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July 11, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (RIN 3038-AC97)

Dear Mr. Stawick:

The Investment Company Institute[1] welcomes the opportunity to provide comments to the Commodity Futures Trading Commission ("CFTC") regarding its proposed margin requirements for swaps that are not cleared.[2] Pursuant to Section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), the CFTC has proposed a risk-based approach to impose margin requirements on swap entities[3] that are not banks, including non-bank subsidiaries of bank holding companies ("covered swap entities"). As participants in the swaps markets, ICI members support the objectives of ensuring the fair and orderly operation of these markets and the safety and soundness of their counterparties to swap transactions and these markets generally.

ICI is concerned that the proposed rules' margin requirements would not satisfy these objectives, and makes several recommendations to address these deficiencies. Among our concerns, the rules would apply only to the collection of minimum margin amounts by a covered swap entity from its counterparties instead of also including specific requirements that a covered swap entity must post

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs) (collectively "funds"). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.3 trillion and serve over 90 million shareholders.

[2] *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 FR 23732 (April 28, 2011) ("proposal"), available at http://www.cftc.gov/LawRegulation/FederalRegister/ProposedRules/2011-9598.html. For purposes of this letter, the term "swap" will refer to both swaps and security-based swaps.

[3] For purposes of this letter, the term "swap entity" will refer to swap dealers, security-based swap dealers, major swap participants ("MSPs") and security-based major swap participants required to register under the Dodd-Frank Act.

margin to its counterparties. ICI therefore recommends that the CFTC modify the proposal to eliminate any regulatory gaps by requiring covered swap entities to post margin at the same levels and in the same manner as would be required under the proposal for the particular type of counterparty. To provide transparency and fair application of the proposed margin models, we recommend that the CFTC allow the end-user to choose between application of the covered swap entity's margin model and the standardized grid set forth in the banking regulators' margin proposal.[4] We also recommend that the CFTC modify the definition of end-user to clarify that registered investment companies are low-risk financial end-users because of the stringent regulatory regime under which they operate.[5] In addition, we recommend that the CFTC expand the categories of eligible collateral in recognition of the practical realities of the swap markets. Finally, we encourage the CFTC to coordinate and harmonize, to the extent possible, the proposed rules with its fellow regulators in the United States and abroad to minimize disruption to and preserve the safety and soundness of the swaps markets.

I. Market Participants

The proposed rules would apply to four categories of market participants: swap dealers and MSPs, high-risk financial entities, low-risk financial entities, and non-financial entities. ICI requests that the CFTC clarify the application of the proposal to registered investment companies ("funds"). We recommend that the CFTC also amend the proposal to include funds within the category of low-risk financial entities because of their extensive regulation under the federal securities laws.

A. Clarification Regarding Categories of Financial End-users

A financial entity would be defined as, among others, a commodity pool, a private fund as defined in Section 202(a) of the Investment Advisers Act of 1940, an employee benefit plan, a person predominantly engaged in activities that are in the business of banking or in activities that are financial in nature as defined in Section 4(k) of the Bank Holding Company Act of 1956, or any other person the CFTC may designate. We request that the CFTC clarify that a fund would be classified as a financial entity under the proposed rules. We further request that the CFTC clarify that the proposed rules would apply to a fund on a portfolio-by-portfolio basis.

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[4] For purposes of this letter, the banking regulators consist of the Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and Federal Housing Finance Agency. *See* Margin and Capital Requirements for Covered Swap Entities, 76 FR 27563 (May 11 2011), available at http://frwebgate3.access.gpo.gov/cgi-in/TEXTgate.cgi?WAISdocID=o7MBDC/0/1/0&WAISaction=retrieve.

[5] Unlike the banking regulators' proposal, the CFTC proposal does not use the terms "high risk" and "low risk" in describing financial entities but the proposed outcome is the same for "low risk" financial entities under the banking regulators' proposal and "certain financial entities" under the CFTC's proposal. In this letter, we will use the term "low risk" financial entity.

Funds participate in the derivatives markets in various ways.[6] The definition used by the CFTC does not explicitly address the categorization of funds. Section 4(k) of the Bank Holding Company Act encompasses activities that are financial in nature including "providing financial, investment, or economic advisory services, including advising an investment company." The language in Section 4(k) focuses on the investment adviser to a fund. For purposes of the CFTC's margin proposal, however, we believe a reasonable interpretation of Section 4(k) would apply the margin requirements to funds to which a person provides investment advisory services. The CFTC should provide legal certainty that funds, whose activity is not otherwise included within one of the categories listed under the definition of "financial entity," are covered by Section 4(k).[7] Alternatively, we recommend that the CFTC provide certainty to such funds by exercising its authority under Section 721(b)(2) of the Dodd-Frank Act to designate other persons as "financial entities" for purposes of these rules.

In addition, we recommend that the CFTC clarify the manner in which the proposed rules would apply to funds in recognition of the unique structure of funds and their relationship with advisers. Funds are frequently organized as a single corporation or statutory trust that have multiple "series," each of which is a separate pool of securities with separate assets, liabilities, and shareholders. A swap transaction, therefore, is fund and series specific because it is the fund, not the adviser, that enters into the swap transaction. Under an International Swaps and Derivatives Association ("ISDA") master agreement, for example, each individual fund and each series within a fund trust stands alone.[8] Further, funds must segregate collateral for derivative instruments on an individual fund or series basis.[9] These and other requirements under the federal securities laws[10] safeguard the assets in an individual portfolio from risks that may negatively affect another portfolio, and consequently the shareholders invested therein and the fund complex more broadly. Accordingly, to appropriately account for the potential counterparty risk associated with a particular swap, the margin requirements for a swap should apply at the individual portfolio or series level. It follows that funds would net positions and exposures for purposes of the proposed margin formulas also at the individual fund or series level.

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[6] For example, consistent with the investment objectives in their prospectus, some of the ways funds use derivatives may include equitizing cash that a fund cannot immediately investing in direct equity holdings; managing the fund's cash positions more generally; and adjusting the duration of the fund's portfolio.

[7] For example, as modified by the Dodd-Frank Act, the term commodity pool means any investment trust operated "for the purpose of trading in commodity interests." Thus a fund with limited swap activity would not satisfy the definition of commodity pool.

[8] In other words, an individual portfolio is liable for its obligations under the ISDA agreement and the swap dealer may not pursue remuneration from another portfolio in the fund trust. *See, e.g.,* ISDA 2002 Master Agreement.

[9] *See* Section 17(f) of the Investment Company Act of 1940 ("Investment Company Act").

[10] For example, Regulation S-X regarding financial statements requires that financial data for funds or series companies be provided on a fund or series-by-series basis, respectively. *See* Rule 6.03(j) of Regulation S-X.

B. Modify Definition of End-user

The proposal, in essence, divides financial end-users into two categories: high risk and low risk.[11] A low-risk financial end-user would be defined to include an end-user that: is subject to capital requirements established by a banking regulator or a state insurance regulator; predominantly uses swaps to hedge or mitigate the risks of its business activities; and does not have significant swaps exposure. All other financial end-users would be high-risk financial end-users. Funds would not qualify as low-risk end-users under this definition because they are not subject to capital requirements established by a prudential regulator or a state insurance regulator. As highly regulated, financially sound swap counterparties and in recognition of the securities, rather than banking, model of regulation to which they are subject, the CFTC should modify the proposal to include funds in the category of low-risk financial end-users. Further, funds should be permitted to use an initial margin threshold below which they are not required to post collateral.

As discussed above, funds are registered under the Investment Company Act, which imposes stringent regulation on funds that is not imposed on other financial institutions or products under the federal securities laws. This oversight prevents excessive speculation and contributes to the stability of funds, ensuring that they do not contribute to systemic risk. In particular, funds have stringent leverage restrictions that reduce the chances of funds losing collateral and limitations on exposure to certain counterparties – *i.e.*, securities-related businesses. In addition to regulating their disclosures to investors and regulating their daily operations, the federal securities laws subject funds and their advisers to antifraud standards, and provide the Securities and Exchange Commission ("SEC") with inspection authority over funds and their investment advisers, principal underwriters, distributing broker-dealers and transfer agents. The Financial Industry Regulatory Authority also has oversight authority with regard to funds' principal underwriters and distributing broker-dealers. Each of these measures contributes to the low-risk nature of funds as swap counterparties.

Under the proposal, non-financial end-users and low-risk financial end-users would not be required to post margin under certain thresholds. The threshold amount would be based on the relative risk of the counterparty. For example, the threshold for a low-risk financial end-user would be the lower of (1) a range of $15 to $45 million or (2) a range of 0.1 to 0.3 percent of the covered swap entity's tier 1 capital. Regardless of whether the CFTC classifies funds as low-risk financial end-users, ICI recommends that funds, and other creditworthy counterparties, be eligible for an initial margin threshold instead of the zero thresholds proposed for high-risk financial entities. The threshold should reflect the counterparty's creditworthiness. For funds, for example, creditworthiness could be determined as a percent of assets under management.[12]

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[11] *See supra* note 5.

[12] ICI also would support the recommendation in the Asset Management Group's letter that the maximum uncollateralized threshold for low-risk financial end users be set at $100 million. *See* Letter from Timothy W. Cameron, Managing Director, Asset Management Group, Securities Industry and Financial Markets Association, to Gary K. Van Meter, Acting Director,

II. Application of Proposal to Pre-Effective Date Swaps

The proposal would apply only to swaps entered into after the effective date of the proposed rules. The CFTC seeks comment, however, on whether a swap entity should be permitted voluntarily to include pre-effective date swaps in portfolios margined pursuant to the proposed rules.[13] ICI recommends that, at the discretion of the end-user, pre-effective date swaps may be included within the margin calculations. Providing the end-user with the ability to include such swaps within the portfolio or aggregate calculations should help to ensure that certain pre-effective date swaps are not unexpectedly included, leaving end-users with inadequate notice regarding the amount of necessary margin, and time to obtain the permitted types and amount of collateral.

III. Margin Requirements

The proposal sets forth the margin obligations, permissible methods for calculating initial and variation margin, and types of eligible collateral. ICI strongly recommends that the CFTC revise the proposal to require corresponding two-way margin requirements between covered swap entities and non-swap entity counterparties. ICI also recommends that the CFTC modify the proposed margin models to provide greater certainty to counterparties and expand the categories of eligible collateral to accommodate market practices and realities.

A. Two-Way Margin

The stated purpose of the proposed rules is to "offset the greater risk to the swap entity and financial system arising from the use of swaps and security-based swaps that are not cleared." Notwithstanding this mandate, the proposal would not require covered swap entities to post margin to their counterparties in those instances when their counterparties were required to post margin. Rather, the proposal only would include requirements regarding the amount of margin that a covered swap entity must collect from its counterparties. To better protect their counterparties and the swaps markets, ICI recommends that the CFTC require covered swap entities to post margin to their non-swap entity counterparties at the same level and in the same manner as required for the counterparty.

Office of Regulatory Policy, Farm Credit Administration, Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation, Alfred M. Pollard, General Counsel, Federal Housing Financing Agency, Jennifer Johnson, Secretary, Board of Governors of the Federal Reserve System, Mary J. Miller, Assistant Secretary for Financial Markets, U.S. Department of the Treasury, and David A. Stawick, Secretary, Commodity Futures Trading Commission, dated July 11, 2011.

[13] The banking regulators' proposal would permit a covered swap entity to calculate initial margin requirements under a qualifying master netting agreement, where used, on a portfolio basis and calculate variation margin requirements on an aggregate net basis.

(i) *Protection for Swaps Markets and Market Participants*

Two-way margin is an essential component to managing risk for swaps transactions. The collection of two-way margin helps to protect the individual counterparties to a swap transaction as well as the swaps and other derivatives markets more broadly. The premise behind collecting margin is to cover exposures by ensuring that counterparties can meet their financial obligations.[14] It is not surprising, therefore, that the proposal emphasizes the importance of imposing minimum margin requirements for uncleared swaps, stating that such requirements "serve both as a check on risk-taking that might exceed a party's financial capacity and as a resource that can limit losses when there is a failure."

On a daily basis, the collection of variation margin serves to remove current exposure from the market for all products and all participants, ensuring that exposures do not accumulate at any level – the counterparty, the swap entity, or the clearing organization.[15] It is the accumulation of such exposures that can build up, threatening systemic stability. In fact, the uncertainty about this accumulation of exposure played a significant role in the most recent financial crisis. The lack of transparency in the swaps markets fueled uncertainty about the exposure market participants faced from potential defaults by their swap counterparties.

The financial crisis also demonstrated that the premise of one-way margin for covered swap entities is flawed. Before the financial crisis, financial regulators were concerned that swap dealers needed protection from risky buy-side counterparties, prompting the development and increasing use of initial margin.[16] Swap dealers, on the other hand, were not expected either to fail, or to take on excessive risks through swaps without sufficient financial resources to cover those contracts, and certainly not in such rapid and extensive fashion. The financial crisis established that the exposures of the swap dealer were real and should be accounted for in managing the dealer's risk and the risk to the dealer's counterparty and the financial system.

The need for two-way margin is reinforced by the recognition in the proposal that swap dealers and MSPs are "at the center" of the swap markets. The proposal specifically states that swap dealers and MSPs "pose greater risk to the markets and the financial system than other swap market participants." It logically follows that (1) the counterparty to the credit risk and exposures of these swap entities likewise should have the protection afforded by minimum margin requirements, and (2) the financial

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[14] Initial margin is an amount calculated based on anticipated exposure to future changes in the value of a swap. Variation margin is an amount calculated to cover the current exposure arising from changes in the market value of the position since the trade was executed or the previous time the position was marked to market.

[15] For cleared swaps, derivatives clearing organizations ("DCOs") currently use variation margin to manage risk for all clearing parties, including swap dealers and end-users, as a mechanism to limit exposure and provide protection to the swaps markets and other derivatives markets.

[16] *See supra* note 8.

system should be protected from the same risks and exposures of these swap entities when they undertake uncleared swap transactions with counterparties other than another swap entity.

In reviewing counterparty risk and appropriate controls for such risk, it bears asking why certain counterparties that are subject to comprehensive regulatory regimes by either the CFTC, banking regulators, or the SEC are treated differently under the proposal. A fund, for example, is subject to extensive and rigorous regulation under the Investment Company Act as enforced by the SEC, including stringent limits on leverage.[17] Yet a fund, as a financial end-user counterparty, would be required to post margin and a covered swap entity would not. Both are regulated entities, subject to various regulatory controls to limit and mitigate their risk exposure, and both should be treated similarly under the proposal.[18]

Ultimately, two-way margin requirements would aid safety and soundness by helping a covered swap entity and its counterparty to offset their exposures and prevent them from building up exposures that they cannot fulfill. Two-way variation margin also would minimize the liquidity risk of uncleared swaps by removing current exposures prior to any efforts by a swap entity to mitigate losses from a default by a counterparty.[19] In addition, requiring a covered swap entity to post initial margin to a non-swap entity counterparty would remove one or more incentives for a covered swap entity to choose, where possible, to structure a transaction so that it need not be cleared in order to avoid posting initial margin. Finally, it would eliminate any perception concerns that a swap entity subject to oversight by the CFTC, and consequently not required to post margin, is more creditworthy than other potential swap counterparties. For these many reasons, ICI urges the CFTC to require equivalent two-way margin obligations for both counterparties to a swap transaction.[20]

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[17] Under Section 18 of the Investment Company Act and subsequent SEC and staff guidance, a fund is prohibited from taking on a future obligation to pay unless it "covers" the obligation by setting aside, or earmarking, assets sufficient to satisfy the potential exposure from the derivatives transaction. The assets used for "covering" such obligation must be liquid, marked to market daily, and held in custody. These limitations ensure that a fund can neither cause nor contribute to systemic risk through its use of derivatives. *See* Dreyfus Strategic Investing and Dreyfus Strategic Income, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) 48,525 (June 22, 1987) and Merrill Lynch Asset Management, L.P., SEC No-Action Letter, 1996 WL 429027 (July 2, 1996) and Investment Company Act Release No. 10666, Securities Trading Practices of Registered Investment Companies, 44 FR 25128 (April 27, 1979).

[18] In fact, the Dodd-Frank Act directs the banking regulators and the SEC and CFTC to jointly adopt margin rules for covered swap entities. This mandate would seem to indicate recognition by Congress that the financial regulators may have different albeit equivalent regulatory regimes for the entities subject to their respective jurisdictions, and that these regulatory regimes should be given due accord and harmonized to the extent practicable.

[19] We agree with the CFTC's analysis that the low levels of liquidity associated with an uncleared swap could hamper efforts or increase costs to liquidate these swaps, particularly in distressed market conditions.

[20] The recommendation for comparable regulatory treatment would extend to the use of thresholds, netting, negotiations between the counterparties and the custody of margin (discussed below).

(ii) *Statutory Construction*

Section 731 of the Dodd-Frank Act requires that margin requirements offset the greater risk to the swap entity and financial system arising from the use of swaps that are not cleared. To offset the risk, the margin requirements must help ensure the safety and soundness of the swap entity and be appropriate for the risks associated with uncleared swaps. We recognize that the statutory language regarding the "standards for capital and margin" speaks to the protection of the swap entity only. We also recognize that the effect of the proposed rules would be to require collection of margin by both parties to a swap transaction when swap entities transact with one another. Collection of margin from covered swap entities only for transactions between such entities, however, leaves a noteworthy gap in the regulatory framework.

Meaningful protection of the safety and soundness of the financial system is explicit in the Dodd-Frank Act provisions and requires risk management of all swap counterparties to a transaction including a covered swap entity. The Dodd-Frank Act specifically provides that covered swap entities shall meet minimum margin requirements as prescribed by the CFTC and that the CFTC shall adopt rules imposing margin requirements on all swaps that are not cleared by a DCO.[21] These provisions provide the CFTC with ample authority to require swap entities to post margin in transactions with financial end-user counterparties.

(iii) *Safeguarding of Two-Way Margin Collateral*

In addition to requiring two-way margin from covered swap entities, the CFTC should address how the collateral should be maintained and who should maintain it. For transactions between covered swap entities, the proposal would require that any collateral that was required to be collected by a covered swap entity must be held by an independent, third-party custodian. In addition, it would allow such treatment for collateral collected by covered swap entities in transactions with non-swap entity counterparties.[22] ICI recommends a similar approach for treatment of covered swap entities' collateral in transactions with non-swap entity counterparties: the covered swap entity's collateral, in particular initial margin, should be held by independent, third-party custodians (*i.e.,* tri-party arrangements) with restrictions on rehypothecation and reinvestment unless the parties determine otherwise.[23]

In tri-party arrangements, the independent tri-party agent assumes certain responsibilities with respect to safeguarding the interests of both counterparties, including maintaining custody of the

[21] Section 731 of the Dodd-Frank Act, which adds new Sections 4s(e)(1)(A) and e(2)(A)(ii) to the Commodity Exchange Act.

[22] ICI strongly supports the proposed requirement that swap counterparties be given the opportunity to select a custodian that is not affiliated with the swap entity, but is not required to do so. In the case of funds, this flexibility allows a fund to determine which custodian best satisfies its needs to safeguard customer collateral posted as margin.

[23] We believe it would be appropriate for the covered swap entity to post the required margin at the same independent, third-party custodian that holds the counterparty's margin.

collateral, and is involved in effecting the transfer of funds and securities between the two parties. This arrangement helps to avoid market disruptions in the case of a default or other event necessitating access to the collateral. The protections provided to covered swap entities from this structure are equally important to managing the risk to the counterparty created by exposure to the particular covered swap entity. Similarly, mitigating this risk serves to reduce the risk to the financial system associated with the particular covered swap entity.

B. Calculation of Margin

(i) *Use of Models*

The CFTC proposal would permit CSEs to calculate margin using the following types of models that meet other specified standards: (1) a model currently in use for margining cleared swaps by a DCO; (2) a model currently in use for margining uncleared swaps by an entity subject to regular assessment by a prudential regulator; or (3) a model available for licensing to any market participant by a vendor. Unlike the banking regulators' proposal, the CFTC proposal would not provide for covered swap entities to use proprietary models because, according to the CFTC, it does not have the resources to review numerous models individually given current budget constraints; however, the CFTC proposal includes a provision that would permit it to issue an order that would allow the use of covered swap entity proprietary models in the future should the CFTC obtain sufficient resources. If no model meeting the standards of the rule were available, the covered swap entity would be required to calculate margin in accordance with an alternative approach that would base the margin requirements on the margin requirements for related cleared products.

ICI appreciates the resource restraints under which the CFTC is operating. We further recognize that the CFTC is trying to provide market participants with a range of alternatives for calculating initial margin for uncleared swaps. ICI respectfully recommends, however, that the CFTC adopt a system of calculating initial margin that would permit the counterparty to choose between a covered swap entity's model and the standardized minimum initial requirements set forth in Appendix A of the banking regulators' proposal.[24] We believe that such a framework for calculating of initial margin will promote greater uniformity and transparency for market participants, and be easier to administer operationally. This system would permit, but not require, covered swap entities to develop initial margin calculations using their own models in the first instance, but would provide that a counterparty could always choose the standardized minimum initial requirements. We also believe that the standards for models being proposed by the CFTC, including that a model be validated by an independent third party prior to use and annually thereafter, and that the model's methodology be stated with sufficient specificity to permit the counterparty and the CFTC to calculate the initial

[24] *See supra* note 4.

margin requirement independently, provide sufficient safeguards to permit the use of covered swap entity proprietary models.

We are concerned, however, that the standard requiring a 10-day liquidation period is too long for initial margin requirements. As proposed, an initial margin model for uncleared swaps would need to set initial margin at a level to cover 99 percent of price changes by product and portfolio over at least a 10-day liquidation horizon. ICI believes that initial margin should be set at a level that reflects a close-out, offset or other risk mitigation that occurs more or less simultaneously with the default. In light of the relatively high 99 percent confidence interval, we recommend that a 5-day liquidation period is appropriate for uncleared swap transactions.

With respect to the proposed alternative, ICI believes that it would be too difficult and cumbersome to use a DCO model for margining cleared swaps as a basis to calculate initial margin for uncleared swaps. Further, trying to find a cleared swap or futures contract that is economically equivalent to an uncleared swap, which would be the basis for the alternative method of calculating initial margin, would also be burdensome to administer. We believe that it would be preferable to permit a counterparty to choose the prudential regulators' standardized minimum initial requirements as the alternative initial margin calculation method.

(ii) *Effective Date*

The final question posed by the CFTC in the proposal concerns the time necessary for covered swap entities to comply with the final margin rules. ICI recommends that, if the CFTC adopts the proposals to require that covered swap entities file their models with the CFTC and that the CFTC approve such models, a mechanism be established so that the margin regulations would not become effective until the CFTC has reviewed all submissions made by a certain cut-off date. Such a procedure should serve to assure that some covered swap entities do not gain a competitive advantage by being able to enter into uncleared swaps when other swap entities are waiting for the CFTC to process their margin model applications.

C. Forms of Margin

The proposal would limit the categories of eligible collateral to cash, U.S. Treasuries and, for initial margin only, certain government securities. Consistent with current swaps market practice, the CFTC should expand the proposed list of eligible collateral to allow counterparties to a swap transaction the flexibility to agree upon the appropriate collateral arrangements for a particular swap.[25] The absence of a range of acceptable collateral may result in a drag in performance as well as a divergence from the benchmark of a portfolio. In other words, a fund's performance may be stifled

[25] In support of this position, it is important to recognize that swap dealers did not have any difficulties during the financial crisis accessing segregated swap customer assets set aside at custodians through bilateral agreements to meet their obligations.

because the fund may be forced to hold low-yielding securities unnecessarily in relation to the transactions hedged by the swaps. With respect to the benchmark, a fund may be forced to hold margin that does not correspond with the fund's benchmark thereby creating basis risk and causing a fund to run counter to its desire to match the benchmark composition. Neither a municipal fund nor an equity fund, for example, would otherwise hold, or be able to hold, many of the eligible types of collateral.

If the CFTC is unwilling to provide that degree of flexibility, ICI recommends that the CFTC permit the use of fixed-income securities issued by a well-known seasoned issuer that has a high credit standing, are unsubordinated, historically display low volatility, are traded in highly liquid markets, and have valuations that are readily calculable. This would include, for example, sovereign debt securities and pre-refunded municipal securities.

To avoid reference to credit ratings, the concept of a "high credit standing" could be defined using option-adjusted spread ("OAS"). OAS generally measures a debt instrument's risk premium over benchmark rates covering a variety of risks and net of any embedded options in the instrument. For a particular fixed-income instrument, the OAS reflects the credit and liquidity risk net of any spread due to option features in the instrument and associated option risk. Because OAS can be calculated in a consistent manner for any fixed-income instrument relative to its benchmark rates, it allows for comparison of fixed income instruments across asset classes.[26] The threshold for high-grade fixed-income instruments can be determined by setting a threshold OAS calculated in accordance with an approved method.

IV. Coordinate Effective Date of Cleared and Uncleared Margin Rulemaking

ICI recommends that the CFTC align the margin rules for uncleared swaps with the effective dates for margin rules mandated for cleared swaps. The proposal would unjustly hamstring swap investors with respect to moving initial margin and would result in disproportionately high margin rates for swaps lacking a cleared alternative. The effective date of the proposal should not apply to any swaps, much less those intended to be cleared, until the entire set of margin-related rules is completed. The likely consequences of applying the proposals at different times would be detrimental to the swaps markets and swap market participants. In some cases, swap market participants would be forced to clear for commercial reasons that, due to standardization, may not fully reflect the risks of the individual swap or allow market participants to appropriately hedge their individualized risks. Alternatively, market participants may seek to use other methods for mitigating or hedging their investment risks, resulting in less liquidity in the swaps markets. Either of these consequences would negatively affect systemic risk.

V. Regulatory Coordination

The swaps markets and swap market participants operate in a global marketplace. Therefore, it is critical that the CFTC have consistent and harmonized regulation domestically and internationally

[26] *See* Frank J. Fabozzi, Fixed Income Analysis for the Chartered Financial Analyst Program (2000).

with respect to its margin proposal. Where harmonization is not possible, regulators should work to coordinate their proposals to the greatest extent possible. To mitigate systemic and counterparty risk, the proposed margin requirements place important, but burdensome, obligations on market participants. These obligations will influence market participants' decisions on whether and how to trade in the swaps markets, affecting the liquidity and stability of these markets. Meaningful inconsistencies and differences between the regulators' proposals may result in several unintended consequences including fragmentation of markets and regulatory arbitrage. Further, as a practical matter, the regulators should ensure that the proposed margin rules do not create overlapping and potentially conflicting rules for swap market participants. The related uncertainty regarding these swap entities could reduce the confidence of market participants seeking to hedge their risks in the swaps markets.

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If you have any questions on our comment letter, please feel free to contact me directly at (202) 326-5815 or Heather Traeger at (202) 326-5920.

Sincerely,

/s/ Karrie McMillan

Karrie McMillan
General Counsel

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
U.S. Securities and Exchange Commission

Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott D. O' Malia, Commissioner
U.S. Commodity Futures Trading Commission

Mr. Gary K. Van Meter, Acting Director, Office of Regulatory Policy
Farm Credit Administration

Mr. Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation

Mr. Alfred M. Pollard, General Counsel
Federal Housing Financing Agency

Ms. Jennifer Johnson, Secretary
Federal Reserve Board

Ms. Mary J. Miller, Assistant Secretary for Financial Markets
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