiated. In many ways, margin requirements will be the most complex element of the Dodd-Frank Act Title VII swap regulatory regime to implement, particularly for asset managers with thousands of clients. If the Commission does not provide sufficient time for this implementation to proceed in an orderly manner, the result could be increased, rather than decreased, systemic risk.
 - **Recommendation 3A:** Regardless of the approach taken by the Commission, market participants should be provided at least 18 months after the Commission, the Prudential Regulators and European Union regulators have adopted substantive margin rules and rules concerning their cross-border application before compliance is required. While a phase-in approach to compliance may be useful, the Commission should recognize that the fact that many asset managers trade in blocks for dozens or hundreds of underlying clients means that, as a practical matter, such asset managers will need to implement any rules for all clients simultaneously. Therefore, if the Commission implements a phase-in approach, it should make sure that the first phase-in date provides a sufficient implementation period for all types of fund clients.

Our detailed observations and recommendations follow.

Observation 1: The Proposal includes highly complex rules that define the application of the Commission's substantive swap requirements and the availability of substituted compliance. These rules do not recognize the fact that global asset managers often trade in blocks for multiple clients with similar trading strategies. The application of different substantive rules to such transactions will result in a system that is fragmented and more prone to systemic risk.

Unlike certain other areas for which the Commission has recently adopted rules governing the swap market, there has been a robust and effective swap margin infrastructure in place for several years, created by market participants to mitigate their own counterparty risk. This infrastructure includes standardized documentation, such as the ISDA Master Agreement and Credit Support Annex, as well as operational mechanisms for the exchange of initial and variation margin. This infrastructure includes, for example, close-out netting through the use of master netting agreements. Close-out netting mitigates credit risk for and, in doing so, decreases the systemic risk posed by market participants in the derivatives space.

During the recent financial crisis that gave rise to the Dodd-Frank Act, this infrastructure worked remarkably well for those institutions that used it. The problem was not the lack of a robust, efficient and effective infrastructure for margin; instead, the problem was that some large market participants did not use this infrastructure to protect themselves from the risk of counterparty default.

We strongly believe that any margin requirements adopted by the Commission should, first and foremost, maintain close-out netting and the other key benefits of the regime that have been put into place by market participants. The Commission should seek to “first, do no harm” to these well-functioning systems. Unfortunately, the Proposal’s complex application of different sets of rules based on five distinct dealer categorizations, three distinct end-user categorizations and element-by-element comparability determinations threatens to fragment swap portfolios in a way that could increase systemic and operational risk due to the uncertainty of which margin regime would apply to a transaction.

Under the Proposal, an uncleared swap between market participants could be subject to numerous different margin posting and collection rules depending on a number of factors, including which legal entity (or branch) of each counterparty acts as the booking entity, whether there is a transaction-level guarantee, whether the regime is one in which substituted compliance is available, and so on. Asset managers frequently engage in block trading for dozens or hundreds of underlying clients with similar trading strategies, which may be located in different jurisdictions. Applying multiple sets of rules to single block trades will significantly complicate such block trading and, for individual clients that may trade out of multiple locations, could lead to fragmentation of swap portfolios that could threaten the continued the benefits of close-out netting.

In addition, the fact that counterparties will face different sets of (complex) rules for their swaps with each other, including as part of block trades, is likely to lead to significant confusion, disputes over timing and amounts of margin calls, and other operational and settlement risks. Documentation of trading relationships commonly takes the form of multi-branch ISDA Master Agreements between AMG members’ clients and a CSE. One benefit of this form of documentation is that the CSE typically has the ability to book the transaction into any of its branches. As a result, the CSE’s counterparty may not know into which branch the CSE has booked the transaction until receipt of the trade confirmation, which may be provided after the deadline for posting and collecting margin for the trade. Under the Proposal, this timing mismatch may lead to an incorrect application of the margin requirements and an increase in margin disputes, since the branch of the CSE into which a transaction is booked may affect the application of margin rules. Second, managers frequently enter into block trades on behalf of dozens or even hundreds of underlying clients. As proposed, the Commission’s margin rules would require determining the status of each client to which the block may be allocated, in advance of trade execution, since the Commission’s margin rules could apply differently to each client–CSE pair. This situation would make pricing and executing block trades significantly more difficult than today.

Recommendation 1A: The Commission should allow market participants to comply with a single set of substantive margin requirements for all uncleared swaps between them, as long as those rules are consistent with the BCBS/IOSCO Framework. Asset managers should be able to comply with a single set of margin rules consistent with the BCBS/IOSCO Framework for block trades with a single CSE.

We believe that there is a straightforward solution to these problems, which would maintain the benefits of the existing regime, including close-out netting, while ensuring that the Commission's key goals in enhancing the swap margin regime are met. Specifically, we believe that the Commission should allow market participants to comply with a single jurisdiction's substantive margin requirements for all uncleared swaps between them, as long as those rules are consistent with the core principles for uncleared swap margin requirements set forth by the BCBS/IOSCO working group in which the Commission participates. In addition, asset managers should be able to comply with a single set of margin rules consistent with the BCBS/IOSCO Framework for block trades with a single CSE.

Permitting all uncleared swaps to be subject to the same margin posting and collection rules would provide clarity as to the application of the rules, thereby maintaining the key benefits described above. In addition, the relatively simple application of a single regime to an entire swap portfolio, rather than a fragmented approach, would decrease complexity and resulting operational and settlement risks, such as margin disputes.

At the same time, requiring that the CSE and its counterparty post and collect margin under a regime consistent with the BCBS/IOSCO Framework would ensure that the Commission's key goals are achieved. In general, we understand (even if we do not always agree with) the Commission's reluctance to provide full and broad substituted compliance across all swap requirements. Various jurisdictions have implemented certain requirements, such as swap documentation, in different ways and without a formal set of agreed-upon standards. The situation with respect to uncleared swap margin, however, is different. Over the past several years, the Commission and other U.S. regulators have worked closely with international counterparts through the BCBS/IOSCO process to develop a comprehensive and robust set of principles to govern posting and collection of uncleared swap margin. The Commission's substantive uncleared swap margin rules closely adhere to these principles. As a result, by virtue of the fact that the single margin regime with which a CSE and its counterparty would comply would need to be consistent with BCBS/IOSCO Framework, it would achieve the key goals of the Dodd-Frank Act and the Commission's underlying margin rules. This will also minimize the opportunity for regulatory arbitrage, as participants will be subject to similar margin rules across jurisdictions.

A broad recognition of BCBS/IOSCO regimes would also achieve the key principles of the BCBS/IOSCO Framework, namely, to "(1) harmonise the rules to the extent possible or (2) apply only one set of rules, by recognising the equivalence and comparability of their respective rules."⁸ Inconsistent rules would provide an incentive to transact in another jurisdiction or to transact with non-U.S. counterparties, based solely on the comparative advantage of complying with less onerous regulations elsewhere. In addition, inconsistent and complicated rules would also lead non-U.S. counterparties to avoid transacting with U.S. CSEs or with non-U.S. CSEs guaranteed by a U.S. person

⁸ *Id.* at 23.

because they would face duplicative margin requirements—those of their home jurisdictions and of the United States—even though the goals of those regimes are similar. Forcing trades away from the United States also may lead to reduced U.S. market liquidity.

Recommendation 1B: In determining which regimes are eligible for substituted compliance, the Commission should look to general compliance with the BCBS/IOSCO Framework and should not engage in an element-by-element comparison with the Commission’s substantive margin rules.

We strongly believe that any comparability analysis engaged in by the Commission for purposes of substituted compliance should look to general compliance with the BCBS/IOSCO Framework, rather than an element-by-element comparison with the Commission’s substantive margin rules.

Under the Proposal, the Commission states that it would apply an outcome-based approach for determining whether substituted compliance is available. However, the Commission also states that it will review and make determinations on an “element-by-element” basis.⁹ The Commission, therefore could potentially find comparability for some, but not all, “elements” of a foreign jurisdiction’s margin regime.¹⁰ The potential for piecemeal comparability determinations – covering, for example, calculation methodologies but not eligible collateral, or covering variation margin but not initial margin – would serve to increase uncertainty, compliance difficulties and the potential for margin disputes.

The Commission’s prior “element-by-element” comparability determinations demonstrate this complexity. In the context of swap trading relationship documentation rules, the Commission found certain subsections of foreign regimes comparable, and other subsections not comparable.¹¹ This has caused unnecessary market confusion regarding which rule sections may be complied with via substituted compliance and which may not, in many cases leading to disagreements on the practical impact of the Commission’s substituted compliance determinations. The “element-by-element” approach outlined in the Proposal appears strikingly similar to the methodology used by the Commission in making prior comparability determinations for transaction-level requirements under the Cross-Border Guidance. If employed in this manner, such an approach would add yet another layer of complexity to comparability determinations and to the application of the margin rules to cross-border transactions.

⁹ Proposal at 41,389.

¹⁰ *Id.* and n.73.

¹¹ *See, e.g.,* Comparability Determination for the European Union: Certain Transaction-Level Requirements, 78 Fed. Reg. 78,878, 78,881 (Dec. 27, 2013).

Such an element-by-element analysis also risks a similar response by foreign regulators, potentially leading to a patchwork quilt of disparate requirements relating to the same activity, thereby forcing counterparties to comply with the strictest standard.

Recommendation 1C: Regardless of the approach to substituted compliance taken by the Commission, the importance of bilateral margining should be recognized. Specifically, CSEs should be eligible to post margin under the rules of a comparable jurisdiction in every case in which they are eligible to collect margin under the rules of that jurisdiction.

Where a CSE is a U.S. swap dealer or a non-U.S. swap dealer guaranteed by a U.S. person, the Proposal would permit substituted compliance for the initial margin that the CSE posts to the client, but not for the initial margin that the client posts to the CSE or for variation margin requirements. Allowing substituted compliance for the CSE's posting, but not collecting, of initial margin is inconsistent with the importance of bilateral margining reflected in the Commission's substantive margin rule proposal. Further, if the Commission finds a foreign jurisdiction's margin regime comparable, that regime should be deemed comparable with respect to all margin requirements, not just certain subsets of the margin requirements. Finally, such a bifurcated approach to substituted compliance adds unnecessary complexity that would increase the potential for margin disputes and increase operational and settlement risk, as well as require development of new systems and revisions to documentation.

Observation 2: The Proposal differs in several important ways from the Commission's Cross-Border Guidance. Perhaps most importantly, the Proposal requires new and different characterizations of market participants. While some of these changes are appropriate, they will only be beneficial if applied uniformly and consistently across the Commission's cross-border regulatory regime. Otherwise, the existence of multiple cross-border approaches, layered on top of a general cross-border regime and set of substantive margin requirements that are already exceedingly complex, will substantially increase operational and settlement risks and will impose significant and unnecessary burdens on buy-side market participants.

Over the past several years, market participants have spent significant resources implementing the Commission's complex cross-border regime. Buy-side participants, in particular, have faced the overwhelming challenge of educating thousands of clients on the complex rules that newly govern their swap activity, and the matrix of application of those rules based on new participant classifications.

The Proposal would increase the complexity of the regime exponentially as it applies to buy-side participants and their clients in two ways. First, the creation of new categories of market participants, based on new definitions, would require buy-side participants to make further significant changes to existing systems. Buy-side participants would need to obtain new U.S. person and guarantee status representations from clients in response to requests from CSEs and, in many cases, would request similar representations from CSEs to ensure that margin calls are in compliance with rule requirements. While such changes to the Commission's existing approach may be

justifiable and advisable in certain circumstances, they should not be taken lightly given the significant additional burden and cost on buy-side participants and their clients.

Second, and far more troublesome, the Proposal would create a margin-specific cross-border regime that would stand alongside the Commission's general cross-border regime. All market participants, including thousands of AMG members' clients, would be subject to multiple sets of categorizations, based on different definitions. It would be nearly impossible to effectively implement and maintain two separate, complex and parallel regimes defining the application of the Commission's rules in the cross-border context.

The existence of a separate regime for the cross-border application of uncleared swap margin requirements is also extremely problematic for buy-side participants when viewed in light of certain specific elements of the underlying substantive margin rules. Several of these issues arise as a result of the fact that a client may have multiple asset managers, with each asset manager having visibility only into the transactions that it has put in place for the specific client. For example, the calculation of the initial margin threshold is required to be made on a consolidated legal entity basis. For clients with multiple asset managers, where any single asset manager has insight into only a subset of that client's swap portfolio, the client is effectively required to manage the calculation themselves, which is further complicated by the need to identify affiliates and their swap positions. When these calculations and rules apply differently according to a unique set of cross-border rules, this task becomes nearly impossible for individual clients.

As a result, we think it is critically important that the Commission harmonize its two cross-border regulatory regimes into a single, consistent regime, and prevent the creation of a margin-specific set of rules and the additional complexity that two parallel regimes would entail.

Recommendation 2A: We agree with the removal of the majority ownership prong and prefatory language to the Commission's "U.S. person" definition but recommend that the Commission implement a consistent "U.S. person" definition for all Commission swap regulations and guidance. We also believe that the Commission should clarify, consistent with the language in the Cross-Border Guidance, that a collective investment vehicle publicly offered only to non-U.S. persons, and not offered to U.S. persons, is not a U.S. person.

We appreciate the Commission's response to the concerns previously raised by commenters in response to prior Commission releases regarding the difficulty in determining U.S. person status under the majority-ownership prong of the "U.S. person" definition. We agree with the Proposal's removal of this prong that rendered a collective investment vehicle a U.S. person by virtue of majority ownership by U.S. persons.¹² We further agree with the Commission's proposal to remove the prefatory "includes, but is

¹² *Id.* at 41,383, 41,401.

not limited to” language in order to provide more legal certainty to the U.S. person definition.¹³

We believe these changes to the definition would provide a useful, bright-line test for determining whether an entity is considered a U.S. person. We are concerned, however, about the implications of inconsistent or multiple definitions across various Commission rules and guidance. We believe it is critical that the Commission implement a consistent definition of “U.S. person” across its swap regulatory regime.

As the Commission is aware, various Commission and other U.S. regulations and guidance in recent years have defined the term “U.S. person” differently for purposes of implementing regulations under Title VII of the Dodd-Frank Act. Specifically, the definition in the Proposal¹⁴ is different from that in the Commission’s Cross-Border Guidance.¹⁵ It is also different from the definitions in the SEC’s Title VII Cross-Border Rule¹⁶ and the Prudential Regulators’ proposed approach.¹⁷ As a result, counterparties could be subject to at least three different “U.S. person” definitions depending on the product traded, the counterparty and the particular regulation being applied. The complexity in this potential piecemeal application would outweigh the benefits that the amendments to the definition of “U.S. person” in the Proposal were designed to achieve. The proposed changes would require new analysis of clients for which efforts have already been made to determine their U.S. person status under the Commission’s guidance, as well as new representations and re-documenting existing agreements with counterparties to account for the new definition. Without a consistently applied U.S. person definition, we believe the costs and burden of implementation, solely to correctly apply the Commission’s margin requirements, would greatly exceed the benefits. However, the benefits of the improvements to the U.S. person definition would be fully achieved if the definition were amended consistently across all Commission swap rules and guidance.

We also urge the Commission to clarify, in any adopted U.S. person definition, that, as stated in the Commission’s Cross-Border Guidance, a collective investment vehicle that is publicly offered only to non-U.S. persons, and is not offered to U.S. persons, is not a U.S. person.¹⁸ Such non-U.S. funds do not pose the types of risk to the

¹³ *Id.* at 41,395, 41,401.

¹⁴ *Id.* at 41,401.

¹⁵ Cross-Border Guidance at 45,316–17.

¹⁶ Application of “Security-Based Swap Dealer” and “Major Security-Based Swap Participant” Definitions to Cross-Border Security-Based Swap Activities. 79 Fed. Reg. 74,278 (Aug. 12, 2014).

¹⁷ *See* Margin and Capital Requirements for Covered Swap Entities; Proposed Rule, 79 Fed. Reg. 57,348 (Sept. 24, 2014).

¹⁸ Cross-Border Guidance at 45,314.

U.S. financial system that the Commission's swap rules, including its margin rules, are meant to protect against and, consistent with principles of international comity, the Commission has justifiably determined that these non-U.S. funds are more appropriately regulated by home country regulators. Based on the language in the Cross-Border Guidance, asset managers have classified such funds as non-U.S. persons for Title VII purposes; reclassifying such entities for purposes of the Commission's margin rules would be not only unnecessary, but would be extremely complicated and impose a significant burden on asset managers and their clients.

We also believe that the addition of the "including any branch of the legal entity" to prongs (iii) and (vi) of the definition creates more uncertainty than clarity. Such additions cause confusion in terms of whether a person having any branches in the United States needs to take into account its U.S. person status, including in assessing the entity's principal place of business. We recommend not including this language in prongs (iii) and (vi) of the new U.S. person definition.

Recommendation 2B: We recommend that the Commission explicitly state that a CSE and its counterparty may reasonably rely on representations absent indications to the contrary, consistent with the Commission's external business conduct rules.

The Commission's Proposal would permit a swap counterparty to reasonably rely on its counterparty's written representation in determining whether the counterparty is, among other things, a "U.S. person," guaranteed by a U.S. person or a Foreign Consolidated Subsidiary. For these purposes, the Commission proposes to interpret reasonable due diligence to be satisfied based on "what is reasonable in a particular situation [depending] on the relevant facts and circumstances."¹⁹ This standard appears to differ, for no discernible or stated reason, from the Commission's view in the external business conduct rules that counterparty representations may be relied upon absent indications to the contrary.²⁰ Indeed, the Commission appears to cite the standard in the external business conduct rules as the basis for the Commission's Proposal.

We recommend that the Commission explicitly state, as it does in the external business conduct rules, that a CSE and counterparty may reasonably rely on counterparty representations, absent indications to the contrary. We are concerned that if a different standard is implemented under the Commission's margin rules, CSEs may engage in further diligence and require additional documentation beyond what was required under prior Commission regulations and guidance, causing unnecessary burdens on market participants. Similarly, a different, and more stringent, standard could require AMG's members to engage in further, unnecessary diligence with respect to their clients and dealer counterparties.

While we understand that non-CSEs, such as investment managers, are not directly subject to the Commission's margin rules, AMG's member managers and

¹⁹ Proposal at 41,384.

²⁰ *Id.* at n.53.

advisers have fiduciary and contractual obligations to their clients that require them to validate the counterparty CSE's status and any margin calls received. Thus, it is also crucial for asset managers to be permitted to reasonably rely on counterparty representations in terms of the CSE's guarantee and Foreign Consolidated Subsidiary status. Because the Proposal does not require that the terms of the guarantee be included within the swap documentation or otherwise reduced to writing,²¹ without the ability to reasonably rely on the general representations of counterparties, it is unclear how a manager would be able to confirm whether a CSE benefits from a U.S.-person guarantee.

A consistent standard for reliance on counterparty representations across Commission regulations and guidance should be implemented to prevent uncertainty and potential unnecessary burdens to document the status of swap counterparties.

Recommendation 2C: We agree with the Proposal's narrower definition of "guarantee" but believe a consistent definition of this key term should apply across all of the Commission's swap regulations and guidance.

We appreciate the Commission's narrowing of the definition of "guarantee," as well as its Proposal to more closely align this definition with that of the SEC. We particularly agree that the definition of "guarantee" should look to a counterparty's rights with respect to a particular swap, rather than to indirect forms of support, such as liquidity puts or keepwells. However, we disagree that this definition should only apply to the application of the Commission's margin rules and believe this revised guarantee definition should be implemented and applicable across the Commission's swap regulatory regime.

The definition of "guarantee" appears in a number of the Commission's swap regulations and guidance. Inconsistent definitions of the same term can lead to market confusion and uncertainty, as well as the requirement to obtain multiple representations, even with respect to a single swap transaction. Such inconsistencies also increase compliance burdens, with little or no benefit to the Commission's oversight of the swap market.

Observation 3: The implementation of a new swap margin regime requires significant new operational and technological systems, as well as new documentation between counterparties that will be highly negotiated. In many ways, margin requirements will be the most complex element of the Dodd-Frank Act Title VII swap regulatory regime to implement, particularly for asset managers with thousands of clients. If the Commission does not provide sufficient time for this implementation to proceed in an orderly manner, the result could be increased, rather than decreased, systemic risk.

As described above, the infrastructure necessary to calculate margin requirements, make margin calls and post or collect margin is extremely complex and intricate, particularly when performed by an asset manager for thousands of clients. Any change to

²¹ *Id.* at 41,384.

this system must be carefully implemented and tested before it is applied to live swap transactions. Otherwise, rather than decreasing risk in the swaps markets, new rules hastily implemented to meet artificial deadlines could increase systemic, operational and settlement risks, as well as lead to a significant increase in margin disputes. More complex changes may also require modification to highly-negotiated documentation, which is a time-intensive process.

As we noted in our prior comment letter, some of the substantial changes to documentation that may be required include, among other things:

- negotiation of agreements for separation of initial margin and variation margin collateral flows;
- negotiation of third-party custodial agreements and their inclusion as credit support documents;
- rethinking of netting sets covered by master agreements and existing cross product master netting agreements (including handling non-swap transactions);
- aggregating thresholds across affiliates and disclosure about methodologies;
- amendments to ISDA Master Agreements, Credit Support Annexes and similar agreements to include specific types of collateral allowed under the final rules, new minimum transfer amounts as allowed under the final rules, time zone issues associated with posting and collecting collateral and similar changes; and
- amending or adopting policies, procedures and systems and implementing training and education relating to the above operational issues.²²

Finally, asset managers will need to educate clients about these changes. Educating clients regarding changes to margin collection and posting for their accounts is likely to be even more complicated and sensitive than previous efforts regarding other Dodd-Frank Act swap changes, as margin requirements have a direct, bottom-line impact.

Recommendation 3A: Regardless of the approach taken by the Commission, market participants should be provided at least 18 months after the Commission, the Prudential Regulators and European Union regulators have adopted substantive margin rules and rules concerning their cross-border application before compliance is required. While a phase-in approach to compliance may be useful, the Commission should recognize that the fact that many asset managers trade in blocks for dozens or hundreds of underlying clients means that, as a practical matter, such asset managers will need to implement any rules for all clients simultaneously. Therefore, if the Commission implements a phase-in approach, it should make sure that the first phase-in date provides a sufficient implementation period for all types of fund clients.

²² 2014 Substantive Margin Requirements Letter at 31.

As a result, we request that the Commission provide market participants with at least 18 months to implement uncleared swap margin rules. This conformance period should not begin until the Commission, the Prudential Regulators and European Union regulators have adopted rules that define both substantive margin requirements and their cross-border application, as market participants will not be able to develop a complete implementation plan without a level of certainty as to application for which final rules are necessary.

In the past, the Commission has had success in phasing in Title VII rules by type of market participant. For example, in the Commission's orderly phase-in of swap clearing requirements, counterparty pairs were divided into three categories with staggered implementation dates. In general, we appreciate this approach, as it allows market participants to first focus on the largest counterparty pairs and learn from the experience of those counterparty pairs in implementing rules throughout the rest of the financial system. We think such an approach would be beneficial for the Commission's implementation of uncleared swap margin rules. However, many asset managers that trade for multiple types of clients, including as part of block trades, will as a practical matter need to implement any rules for all clients simultaneously. Therefore, if the Commission implements a phase-in approach, it should make sure that the first phase-in date provides a sufficient implementation period for all types of fund clients.

* * *

We thank the Commission for its consideration of our comments. If you have any questions, please do not hesitate to contact Tim Cameron at 202-962-7447 or tcameron@sifma.org or Laura Martin at 212-313-1176 or 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: Honorable Timothy G. Massad, Chairman
Honorable Sharon Y. Bowen, Commissioner
Honorable J. Christopher Giancarlo, Commissioner

Commodity Futures Trading Commission

Honorable Janet L. Yellen, Chair
Honorable Stanley Fischer, Vice Chairman
Honorable Daniel K. Tarullo, Governor
Honorable Jerome H. Powell, Governor
Honorable Lael Brainard, Governor

Board of Governors of the Federal Reserve System

Honorable Thomas J. Curry, Comptroller of the Currency
Office of the Comptroller of the Currency

Honorable Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Honorable Kenneth A. Spearman, Chair and Chief Executive Officer
Farm Credit Administration

Honorable Melvin L. Watt, Director
Federal Housing Finance Agency

Honorable Mary Jo White, Chair
Honorable Luis A. Aguilar, Commissioner
Honorable Daniel M. Gallagher, Commissioner
Honorable Kara M. Stein, Commissioner
Honorable Michael S. Piwowar, Commissioner
Securities and Exchange Commission