



asset management group

By Electronic Mail

June 7, 2019

Brian A. Bussey, Director
Division of Clearing and Risk
Commodity Futures Trading Commission
1155 21st Street NW
Washington DC 20581

Matthew B. Kulkin, Director
Division of Swap Dealer and Intermediary
Oversight
Commodity Futures Trading Commission
1155 21st Street NW
Washington DC 20581

**Re: Commodity Futures Trading Commission Rules 1.56(b) and 39.13(g)(8)(iii)
Request for Interpretation**

Dear Messrs. Bussey and Kulkin:

The Asset Management Group of the Securities Industry and Financial Markets Association¹ (“**SIFMA AMG**”) respectfully requests that the Division of Clearing and Risk (“**DCR**”) and the Division of Swap Dealer and Intermediary Oversight (“**DSIO**” and together with DCR, the “**Divisions**”) provide interpretations related to CFTC Rule 1.56(b) and CFTC Rule 39.13(g)(8)(iii) as set forth below. As the Divisions are aware, SIFMA AMG has been in discussions with regard to the interpretations at issue and, therefore, in the interest of time and given the urgency of the request, this letter provides brief background information and focuses, instead, on the requested relief.

Interpretation with respect to Rule 1.56(b). As you are aware, Commodity Futures Trading Commission (“**Commission**” or “**CFTC**”) Rule 1.56(b) provides that a futures commission merchant (“**FCM**”) may not in any way represent that it will, with respect to any commodity interest in any account carried by the FCM: (i) guarantee a customer or noncustomer against loss; (ii) limit the loss of such customer or noncustomer; or (iii) not call for or attempt to collect required margin.² On May 14, 2019, the Joint Audit Committee (“**JAC**”) published Regulatory Alert #19-03, providing the JAC’s “reading, interpretation and application” of Commission Rule 1.56(b). In particular, the JAC stated that, in its view, even in the case of a separate account of a beneficial owner managed by an independent asset manager, Rule 1.56(b) requires that an FCM “*must have at all times the absolute right to look to funds in all accounts of the beneficial owner even accounts that are under different control*, as well as the right to call the underlying beneficial owner for funds even if beyond the amount the beneficial owner has allocated to the asset manager(s).” [Emphasis supplied.]

¹ 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.

² 17 CFR § 1.56(b).

³ The JAC is a representative committee of US futures exchanges and the National Futures Association.

New York | Washington

120 Broadway, 35th Floor | New York, NY 10271-0080 | P: 212.313.1200 | F: 212.313.1301
www.sifma.org

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However, SIFMA AMG respectfully submits that the JAC's position that an FCM "must have *at all times* the absolute right to look to funds in all accounts of the beneficial owner even accounts that are under different control", is not required by a plain reading of the rule.

Request for interpretation with respect to Rule 1.56(b) and for time to review relevant customer agreements.

For the reasons discussed above, SIFMA AMG asks DSIO to confirm that:

- an FCM is in compliance with Rule 1.56(b), as long as the FCM retains the right, in the agreement with the customer (the "**customer agreement**") or otherwise, to seek payment of unpaid debit balances from the customer or initiate a legal proceeding against the customer to recover any shortfall after the customer's default and non-payment.

In light of the variety of limited recourse provisions among investment managers and among FCMs and in light of the fact that many of these customer agreements were entered into many years ago, SIFMA AMG requests that FCMs have an opportunity to review their existing agreements with their customers to assure that they do not conflict with Rule 1.56 and, where conflicts are present, to amend agreements to conform. Further, asset managers will need an opportunity to review the investment management agreements with clients. In this regard, therefore, we ask that DSIO afford FCMs a reasonable period of time to assure that their agreements are in compliance with Rule 1.56. FCMs will need to develop a plan to bring customer agreements into compliance and make progress ratably over a reasonable period of time until all agreements requiring amendments have been completed. In formulating their plan, FCMs will need to take into account the work required for asset managers to review and revise investment management agreements prior to amending clearing agreements.

Interpretation with respect to Rule 39.13(g)(8)(iii). The JAC recently issued Regulatory Alert #19-02, Combining Accounts for Margin Purposes ("**JAC 19-02**"). In the introduction to JAC 19-02, the JAC notes that the guidance set out is based, in part, on "regulations of the CFTC requiring the combining of accounts for margin purposes specifically with regards to the release of excess margin funds." Although not specifically identified in JAC 19-02, we understand that the JAC is referring to CFTC Rule 39.13(g)(8)(iii), which provides:

(iii) Withdrawal of customer initial margin. A derivatives clearing organization shall require its clearing members to ensure that their customers do not withdraw funds from their accounts with such clearing members unless the net liquidating value plus the margin deposits remaining in a customer's account after such withdrawal are sufficient to meet the customer initial margin requirements with respect to all products and swap portfolios held in such customer's account which are cleared by the derivatives clearing organization.

As a matter of law or contract, certain accounts carried by FCMs that have the same beneficial owner are treated for all purposes as accounts for different legal entities (each a "**separate account**"). We respectfully submit that such purposes include Commission Rule 39.13(g)(8)(iii). That is, such separate accounts should be treated as separate legal entities and should not be combined when determining an account's margin funds available for disbursement.

Accordingly, treating these accounts as separate legal entities should not expose an FCM to any greater regulatory or financial risk. To the contrary, an FCM's internal controls and procedures, as outlined below, should assure that the FCM is not undertaking any additional risk as to the separate account.

The FCM's written internal controls and procedures related to separate accounts, may include requirements that:

- The FCM is satisfied that the beneficial owner has a bona fide purpose for establishing separate accounts and for requesting the FCM to treat them as separate accounts for margin purposes.⁴
- Where an FCM separately margins accounts managed by one or more asset managers, the FCM is capable of assessing the value of the assets dedicated to such separate account.
- If applicable, in establishing risk-based limits for each separate account under Commission Rule 1.73, the FCM considers only the value of the assets that the beneficial owner and the FCM have agreed are dedicated to such separate account.⁵
- Except in the case of portfolio margining arrangements, the margin requirement for each separate account is calculated independently from all other separate accounts of the same beneficial owner with no offsets/spreads recognized across the separate accounts.
- Consistent with and subject to other applicable Commission rules and interpretive guidance, including JAC regulatory alerts, required margin calls for separate accounts are made within one business day after the occurrence of the event(s) giving rise to the call. The FCM will monitor each separate account and assure that required initial and variation margin is received timely.⁶
- If the margin call is not received timely, the FCM will contact the responsible person for assurances that the margin will be paid and when payment should be received.⁷
- Consistent with the Margins Handbook, if an account is undermargined for an unreasonable time (as defined in the Margins Handbook), the FCM will only accept orders for risk reducing trades for

⁴ An FCM may deem accounts to have been established for a bona fide purpose, for example, if such accounts are: (i) separately contracted for with different asset management firms; (ii) established as a separate investment portfolio within the same asset management firm; (iii) established by a commercial entity for the purpose of a commodity or margin financing arrangement and secured by the lender as a secondary security interest; or (iv) necessary to separately account for or settle obligations of separate branches established pursuant to separate legal/country jurisdictions.

⁵ The FCM must retain the ability, after the exercise of all other risk reducing procedures that the FCM deems appropriate in the circumstances and consistent with its internal controls and procedures, to ultimately look to funds in other accounts of the beneficial owner, including accounts that are under different control, as well as the right to call the beneficial owner for funds.

⁶ There may be situations where the margin call is not made within the one-day time period, including, but not limited to, where due to administrative error or operational constraints. Such situations must be *bona fide* and consistent with the FCM's risk management policies.

⁷ A responsible person could be investment manager or the custodian or underlying beneficial owner, or other similar party, as appropriate.

that separate account until the margin deficit has been extinguished with respect to that separate account.

- The FCM records each separate account independently in the FCM's books and records, *i.e.*, the FCM records each separate account as a receivable (debit/deficit) or payable with no offsets between the other separate accounts of the same beneficial owner (except in the case of portfolio margining arrangements). Similarly, the receivable from a separate account will only be secured (considered a current/allowable asset) based on the assets of that separate account, not on the assets held in another separate account of the same beneficial owner.
- The FCM covers with its own funds any margin deficiency for each separate account in its Residual Interest and Legally Segregated Operationally Commingled Compliance Calculations, *i.e.*, each separate account is treated independently to determine the amount of FCM residual interest that must be maintained in segregated, secured and cleared swap customer accounts, as applicable. The FCM continues to comply with existing regulatory guidance and interpretations in respect of all other calculations.

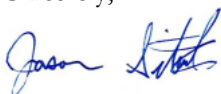
Based on the above, an FCM may agree to first satisfy any amounts owed from agreed assets related to the separate account (e.g., assets under management) and continue to release funds until the FCM has provided a separate account with a notice of an Event of Default under the applicable clearing account agreement and determined that it is no longer prudent to continue to separately margin the separate accounts provided that such actions are consistent with the FCM's written internal controls and procedures. As explained with respect to Commission Rule 1.56, the FCM would under such circumstances retain the ability to ultimately look to funds in other accounts of the beneficial owner, including accounts that are under different control, as well as the right to call the beneficial owner for funds.

SIFMA AMG requests that DCR confirm that a derivatives clearing organization (“**DCO**”) would not be acting contrary to CFTC Rule 39.13(g)(8)(iii) if the DCO permits its clearing members to choose to treat as a separate account each account of the same beneficial owner, such that such accounts will not be required to be combined for margin purposes. Consistent therewith, SIFMA AMG requests DCR to confirm that an FCM would not be acting contrary to any CFTC rule or interpretation, if such FCM elects to treat as a separate account each account of the same beneficial owner, such that such accounts will not be required to be combined for margin purposes. The requested relief will confirm that an FCM may release excess funds from a separate account notwithstanding an outstanding margin call in another account of the same customer, *i.e.*, beneficial owner.

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Thank you for your consideration of this request. If you have any questions or if you need any additional information, please contact Jason Silverstein, SIFMA AMG's Managing Director & Associate General Counsel, at jsilverstein@sifma.org or 212-313-1176.

Sincerely,



Jason Silverstein