Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW.
Washington, DC 20581

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Dear Secretary Kirkpatrick,

AIMA submission: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements

The Alternative Investment Management Association[1] (**AIMA**) and The Investment Association[2] (hereafter, **we**) welcome the opportunity to comment on the Commodity Futures Trading Commission's (CFTC; **the Commission**) proposed rule on Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements[3] (**the Proposed Rule**).

AIMA and its members have been vocal supporters of measures to reduce risk and increase transparency in OTC derivatives markets and note that robust, coherent rules on margin are an important element of this. We likewise believe that it is vital that regulators globally cooperate to ensure that rules are designed in a way that minimizes overlap and allows for deference to each other's rules, whether through substituted compliance or equivalence.

In the Annex that follows, we make the following points:

- We are concerned that the framework presented in the Proposed Rule is extremely complex, which could make it more difficult for market participants – and foreign regulatory counterparts – to understand and apply. A consequence of this could be the cessation of existing business relationships and greater fragmentation of market liquidity.

- We also believe that it would be preferable to prioritise bilateral discussions with foreign counterparts, including the European Commission, over finalisation of the Proposed Rule, to ensure that a comprehensive cross-border agreement is first in place before rules are finalised. Proceeding rapidly to finalise the rule would only serve to increase the risk that the framework will not effectively deliver on the Commission's policy objectives.

- We strongly support the Commission's proposed revision to the U.S. Person definition to exclude entities that are majority-owned by U.S. Persons; we believe that this will greatly improve the prospects of agreement between the Commission and foreign counterparts regarding the cross-border application of their respective rules. We continue to see a case for the Commission to further harmonise its rules with the SEC's U.S. Person definition, to ensure consistency domestically between the key agencies responsible for oversight of the swaps market and to limit the compliance burden placed on market participants.

[1] Founded in 1990, the Alternative Investment Management Association (AIMA) is the global representative of the hedge fund industry. Our membership is corporate and comprises over 1,500 firms (with over 9,000 individual contacts) in more than 50 countries. Members include hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. AIMA's manager members collectively manage more than $1.5 trillion in assets. See www.aima.org.
[2] The Investment Association represents UK investment managers. We have over 200 members who manage more than £5 trillion for clients around the world, helping them to achieve their financial goals.
[3] 80 FR 41376. Online at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2015-16718a.pdf.

- We are not convinced that the concept of partial substituted compliance will work well in practice, and could lead to market participants being forced to margin their positions fully under the CFTC's rules, given that margining under two separate legal regimes would be commercially and legally challenging. We believe that substituted compliance should automatically be made available in full where a transaction is subject to the rules of jurisdiction that participated in the work of the BCBS-IOSCO's Working Group on Margining Requirements (WGMR).

- We believe that there is a strong case to revisit the proposed implementation timetable associated with the margin rules and encourage the Commission to raise the possibility of a further extension of 9 months with foreign counterparts.

If you would like to discuss any aspect of our submission, please contact Adam Jacobs (ajacobs@aima.org) or Richard Metcalfe (richard.metcalfe@investmentuk.org).

Yours sincerely,

Jiří Król
Deputy CEO
Global Head of Government Affairs
The Alternative Investment Management Association (AIMA)

Richard Metcalfe
Director of Regulatory Affairs
The Investment Association

Annex 1

1. Application of the Proposed Rule

As a general observation, we are concerned that the degree of complexity inherent in the Commission's framework is such that it is extremely hard to arrive at an overall understanding of the situations in which CFTC margin requirements apply. At the same time, there are also apparent gaps in the framework, with no provision for substituted compliance for transactions involving a non-US branch of a U.S. CSE.

The Commission notes in the Proposed Rules that some non-U.S. Covered Swap Entities (CSEs) have removed guarantees in order to fall outside the scope of certain Dodd-Frank requirements and therefore proposes to subject foreign subsidiaries of a U.S. person to its rules through the establishment of the "Foreign Consolidated Subsidiary" concept. The Commission explains that its intention is to "identify swaps of those non-U.S. CSEs whose obligations under the relevant uncleared swap are not guaranteed by a U.S. person but that raise substantial supervisory concern in the United States, as a result of the possible negative impact on their U.S. parent entities and the U.S. financial system".

From the point of view of market participants, this complexity could make it more difficult to ascertain and monitor a counterparty's regulatory status – for example, requiring legal investigation and representations to be obtained from all non-US CSE counterparties whether they are in fact guaranteed by a US entity or are a Foreign Consolidated Subsidiary (FCS) - and could in the extreme lead to the cessation of certain business relationships in order to avoid such uncertainty. The application of the Proposed Rule could also require a significant amount of replacement and additional documentation to account for different counterparty combinations and the possibility of the piecemeal application of different jurisdictions' rules to the same transaction. The end consequence of this would be greater fragmentation of liquidity in OTC derivatives markets along regional regulatory boundaries. It also increases the risk that particular participants will not interpret the rule correctly, leading to the potential for inconsistency in how firms approach the requirements.

We are similarly concerned that the structure of the rules could further complicate discussions between the Commission and foreign regulators regarding the respective scope of their rules and options for substituted compliance, ultimately making it more difficult to put in place agreements to resolve issues of overlap and inconsistency between rules.

On a related note, we are not persuaded by the Commission's stance that discussions with foreign regulatory authorities (including in the EU and Japan) "will continue as it finalizes and then implements its framework for the application of margin requirements to cross-border transactions, and as other jurisdictions develop their own respective approaches".[4] While the goal of arriving at a coherent global approach is highly laudable, we would urge the Commission to ensure that it allows sufficient time to reach agreement with foreign counterparts **before** finalising its own approach. Proceeding to finalise rules in the absence of agreement with other regulators will inevitably complicate bilateral discussions and make it harder to arrive at workable solutions.

2. U.S. Person definition

We note that the Proposed Rule would not include within the U.S. Person definition the U.S. majority-ownership prong that was included in the CFTC's Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations (**the Guidance**).[5]

We strongly welcome this move and commend the Commission for its willingness to reconsider the approach taken in the Guidance. As we have explained previously, the majority-ownership limb of the U.S. Person definition is deeply problematic and is a key driver of overlap between the rules of the CFTC and other jurisdictions, most notably the EU.[6]

As the Commission rightly identifies, ownership alone is not indicative of whether the activities of a non-U.S. fund with a non-U.S.-based manager have a direct and significant effect on the U.S. financial system. At the same

[4] 80 FR 41378.

[5] 78 FR 45292. Online at: http://www.gpo.gov/fdsys/pkg/FR-2013-07-26/pdf/2013-17958.pdf.

[6] *See* AIMA Request for Time-Limited No-Action Relief with respect to Section 2(h)(1)(A) of the CEA in respect of EMIR covered fund, dated 9 October 2013. Online at: http://www.aima.org/objects_store/aima_request_for_time-limited_no-action_relief_10092013.pdf.

time, the majority-ownership limb also gives rise to potential operational difficulties relating to the identification of the beneficial owner of a fund in certain fund management structures, including those where investors' positions are held in a nominee account.

The Commission highlights a potential argument in favour of maintaining the majority-ownership limb, namely that many funds that fall within this limb have large U.S. investors, who could be adversely impacted in the event of a counterparty default.[7] We do not view this as a compelling argument: in the overwhelming majority of situations, the fund will be subject to comparable foreign rules that aim to limit the likelihood and impact of a counterparty default through rules on central clearing, margin and reporting. It is also worth noting that the U.S. investors are not the direct counterparty to the transaction, and will only be impacted by a counterparty default to the extent that the redemption value of their investment in the fund falls; no additional payments would be required by the U.S. Persons.

Notwithstanding our support for the Commission's approach, we note that it is not at this stage clear how the Proposed Rule impacts the existing Guidance and questions will inevitably arise as to whether it supersedes the Guidance. At the same time, construction of a new definition also adds to the number of distinct definitions that market participants will have to adopt in their activities, thereby increasing compliance costs.

In light of this, the Commission specifically asks in the release whether the definition of U.S. Person should be identical to the one adopted by the SEC in its August 2014 rulemaking.[8] We believe that there is a very strong case for the CFTC to consider adopting the SEC's U.S. Person definition, to ensure consistency across the Agencies with responsibility for oversight of the swaps market, and to make it easier for market participants to implement and comply with the substantive requirements of the CFTC and SEC regimes. We stress that any move to harmonise the definition of U.S. Person should relate to all CFTC requirements in respects of swaps markets, rather than being confined to a particular substantive area of the rules, e.g. margin requirements. This would also imply rescission or amendment of the Guidance as it currently stands, which we believe is an important step to improve harmonisation.

3. Substituted compliance

A related issue to how the rule will apply is the circumstances in which the Commission would permit substituted compliance. In the Proposed Rule, the Commission notes that non-U.S. CSEs and non-U.S. counterparties may be subject to comparable or different rules in their home jurisdictions. Conflicting and duplicative requirements between U.S. and foreign margin regimes could potentially lead to market inefficiencies and regulatory arbitrage, as well as competitive disparities that undermine the relative position of U.S. CSEs and their counterparties.[9]

Accordingly, the Commission is proposing a substituted compliance framework that allows CSEs and FCS to benefit from full or partial substituted compliance, depending on the nature of the other counterparty to the transaction.

While we strongly welcome the Commission's recognition of the need to provide for substituted compliance, we believe that substituted compliance should always be all encompassing, and applicable to all parties to a transaction, rather that requiring one side to the transaction to continue to post or collect margin under the CFTC framework in certain situations.

From discussions with our members, it is clear that putting in place a legal agreement with a counterparty that would imply transfer of margin amounts according to different regulatory regimes would be commercially and legally problematic and is unlikely to be widely adopted. The alternative would be to margin the relationship solely under CFTC requirements, which would in practice negate the value of having a substituted compliance framework.

Accordingly, we believe that the Commission should ensure that substituted compliance is fully available for situations where a contract is margined under the rules of a jurisdiction which has in place comparable rules. We believe that it would be reasonable to adopt the approach that any transaction involving an entity from a jurisdiction that participated in the BCBS-IOSCO WGMR discussions would be able to benefit in full from

[7] 80 FR 41383.

[8] 79 FR 47371. Application of ''Security-Based Swap Dealer'' and ''Major Security-Based Swap Participant'' Definitions to Cross-Border Security-Based Swap Activities, 12 August 2014. Online at: http://www.gpo.gov/fdsys/pkg/FR-2014-08-12/pdf/R1-2014-15337.pdf.

[9] 80 FR 41377.

substituted compliance, such that the counterparties to the transaction would be able to agree bilaterally the regulatory regime under which margin would be transferred between them. This would overcome the problem that is otherwise presented by an approach based on an elemental test for substituted compliance, namely the fact that there are sufficient differences between the Commission's framework and those of foreign counterparts, notably the EU, that could frustrate a positive substituted compliance determination (differences in respect of minimum margin transfer amounts and the initial margin threshold, for example). If the Commission elects not to adopt an approach that would provide for automatic substituted compliance for key WGMR members, then it should at least ensure that substituted compliance is premised on broad comparability of requirements rather than detailed correspondence of rules.

In this manner, the Commission's regulatory objectives would still be met, whilst also ensuring that the regime gives due deference to foreign regulators' rules and allows participants to comply with the rules without undue legal and commercial complications.

4. Implementation timeline

Given that there is not at this stage a comprehensive agreement between U.S. and EU authorities regarding the cross-border application of their respective rules, we are concerned that the implementation timeline envisaged by BCBS-IOSCO might ultimately prove too tight – even despite the recent extension that has been provided.[10] We encourage the Commission to consider with its regulatory counterparts whether a further delay of 9 months might at this point be appropriate to ensure that market participants have adequate time to implement the new rules correctly.

[10] See http://www.bis.org/bcbs/publ/d317.htm