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VIA EMAIL (Debbie.Kokal@cmegroup.com)

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Re: Response to Joint Audit Committee ("**JAC**") Alert 14-03 on Margining of Accounts Held by the Same Beneficial Owner

Dear Ms. Kokal:

The Asset Management Group (the "**AMG**")[1] of the Securities Industry and Financial Markets Association ("**SIFMA**") is concerned about the potential negative impacts on our members and their clients and the asset management business as a whole of the recently issued JAC Regulatory Alert 14-03 (the "**Alert**") addressing the Receipt of Margin Funds and Combining Accounts for Margin Purposes.[2] Specifically, AMG is concerned about the implications of the following provisions of the Alert, particularly the language AMG has added emphasis:

- all accounts of the same beneficial owner within the same regulatory account classification (i.e., customer segregated, customer secured, cleared swaps customer, or noncustomer) should be combined for margin purposes.
- when determining an account's margin funds for disbursement all accounts of the same beneficial owner, even if under different control, within the same regulatory account classification must be combined.

[1] Members of AMG 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, ERISA plans, and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

[2] The Alert is available at: http://www.wjammer.com/jac/jacupdates/2014/jac1403.pdf. The Alert does not provide additional background on the underlying purpose or policy objective of the Alert.

The Alert further specifies that Futures Commission Merchants ("**FCMs**") are only permitted to issue margin calls on an individual account basis if the gross margin calls are "conservative" in relation to the aggregate margin call calculated for the combined account.

AMG respectfully requests that the JAC withdraw the aforementioned provisions of the Alert because the provisions negatively impact the "beneficial owners" (i.e., institutional investors, including registered investment companies, ERISA plans, mutual funds, pension funds, etc.). In the alternative, AMG requests the JAC amend the Alert to allow FCMs to continue the long established practice of determining margin funds for disbursement separately for each separately margined account based solely on the transactions associated with that specific account. In short, the Alert should not disrupt FCMs' risk management and margining procedures which recognize the separateness of accounts, pursuant to which transactions and margin cannot be comingled.

AMG understands that the Futures Industry Association and the International Swaps and Derivatives Association have expressed or will express similar concerns to ours in separate comment letters.

I. The Alert Runs Counter to Contractual Arrangements That Asset Managers Have Agreed to with Their Clients and FCMs

Pension funds, retirement plans, investment funds and other institutional clients often use multiple asset managers to manage separate and distinct pools of assets using distinct investment strategies and maintaining separate investment results. Each such pool of assets is considered to be a separate account or portfolio. Additionally, an institutional client may also hire an asset manager to manage more than one portfolio for such institutional client, with each portfolio being a distinct pool of assets, employing a different investment strategy, and maintaining separate investment results, despite the fact that they are controlled by the same asset manager and owned by the same beneficial owner. The use of separate asset managers and the separation of accounts are part of longstanding business practices in the asset management industry and such practices with respect to cleared swaps would be jeopardized by the Alert. As discussed further below, these longstanding business practices are often memorialized in client and trading documentation.

The institutional client and an asset manager enter into an Investment Management Agreement ("**IMA**") under which the asset manager is given sole responsibility and authority for the management of the specified portfolio, including investments in futures and cleared swaps and the associated margin. Such IMAs often contain limited recourse provisions, which provide that the asset manager will limit any liability arising from its investments to the assets in that portfolio. Moreover, IMAs between asset managers and highly regulated clients (e.g., central banks, sovereign wealth funds, government organizations, etc.) are governed by laws that often require the inclusion of a limited recourse provision. The purpose of such provisions is to protect the beneficial owners and, ultimately, the investors as applicable (e.g., investors in a fund or beneficiaries in a pension plan that owns an account), by allowing the asset manager to manage risk exposure through use of separate pools of assets for different strategies.

When an asset manager opens a futures or cleared swaps account for a portfolio, the Futures Agreement and the Cleared Swaps Addendum frequently contain limitation of liability language that makes clear that the FCM's recourse is limited to only the assets in that particular portfolio, meaning the FCM cannot reach assets in any other of the client's accounts set up for other portfolios (whether controlled by the same or a different asset manager). As a result, one institutional client, such as a pension fund, could have multiple accounts controlled by the same or different asset managers at the same FCM. While those accounts have the same "beneficial owner," which is the pension fund itself, the accounts are separate and distinct pools of assets with limited liability. As the assets and liabilities of these accounts are contractually and legally separate, the accounts are also separately margined without netting across accounts. These contractual agreements are entered into and negotiated by large, sophisticated market participants with the specific purpose of separation of accounts. Such contractual agreements would be contravened by the Alert because prohibiting distribution of excess margin in an individual account due to a deficit in another separately margined account would look beyond the limited recourse provisions of the contractual agreement. In short, the Alert interferes with and overrides the provisions in existing commercial arrangements that properly coexist with CFTC regulations and permit different approaches based on an institutional client's needs.

II. The Alert Sets Forth a Policy That is Not Necessary Under the Current Regulatory Landscape and Margining Practices

Although the Alert is described by the JAC as a "reminder" to FCMs, it is contrary to the margining practices currently employed by FCMs. It also is inconsistent with the existing margining practices associated with separately managed institutional client accounts in respect of other products, such as OTC swaps and repurchase transactions. Such a significant departure from standard industry practice will negatively impact the asset management business, both the members of AMG and their clients. Moreover, the Alert builds interconnectivity among accounts where it does not otherwise exist and where AMG members' clients have determined the limitation of liability is needed to manage risk and measure investment performance. Furthermore, the position in the Alert is not necessary given the protections already in place under the CFTC's regulatory approach on risk management at the FCM and DCO levels (i.e., gross margining and segregation provisions).[3]

Because the accounts are margined individually (including initial margin), each on a gross basis (which maximizes the margin collected), the overall risk management objective of clearing is achieved by the margining methodology currently employed by FCMs. Under the current construct, it is easy to isolate deficiencies and understand precisely for which account additional margin is required. The margin calculation itself is based on the time required to liquidate a clearing member's positions and, therefore, is commensurate with the risk associated with the given account's positions. To further enhance customer protection, the CFTC has also put in place requirements for the protection of collateral for cleared swaps, including the

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[3] Risk Management Program for Futures Commission Merchants, 17 C.F.R. § 1.11 (2013); Derivatives Clearing Organizations Risk Management, 17 C.F.R. § 39.13(g)(8) (2013).

"residual interest" requirement, the full segregation model (also known as "legally separate, operationally commingled" or "LSOC"), and risk management rules for FCMs and DCOs.[4] In sum, the account set-up and margin methodology in place today adequately protects the client's funds and satisfies the risk requirements of the FCM and the DCO without the need for the additional guidance provided in the Alert.

III. The Alert Will Negatively Impact the Operation of the Asset Management Business

Compliance with the Alert will restrict asset managers' ability to effectively employ different strategies with measurable investment results by interfering with their management of cleared swaps in separate pools of assets of the same beneficial owner. In addition to limiting Asset Managers' business, it will increase the cost to the beneficial owners and create uncertainty. As a consequence of the Alert, an FCM will be required to withhold excess collateral in a particular client account so long as there exists a deficit in a separate account if those accounts have the same beneficial owner. Having the same beneficial owner does not justify allowing one asset manager's trading to impact the ability of another asset manager to have excess collateral returned. Indeed, the approach set forth in the Alert undermines a key purpose of diversifying assets among multiple asset managers. The same principle holds true for separate accounts managed by the same asset manager for the same client (e.g., where separate strategies are being followed or where the client otherwise desires segregation of positions). Utilizing separate accounts for one client, which many asset managers do today, sacrifices the margin cost savings associated with combining accounts, which means entities are incurring cost in exchange for the protections of separation. The Alert will further increase cost, while inappropriately interfering with clients' priorities and creating unnecessary interconnectedness.

The Alert's margin treatment of such accounts will also result in additional operational and financing costs. If excess margin (i.e., cash that does not secure a commodity interest position) is not available to be called back, it is not available to use for another investment or to cover a margin call on a hedge of the investment that generated the excess. Furthermore, FCMs may, in order to avoid the complications described herein, be incentivized to require clients to post maintenance margin in excess of what would otherwise be required by the FCM and the clearinghouse, thereby raising costs to asset managers and their clients. Individual accounts that are subject to such increased margin requirements run a heightened risk of an individual deficiency that can have a ripple effect across other accounts within the same FCM. Moreover, if a deficiency occurs in one account, an FCM may then feel compelled to raise the margin requirements for other accounts of the same beneficial owner, irrespective of whether managed by the same asset manager, which could result in further interconnection between accounts that were intended to be maintained separately. This heightened risk of further

[4] Futures Commission Merchants: Treatment of Cleared Swaps and Associated Cleared Swaps Customer Collateral, 17 C.F.R. §§ 22.2(b), (f) (2013); Derivatives Clearing Organizations: Treatment of Cleared Swaps Customer Collateral, 17 C.F.R. § 22.3(b) (2013); 17 C.F.R. § 1.11; 17 C.F.R. § 39.13(g)(8).

deficiencies will be exacerbated for accounts of the same beneficial owner managed by different asset managers.

An asset manager will not be able to anticipate when the excess collateral in its client's account will be withheld during a deficit in that client's account controlled by another asset manager. When excess collateral is withheld, asset managers will not have transparency as to where the deficit is located as there is no process in place to provide this information. In addition, there is no explanation in the Alert or otherwise as to how it will be determined which account's (or accounts') excess collateral will not be returned promptly. It could be pro rata, evenly split, all from the account with the greatest excess, or by some other method. Additionally, it is not clear which party will make that determination. Such opacity is not acceptable business practice, particularly in the asset management business as asset managers have fiduciary duties to their clients. Alternatives are not feasible as there is a separate fiduciary duty and contractual obligation of asset managers to each client separately and on an account-by-account basis. Also, putting collateral management responsibilities on the underlying beneficial owners themselves is not a practicable solution. Most clients of asset managers are not equipped to manage collateral and typically rely on the various asset managers they hire to fulfill this function on an account-by-account basis. Additionally, asset managers do not have insight into one another's client positions and cannot practically be given this access without client consent as it would violate confidentiality and the managers' duties to their clients. In sum, the negative impacts of the Alert are many and are unworkable in the asset management business.

IV. AMG Respectfully Requests the Withdrawal or Amendment of the Alert

For the aforementioned reasons, AMG respectfully requests the JAC withdraw the provisions of the Alert that negatively impact the "beneficial owners," as discussed above. Alternatively, AMG respectfully requests the JAC amend the Alert to allow FCMs to determine margin funds for disbursement separately for each separately margined account based solely on the transactions associated with that specific account.

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AMG would be interested in meeting with the JAC to further discuss our comments. In the interim, should you have any questions, please do not hesitate to contact Tim Cameron of AMG at 202-962-7447 or Matt Nevins of AMG at 212-313-1176 or Stephen Humenik or Isabelle Corbett of Covington & Burling LLP at 202-662-5803.

Sincerely,

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