October 10, 2023

Submitted electronically via CFTC Comments Portal

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

Re: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (RIN 3038–AF36)

Dear Mr. Kirkpatrick:

The Securities Industry and Financial Markets Association ("SIFMA"),[1] including SIFMA Asset Management Group ("SIFMA AMG"),[2] and the International Swap and Derivatives Association ("ISDA"),[3] (collectively, the "Associations") appreciate the opportunity to provide comments to the Commodity Futures Trading Commission (the "CFTC" or "Commission") on the proposed amendments to the margin requirements for uncleared swaps ("Margin Rules")[4] for swap dealers and major swap participants (collectively, "Covered Swap Entities," or "CSEs") to:

(1) Deem, for three years after they begin trading, certain collective investment funds that receive all of their start-up capital, or a portion thereof, from a sponsor entity ("Seeded

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA").

[2] 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.

[3] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 77 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook, and YouTube.

[4] 17 C.F.R. §§ 23.150 – 23.161.

Funds") not to have any "margin affiliates" for the purposes of determining whether initial margin ("IM") is required to be exchanged (the "Seeded Fund Proposal");

(2) Eliminate a provision disqualifying money market funds and similar funds ("MMFs"), from being eligible collateral under the Margin Rules solely because they transfer their assets through securities lending, repurchase agreements and other similar agreements (the "MMF Proposal")[5]; and

(3) Add a footnote to the haircut schedule describing the haircut applicable to securities of MMFs (the "MMF Haircut Footnote").

The Associations appreciate the Commission's recognition, both from its own experience with the implementation of the Margin Rules and from the report issued by the Global Markets Advisory Committee margin subcommittee ("GMAC Report")[6], that changes to the Margin Rules are appropriate to achieve the Commission's regulatory objectives without creating undue burdens experienced by market participants that are Seeded Funds or that wish to post or transfer securities in MMFs as eligible collateral as anticipated by the Margin Rules. We welcome the Proposal's thoughtful approach to address these obstacles, but, as discussed in detail below, believe additional tailoring is necessary to achieve the Commission's stated objective; in particular certain of the currently proposed restrictions and conditions would render implementation unworkable and would need to be addressed to achieve a change in the status quo of Margin Rules implementation.

I. Executive Summary.

We respectfully provide the following recommendations and feedback for consideration by the Commission in respect of the Proposal:

- The Commission should remove from the definition of "eligible seeded fund" the requirement that none of the sponsor entity's margin affiliates controls or has transparency into the management or trading of the fund. This requirement is not necessary to ensure that the fund is sufficiently independent and risk-remote from other entities in the sponsor group, and would preclude most Seeded Funds operated by independent asset managers from qualifying as eligible seeded funds and benefiting from the Proposal simply because the asset managers are consolidated with sponsor entities

[5] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 88 Fed. Reg. 53409 (Aug. 8, 2023) ("Proposal").

[6] Recommendations to Improve Scoping and Implementation of Initial Margin Requirements for Non-Cleared Swaps, Report to the CFTC's Global Markets Advisory Committee by the Subcommittee on Margin Requirements for Non-Cleared Swaps (May 2020), https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download.

from an accounting perspective even if the sponsor entities do not have the requisite control or visibility of the management or trading of the Seeded Funds.

- The Commission should remove from the definition of "eligible seeded fund" the requirement that one or more of the fund's margin affiliates must post and collect IM pursuant to CFTC Regulation 23.152. This requirement would limit the relief to only funds with an affiliate that is a CSE subject to the Commission's Margin Rules, and would inappropriately exclude funds without CSE affiliates or whose CSE affiliates are subject to the prudential regulators' margin rules. Whether or not a Seeded Fund has an affiliate that is a CSE (or indeed, an affiliate in scope for IM under the Margin Rules facing a CSE counterparty) should not impact whether such Seeded Fund may be an eligible seeded fund.

- The Commission should deem eligible seeded funds to not constitute margin affiliates of any other entity during the seeding period. Without this change, eligible seeded funds hoping to avail themselves of the relief would have to—as they do under the status quo—share information about their uncleared swap exposure with its group and require it and its CSE counterparty to calculate theoretical IM amounts that would have to be posted or collected in the absence of the proposed relief on a real-time basis. This requirement currently restricts Seeded Funds from utilizing uncleared swaps and, in some cases, has caused Seeded Funds to move their businesses overseas and trade only with non-U.S. swap providers such that their uncleared swaps would not be directly subject to the Margin Rules.

- The Commission should adopt the MMF Proposal as proposed. MMF securities are safe investments subject to extensive regulation, and the Margin Rules already include additional safeguards for MMF securities as eligible collateral by limiting the types of underlying investments an MMF may make. The Commission should not impose additional restrictions that would be inconsistent with ongoing global efforts to facilitate market participants' use of securities in MMFs and similar funds as IM under the global uncleared derivatives margin framework.

- The Commission should not condition eligibility of MMF securities as eligible collateral under the Margin Rules on the MMF clearing its repo transactions. The Treasury clearing market is in a state of transition due to the proposal by the Securities and Exchange Commission ("SEC") to require clearing of certain Treasury transactions. Given this state of uncertainty, the Commission should not require that MMFs clear their repos in order for securities of such MMFs to constitute eligible collateral.

- The Commission should not adopt the MMF Haircut Footnote as proposed. The prudential regulators' approach to mandatory haircuts for MMF securities has, in practice, curtailed market participants' ability to use MMF securities as collateral. We

recommend that the Commission allow CSEs to determine the appropriate haircut for MMF securities according to their ordinary risk management process. To the extent that the Commission wishes to specify a mandatory haircut for MMF securities, we recommend a standard two percent haircut which would be consistent with market practice outside of the uncleared swaps margin rules in relation to MMF securities pledged as collateral.

- The Commission should adopt the Proposal (with recommended changes discussed herein) as soon as possible, regardless of whether the prudential regulators take a similar approach. We anticipate that the important benefit to buy-side market participants hoping to pledge MMFs securities as IM collateral would outweigh any documentation or operational costs in managing the discrepancy with other regulators' uncleared swap margin rules.

II. Recommendations on the Seeded Fund Proposal.

Under the Margin Rules, a CSE is required to collect and post IM in respect of swaps between such CSE and a counterparty that is a financial end user ("FEU") with material swaps exposure ("MSE") or a CSE.[7] FEUs include entities, persons, and arrangements whose business is financial in nature (including many investment funds).[8] An FEU will have MSE if, as of September 1 of any year, the FEU *and* its margin affiliates have a month-end average aggregate notional amount ("AANA") of uncleared swaps, uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps above $8 billion with all counterparties for March, April, or May of that year ("MSE Calculation Period"). Absent an exemption, CSEs would be required to post and collect IM in relation to swaps with any investment fund with MSE once the amount of IM that would be required to be posted or collected between the fund and its margin affiliates, on one hand, and the CSE and its margin affiliates, on the other, would exceed $50 million (the "IM threshold").

Under the Seeded Fund Proposal, an "eligible seeded fund" would be deemed not to have any margin affiliates for the purpose of calculating the fund's MSE and for purposes of determining whether the IM threshold had been exceeded for three years after the fund's trading inception date. The Proposal would define "eligible seeded fund" as any collective investment vehicle that has received a part or all of its start-up capital from a parent and/or affiliate where:

- The fund is a distinct legal entity from each sponsor entity;

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[7] 17 C.F.R. § 23.151.

[8] *Id.*

- One or more of the fund's margin affiliates is required to post and collect IM pursuant to CFTC Regulation 23.152 ("In-Scope Affiliate Condition");

- The asset manager manages the fund's assets in accordance with a specified written investment strategy;

- The asset manager has independence from the sponsor entity or the sponsor entity's affiliates and, to the extent applicable, has independent fiduciary duties to other investors in the fund, such that no sponsor entity or any of the sponsor entity's margin affiliates controls or has transparency into the management or trading of the fund ("Independent Management Condition");

- The fund follows a written plan for reducing each sponsor entity's ownership over a three-year period that stipulates divestiture targets over the three-year period after the date on which the seeded fund's asset manager first begins to make investments on behalf of the fund ("Written Plan Condition");

- The fund's obligations are not collateralized, guaranteed, or otherwise supported by any sponsor entity or sponsor entity's affiliate or other collective investment vehicle or the fund manager;

- The fund has not received any of its assets from an eligible seeded fund that has itself relied on the eligible seeded fund exception; and

- The seeded fund is not a securitization vehicle.

a. The Commission should Modify the Independent Management Condition to Permit a Sponsor Entity's Margin Affiliate to Act as an Independent Asset Manager of an Eligible Seeded Fund.

In proposing the Independent Management Condition, the Commission noted its intent to ensure that eligible seeded funds are "sufficiently independent and risk-remote from other entities in their group," ensure "genuine independence'" and provide "effective safeguards against financial contagion."[9]

However, the proposed Independent Management Condition—specifically, the requirement that "no sponsor entity or any of the sponsor entity's margin affiliates controls or has transparency into the management or trading of the seeded fund"—is overly broad and would make it impossible for many genuinely independent Seeded Funds to rely on the exception.

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[9] 88 Fed. Reg. at 53415.

Many Seeded Funds are operated by independent asset managers that have the same ultimate parent as, and accordingly are subject to accounting consolidation with, the sponsors of such Seeded Funds. Even in circumstances where the asset manager and the affiliated sponsor entity are completely separate when it comes to the operation of the Seeded Funds, and the asset manager is subject to fiduciary duties[10] and legal obligations that limit the sponsor's influence over, or visibility into, the asset manager's trading decisions and day-to-day management of the Seeded Fund, the asset manager would still constitute a margin affiliate of the sponsor.[11]

Disqualifying such Seeded Funds from the eligible seeded fund exception would not serve to advance any stated regulatory objective of the Commission in the Proposal. Instead, the Independent Management Condition, as proposed, would unfairly favor some Seeded Funds over others and skew market practice by disincentivizing the use of sponsor-affiliated asset managers. Accordingly, we recommend that the Commission modify the Independent Management Condition, e.g., by amending the language of the Independent Management Condition to say, "no sponsor entity (directly or indirectly through any of the sponsor entity's margin affiliates) controls or has transparency into the management or trading of the seeded fund."

b. The Commission should remove the In-Scope Affiliate Condition.

In proposing the In-Scope Affiliate Condition, the Commission noted its goal to limit the exception to "seeded funds that have limited individual swaps exposure, but, due to their affiliation with an entity or group of entities, have on a collective basis sufficient AANA to meet the MSE threshold."[12]

However, the In-Scope Affiliate Condition, as proposed, would limit the eligible seeded fund exception to only funds that have a registered swap dealer or major swap participant as an affiliate. The In-Scope Affiliate Condition would require an eligible seeded fund to have a margin affiliate that "is required to post and collect initial margin pursuant to § 23.152." The Margin Rules only directly obligate CSEs to post and collect IM. Non-registered entities only have to post and collect IM at the request of their CSE counterparties, which would not be "pursuant to" the Commission's IM requirement. As a result, the In-Scope Affiliate Condition would effectively prevent all Seeded Funds without a CSE affiliate from relying on the eligible seeded fund exception.

Further, the In-Scope Affiliate Condition would not be appropriate even if it were revised to cover Seeded Funds with affiliates that are required to post and collect IM because of their

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[10] Section 206 of the Investment Advisers Act of 1940; SEC, Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33669 (July 12, 2019).

[11] We would note in this regard that in connection with disaggregation from position limits under 17 C.F.R. § 150.4 there is no condition or requirement pertaining to affiliation of independent account controllers, the independence of which can be satisfied through independent control over trading activity of the fund.

[12] *See* 88 Fed. Reg. at 53412.

counterparty's regulatory obligations under the Margin Rules (the "Revised In-Scope Affiliate Condition"). In our experience, it would be common for a funds group to collectively meet the IM threshold or have MSE when no individual entity in the group is required to comply with the CFTC's IM requirements. For example, a funds group may only have swaps that result in exposure required to be counted towards the MSE calculation with counterparties who are not subject to the Commission's Margin Rules, including CSEs complying with prudential regulators' margin rules. Since Seeded Funds in such a group would not be able to rely on the eligible seeded fund exception, the Revised In-Scope Affiliate Condition would still create inequity between (x) Seeded Funds whose affiliates are in-scope of the Commission's Margin Rules, and (y) Seeded Funds whose affiliates are complying with prudential regulators' margin rules.

More fundamentally, the In-Scope Affiliate Condition is not necessary for achieving the regulatory objective behind the Seeded Fund Proposal, as the other prongs of the "eligible seeded fund" definition should be sufficient to ensure that only bona fide Seeded Funds that would otherwise be facing undue burden under the current Margin Rules could take advantage of the exemption. Accordingly, we recommend that, in the final rules, the Commission remove the In-Scope Affiliate Condition from the "eligible seeded fund" definition. Requiring the aggregation of swaps as currently set out in the Proposal would be inconsistent with the Commission's stated objective of "address[ing] challenges confronted by seeded funds that have limited individual swaps exposure, but, due to their affiliation with an entity or group of entities, have on a collective basis sufficient AANA to meet the MSE threshold."[13]

c. The Commission should deem eligible seeded funds to not constitute margin affiliates of any other entity during the seeding period.

Under the Seeded Fund Proposal, an eligible seeded fund would be deemed not to have margin affiliates during the 3-year seeding period; however, an eligible seeded fund would still be a margin affiliate of its sponsor entity and other affiliates. As a result, the seeded fund would have to share information about its uncleared swaps, uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps with such entities in order to allow them to determine (i) whether they have MSE, and (ii) if they have MSE, the amount of IM that they would hypothetically post, for purposes of determining whether the IM threshold of its margin affiliates had been exceeded.

However, such information sharing may not be workable in practice given both the operational challenges for funds to share with affiliates details regarding their uncleared swap positions and exposures on a dynamic, real-time basis and, as indicated in the GMAC Report and acknowledged by the Commission in the Proposal, the potential legal challenges arising from

[13] 88 Fed. Reg. at 53412.

confidentiality obligations and regulatory restrictions to which a Seeded Fund may be subject.[14] The operational challenges are particularly salient in the context of calculating the IM threshold because, in order to determine whether the Seeded Fund's sponsor entity and affiliates have breached the IM threshold, the initial margin amount that a Seeded Fund would have to collect or post must be determined on a real-time basis using a model-based or standardized approach.[15]

Even if margin affiliates were to rely on their CSE counterparties for those calculations (which would not necessarily be prudent risk management), it is likely that CSEs would likely determine the cost-and-benefit analysis would not make it worth their while to enter into swaps with the relevant margin affiliates.[16]

The difficulty in information sharing and the operational burden to monitor the IM threshold have been impediments for certain market participants under the current Margin Rules and have prevented many funds that are subject to information sharing restrictions from accessing the uncleared swaps markets. Even those fund groups that are not restricted from sharing necessary information by their confidentiality obligations must currently monitor—sometimes at great expense—Seeded Funds' uncleared swap activities in order to determine IM obligations of the group's member funds or cause their Seeded Funds to forgo entering into uncleared swaps either during the MSE Calculation Period or at all – an approach unavailable to funds generally given ongoing hedging and trading needs.

Many Seeded Funds, at least until such time as they are no longer subject to accounting consolidation with their sponsor groups, are forced to rely on cleared derivatives for risk management and excluded from the advantages and innovation offered by the uncleared derivatives markets. Some fund groups have moved or set up Seeded Funds offshore, and such non-U.S. Seeded Funds have to rely on swap providers who are able to avoid the application of the Margin Rules.

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[14] *See* 88 Fed. Reg. at 53412 ("In addition to operational challenges, the [GMAC Report] indicated that potential confidentiality obligations may prevent the different affiliates within the seeded fund's consolidated group from sharing uncleared swaps exposure information. As an example, the Report noted that because of regulatory restrictions, an insurance company that sponsors a seeded fund would not be permitted to share information about the fund's trading activity with an affiliate engaging in swap transactions for purposes of hedging general insurance risk."). For example (and the Associations respectfully note that this is only one potential concern with the Commission's current Proposal relating to information sharing), certain exemptions from the aggregation requirements under the Commission's position limit rules are conditioned on the use of adequate information barriers regarding the positions of a fund. See 17 C.F.R. §§ 150.4(b)(1)(ii)(A) (exemption for certain limited partners, shareholders, or other participants in a commodity pool conditioned on "[t]he pool operator has, and enforces, written procedures to preclude the person from having knowledge of, gaining access to, or receiving data about the trading or positions of the pool"); 150.4(b)(2)(i)(C) (exemption for certain persons with ownership or equity interest in a fund conditioned on such person and the fund "[h]ave and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about, trades of the other"); 150.4(b)(4)(i)(A) (exemption for certain independent account controllers on the condition that it and its affiliated fund "[h]ave, and enforce, written procedures to preclude the affiliated entities from having knowledge of, gaining access to, or receiving data about, trades of the other") (emphasis added).

[15] *See* 17 C.F.R. § 23.154.

[16] *See* discussion *supra* note 14.

If the Commission retains the requirement that an eligible seeded fund be treated as a margin affiliate of its sponsor group, the Proposal's objective to "prevent[] potential reductions in liquidity or trading disruptions"[17] would not be achieved given the existing compliance approaches which would effectively serve to reduce liquidity and disrupt trading. In the long run, U.S.-based sponsors and Seeded Funds would remain at a competitive disadvantage and funds would continue to be incentivized to move their business overseas to the detriment of U.S. interests.

Most crucially, if the Seeded Fund Proposal were adopted with a requirement that, when determining if margin affiliates of an eligible seeded fund have exceeded the IM Threshold, such margin affiliates must take into account the IM amount for which such eligible seeded fund would be responsible in the absence of the Proposal, such margin affiliates would be economically responsible for the Eligible Seeded Fund.

Consider, for example, a situation where entities in a sponsor group have uncleared swaps with a CSE and no uncleared swaps with the CSE's margin affiliates, and the sponsor group would not have breached the IM Threshold *but for* the exposure of eligible seeded funds. In such a case, the CSE could become obligated to collect IM from the sponsor and its margin affiliates that are not eligible seeded funds even though the CSE does not have sufficient credit exposure from the sponsor and those margin affiliates to generate an IM amount that is greater than the IM Threshold. Further, swap counterparties currently enter into IM documentation that provides for exchange of IM by reference to the swaps exposure of the legal entities that are parties to such documents. If a sponsor has to treat eligible seeded funds as margin affiliates, the eligible seeded funds will not need to enter IM documentation, but their IM exposure amount would need to be included in the IM Threshold of the sponsor, whose own IM documentation would need to be amended to cover the eligible seeded funds.

We therefore propose that the Commission both (i) deems eligible seeded funds to not have margin affiliates, *and (ii) deems eligible funds not to constitute margin affiliates of any other entity*, during the seeding period. This approach would be consistent with not only the GMAC Report's recommendation—which itself is based on the BCBS-IOSCO final statement on margin requirements for non-centrally cleared derivatives[18]—but also harmonize the Commission's Margin Rules with margin rules adopted by regulators in other jurisdictions.

For example, under the European Union ("EU") margin rules ("EU Margin Rules") and United Kingdom ("UK") margin rules ("UK Margin Rules"), investment funds "shall be considered distinct entities and treated separately when applying" the threshold based on notional amount, threshold based on IM amount, and the calculation of aggregate notional amount when

[17] 88 Fed. Reg. at 53412.

[18] See footnote 10 to Requirement 2.2 of Basel Committee on Banking Supervision (BCBS)-International Organization of Securities Commissions (IOSCO) framework, *available at* https://www.iosco.org/library/pubdocs/pdf/IOSCOPD651.pdf.

"the funds are distinct segregated pools of assets for the purposes of the fund's insolvency or bankruptcy" and "the segregated pools of assets are not collateralized, guaranteed, or otherwise financially supported by other investment funds or their managers."[19] Accordingly, under the EU Margin Rules and UK Margin Rules, when a Seeded Fund is part of a group of affiliated entities, (1) the affiliates' swaps activities are not aggregated with those of the Seeded Fund, and (2) the Seeded Fund's swap activities are not aggregated with any affiliate.[20] Regulators in Canada, Japan, Australia also have fully adopted the BCBC-IOSCO framework in this context.[21]

This approach would also be consistent with how the Volcker Rule, which was cited by the Commission in its Proposal, treats seed investments in funds.[22] Under the Volcker Rule, banking entities are generally prohibited from investing in "covered funds," but they can make seed investments and retain de minimis investments in covered funds they organize and offer in connection with a bona fide asset management business, provided that any seed investment is reduced to a de minimis (3%) per fund amount after a seeding period that can reach up to three years.[23]

In separate guidance released by the Commission and other regulatory agencies responsible for implementing the Volcker Rule, the Commission has also clarified that a foreign public fund or registered investment company partially or wholly owned by a banking entity should not be treated as an affiliated banking entity during a seeding period "during which the banking entity is testing the fund's investment strategy, establishing a track record of the fund's performance for marketing purposes, and attempting to distribute the fund's shares."[24] The Seeding FAQ acknowledges that such a seeding period "may take some time, for example, three years, the maximum period of time expressly permitted for seeding a covered fund."[25]

In the Proposal, the Commission stated that the requirement for an eligible seeded fund's sponsor entity and other margin affiliates to continue to include the eligible seeded fund's exposure in the MSE calculation and the IM threshold determination was intended to "prevent

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[19] Articles 28(3), 29(3) and 29(2) of Commission Delegated Regulation No. 2016/2251 with regard to Regulatory Technical Standards for Risk-Mitigation Techniques for OTC Derivative Contracts Not Cleared by a Central Counterparty, 2016 O.J. L340/11 (the "**EMIR RTS**") (available at https://eurlex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R2251&from=EN) and the EMIR RTS as they have effect in UK domestic law by virtue of the European Union (Withdrawal) Act 2018.

[20] *Id*., at Articles 28(3), 29(3), and 39(2).

[21] GMAC Report at 29.

[22] *See* 88 Fed. Reg. at 53413.

[23] *See, e.g.,* 17 C.F.R. §§ 75.11 and 75.12(a)(1)-(2).

[24] *See* CFTC Division of Swap Dealer and Intermediary Oversight Responds to Frequently Asked Question Regarding Certain Requirements under Section 13 of the Bank Holding Company Act of 1956 and Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (July 16, 2015) (the "Seeding FAQ").

[25] *Id*.

CSEs and their counterparties from creating legal entities and netting sets that have no economic basis and are constructed solely for the purpose of applying additional thresholds to evade margin requirements" and to prevent a sponsor entity from "creating seeded funds merely to reduce its own exposure" and evade the Margin Rules. We don't believe such concern, while theoretically possible, justifies the Proposal's departure from the banking regulators' approach—and indeed, the Commission's own approach—in the context of the Volcker Rule as illustrated above or from the approach adopted by international market regulators in the implementation of their uncleared margin rules by declining to treat Seeded Funds that meet the eligibility standard for exemption as fully separate entities from its affiliates. We are not aware of any concerns raised by the Commission or banking or market regulators that market participants are creating seeded funds to evade the Volcker Rule or foreign uncleared margin rules. To the extent that any market participant actually abuses the exemption for Seeded Funds to circumvent IM requirements, the Commission has ample means to directly address this concern pursuant to its anti-evasion authority.[26]

The Commission has determined, in the context of the Commission's position limit rules, that risks associated with accumulation of positions and related exposures due to the trading activities of a fund are mitigated where its sponsor is not actively involved in or aware of the fund's trading activities. Specifically, a fund's sponsor may avail itself of exemptions from aggregation of the positions of the fund so long as the conditions (which are generally designed to ensure that the person claiming the exemption does not have knowledge about, or control over, the fund's trading activities) for the relevant exemptions are met, effectively treating the entities as unaffiliated for this purpose.[27] Position limits exemptions from aggregation also resolve the practical, legal and operational issues that would otherwise result where trading information would be required to be shared between funds, managers, participants and owners. We respectfully request that the Commission take a consistent approach to both the Proposal and the position limits rules, which share common objectives of reducing systemic risk and preventing evasion.

III. The Commission should adopt the MMF Proposal as proposed.

Under the Margin Rules,[28] eligible collateral for IM includes, among other items, certain securities in the form of redeemable securities in a pooled investment fund that (a) represent the security holder's proportional interest in the fund's net assets and (b) are issued and redeemed only on the basis of the market value of the fund's net assets prepared each business day after the

[26] *See* 17 C.F.R. § 23.402(a)(1)(ii) (requiring CSEs to have written policies and procedures to prevent the evasion, or participation in or facilitation of an evasion, of any provision of the Commodity Exchange Act or Commission regulations); 23.151 (definition of MSE, which states that activities not carried out in the regular course of business and wilfully designed to circumvent the calculation of the AANA at month-end to evade meeting the definition of MSE shall be prohibited).

[27] 17 C.F.R. § 150.4(b).

[28] 17 C.F.R. § 23.156.

security holder makes its investment commitment or redemption request to the fund. These eligibility requirements are consistent with regulations under the United States Investment Company Act of 1940 ("40 Act") that apply to the operation and management of MMFs, including SEC Rule 2a-7.[29]

Further, securities in such MMFs would only be eligible collateral if (1) the MMF's investments are securities that are issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury, and immediately-available cash funds denominated in U.S. dollars, or securities denominated in a common currency and issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20% risk weight under the capital rules applicable to swap dealers subject to regulation by a prudential regulator, and immediately-available cash funds denominated in the same currency; and (2) assets of the fund may not be transferred through securities lending, securities borrowing, repurchase agreements, reverse repurchase agreements, or other means that involve the fund having rights to acquire the same or similar assets from the transferee (collectively, "repos", and the condition described in this prong (2), the "Asset Transfer Restriction").

The MMF Proposal would eliminate the Asset Transfer Restriction and add a footnote to the Margin Rules' haircut schedule to describe the haircut applicable to securities of MMFs, which would be the weighted average discount on all assets within the funds calculated as a fraction of each fund's total market value. The Proposal would not change any of the other conditions, including in particular the type of assets that an eligible MMF may invest in.

a. Additional restrictions on MMFs are unnecessary to ensure the safety of MMFs securities as eligible collateral under the Margin Rules and may interfere with global efforts to improve the utilization of MMF securities in the efficient cross-border application of uncleared derivatives margin requirements.

We recommend that the Commission adopt the proposed elimination of the Asset Transfer Restriction without introducing further restrictions such as those discussed in the Commission's request for comments.

As noted in the GMAC Report, the Commission has recognized such MMFs as safe investments under CFTC Regulation 1.25, which permits the investment of futures and cleared swaps customer margin by Futures Commission Merchants (FCMs") without similar restrictions.[30] CFTC Regulation 1.25 specifically permits, subject to certain conditions, FCMs to

[29] 17 C.F.R. § 260.2a-7.

[30] 17 C.F.R. § 1.25(a)(1)(vii), (c).

buy and sell otherwise permitted investments pursuant to repurchase and reverse repurchase agreements.

A number of existing restrictions help ensure the safety of MMFs securities as eligible collateral under the Margin Rules. First, under CFTC Regulation 23.156(a)(1)(ix)(A) and (B), MMF securities are eligible collateral only if the MMF invests in (A) securities unconditionally guaranteed as to the timely payment of principal and interest by the U.S. Department of the Treasury and immediately-available cash funds denominated in U.S. dollars; or (B) securities denominated in a common currency and issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20% risk weight under the capital rules applicable to swap dealers subject to regulation by a prudential regulator and immediately-available cash funds denominated in the same currency.

In our experience, the MMFs most impacted by "runnability" and "breaking the buck" in past crises were those that invested in a broader range of assets and accordingly would not be eligible collateral under the Margin Rules regardless of whether there is an Asset Transfer Restriction or other restrictions on the MMF's use of repos. We agree with the Commission that the list of underlying assets which an eligible MMF invests in does not, at this time, need to be adjusted.

Second, MMFs are subject the extensive regulation under the 40 Act aimed at protecting customers that invest in MMFs (such as uncleared swap counterparties that wish to pledge MMF securities as IM), including the requirements under SEC Rule 2a-7 relating to credit quality, liquidity, diversification, and maturity of MMF investments, which are intended to limit risk in MMFs' portfolios. MMFs generally invest in repos as lender (i.e., repo buyer), which protects MMFs from custodian insolvency risk which arises where custodians hold cash in deposit accounts. This is the same risk that caused the Commission to restrict and condition the eligibility of cash as IM.[31]

Furthermore, SEC regulations restrict the ability of an MMF issuer to act as borrower in repos (i.e., repo seller), in particular because of the SEC's Derivatives Rules for 40 Act funds.[32] As a result, we believe there would be no discernable benefits for the Commission to retain the

[31] 17 C.F.R. § 23.157(c)(1).

[32] Use of Derivatives by Registered Investment Companies and Business Development Companies, 85 Fed. Reg. 83162 (Dec. 21, 2020) ("Derivatives Rules"). The "senior security" prohibition in section 18 of the 1940 Act for open-end funds restrict MMFs from acting as a borrower in repos. Prior to the Derivatives Rules' adoption, MMFs may rely on an older SEC release ("Release 10666"), which "recognized that, while section 18 would generally prohibit open-end funds' use of reverse repurchase agreements, firm commitment agreements, and standby commitment agreements, . . . [40 Act funds may] use these and similar arrangements subject to certain constraints." *Id.* at 83166. However, in the Derivatives Rules, the SEC has (i) provided that the rules do not apply to money market funds and (ii) rescinded Release 10666. Thus, there is no clear method by which MMFs can act as borrower under a repo.

Asset Transfer Restriction or impose any new conditions regarding MMFs' use of repos for MMF securities to be eligible collateral.

There are ongoing efforts in other jurisdictions to reform regulations of MMFs and similar funds in order to facilitate market participants' use of securities in pooled investments such as MMFs as IM under the global uncleared derivatives margin framework. For example, the EU Margin Rules currently require that, for MMF securities to constitute eligible collateral thereunder, MMFs constitute Undertakings for the Collective Investment in Transferable Securities ("UCITS"), as defined in the UCITS Directive, and therefore need to be established in the EU.[33] As a result, MMFs established in jurisdictions other than member states of the EU, including U.S. MMFs, would not constitute eligible collateral under the EU Margin Rules.

This has been more favorably addressed by the United Kingdom regulators in its margin regulations and is being advocated for reform by market participants before the EU regulators.[34] We respectfully suggest that the Commission should not impose restrictions on MMFs that could unduly burden MMFs and swap counterparties who look to post MMF securities as a means to address custodial risk without suffering the burdens which the Proposal seeks to mitigate.

b. The Commission should not condition eligibility of MMF securities as collateral under the Margin Rules on the MMF clearing its repo transactions.

The Associations would also like to provide feedback to the Commission on whether to condition eligibility of MMF securities as collateral under the Margin Rules on the MMF clearing its repo transactions.[35] Given that the Treasury clearing market is in a state of transition, the Commission should not impose any such requirement at this time.

On October 25, 2022, the SEC proposed amendments to its covered clearing agency standards that would dramatically change the way in which repos on Treasury securities are cleared. [36] That proposal would require SEC-registered clearing agencies that offer Treasury clearing services to (i) require their direct participants to clear virtually all Treasury repos with

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[33] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), as amended by Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions.

[34] The GMAC Report noted that there are currently no MMFs that are eligible under both the EU Margin Rules and either the CFTC's Margin Rules or the U.S. prudential regulator Margin Rules, which creates complications for FEUs that pledge IM to both U.S. and EU CSEs and asset managers trading in blocks across U.S. and EU clients with a single CSE. *See* GMAC Report at 26-28.

[35] Proposal, Request for Comment No. 11, 88 Fed. Reg. at 53419.

[36] *See* Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule with Respect to U.S. Treasury Securities, 87 Fed. Reg. 64610 (Oct. 25, 2022).

MMFs, (ii) calculate and collect house and customer margin separately, and (iii) consider ways to improve access to clearing.

As described in SIFMA AMG's comment letter dated December 22, 2022,[37] the SEC's proposal raises a number of concerns because central clearing of repos currently involves substantial costs without offering the same protections that apply to cleared OTC derivatives. In addition, a number of market participants, including some MMFs, are subject to restrictions that limit their ability to enter into cleared repos.

We understand that the SEC has actively been considering this feedback as well as comments from other stakeholders. In addition, the Fixed Income Clearing Corporation, the only clearing agency that provides Treasury clearing services, has made clear that it is actively considering major changes to its rules and processes in order to implement any final rule. Given this state of uncertainty, the Commission should not require that MMFs clear their repos in order for securities of such MMFs to constitute eligible collateral. Rather, the Commission should wait until any SEC final rule is adopted and the associated FICC rule changes are implemented. Only at that time would the Commission fully be able to assess the extent to which clearing is available to MMFs and the benefits—and drawbacks—of central repo clearing.

IV. The Commission should not Adopt the MMF Haircut Footnote.

The Commission proposed to add a footnote to the haircut schedule currently set out in the Margin Rules, which would clarify the haircut applicable to MMF securities in a manner consistent with that under the prudential regulators' margin rules.[38] Under the prudential regulators' margin rules, MMF securities would be valued at market and subject to a haircut based on the maturity of the fund's investments, and the discount to be applied to an eligible investment fund is the weighted average discount on all assets within the eligible investment fund at the end of the prior month. The weights to be applied in the weighted average would be calculated as a fraction of the MMF's total market value that is invested in each asset with a given discount amount.

While the Associations appreciate the Commission's effort to harmonize margin rules within the U.S., the current approach to mandatory haircuts for MMF securities under the prudential regulators' margin rules is overly cumbersome in practice and has severely curtailed market participants' ability to use MMF securities as collateral. Under the SEC's regulation of MMFs, fund managers of MMFs must execute daily redemptions and subscriptions, causing

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[37] *Available at* https://www.sifma.org/wp-content/uploads/2022/12/Standards-for-Covered-Clearing-Agencies-for-U.S.-Treasury-Securities-and-Application-of-the-Broker-Dealer-Customer-Protection-Rule-with-Respect-to-U.S.-Treasury-Securities-SIFMA-AMG.pdf; ; see also DTCC, Looking to the Horizon: Assessing a Potential Expansion of U.S. Treasury Central Clearing: a DTCC White Paper to the Industry (Sept. 2023), available at https://www.dtcc.com/-/media/Files/Downloads/WhitePapers/Accessing-Potential-Expansion-U S-Treasury-Clearing-White-Paper.pdf.

[38] *See* Footnote 1 to Appendix B to 12 C.F.R. Parts 45, 237, 349, 624, and 1221.

underlying portfolios and assets for MMFs to change daily. Because not all MMFs publish updated portfolio information on a real-time basis, accurate information about the end-of-month assets composition of an MMF may not be available at the end of each month. As a result, market participants who want to use MMF securities as uncleared swap margin would be required to either (i) calculate the haircut to the MMF securities based on the longest dated asset the MMF could hold, which information may not always be available from the MMFs, or (ii) regularly ascertain any changes in an MMF's portfolio, including through other sources. Both options are unduly burdensome in practice and contribute to the fact that market participants entering into uncleared swaps subject to the prudential regulators' margin rules generally do not pledge MMF securities as collateral.

Given the safety and liquidity of MMF securities mandated by the SEC's regulation of MMFs as discussed in Section III above, we respectfully recommend that the Commission allow CSEs to determine the appropriate haircut for MMF securities used as uncleared swap collateral pursuant to the CSEs' standard risk management process. If the Commission wishes to adopt a specific haircut applicable to MMF securities used as collateral under the Margin Rules, the Associations recommend that the Commission adopt a standard two percent haircut for MMF securities. The high liquidity and low volatility of MMF securities as a result of the SEC's regulation of MMFs makes it unnecessary to apply a complex, MMF-specific valuation and haircut calculation, as such calculation would result in negligible changes for an investment product with economics attributes very similar to cash. We note in this regard that as a matter of standard market practice outside of the uncleared swaps margin rules market participants often apply a two percent haircut to MMF securities pledged as collateral, and that two percent is likely higher than the haircut percentage that would be determined using the methodology that would be determined using the methodology that would be in the proposed MMF Haircut Footnote.[39]

V. Recommendation on Effective Date.

The Commission should adopt the Proposal (with recommended changes discussed above) as soon as possible, regardless of whether the prudential regulators take similar actions. We believe the burden on market participants to make documentation and operational changes to accommodate different requirements under the two U.S. regimes for uncleared swap margins in respect of Seeded Funds and MMF securities collateral would not be significant, because current documentation and systems can continue to be used in connection with prudentially regulated CSEs. The costs for developing the new operational system and documentation for non-prudentially regulated CSEs would be the same whether or not the prudential regulators' margin rules are amended at the same time. In any event, we believe the important benefits to Seeded

[39] Under Rule 2a-7, MMFs cannot maintain a dollar-weighted average portfolio maturity that exceeds 120 calendar days, and we understand from a member that effectively this means MMFs would have to hold close to 85% in securities that mature in 1 day in order to maximize exposure to Treasury maturing in 2 years. Under the Margin Rules' current haircut schedule, U.S. government securities with residual maturity less than 1 year have a 0.5% haircut, while U.S. government securities with residual maturity between 1 and 5 years have a 2% haircut. Accordingly, the weighted average discount on all assets of an MMF at any given time would likely be under 2%.

Funds and market participants hoping to pledge MMFs securities as IM collateral would outweigh any such costs.

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On behalf of the Associations, we appreciate the opportunity to respond to the Proposal and your consideration of our comments and recommendations. If you have any questions or require additional information, please do not hesitate to contact SIFMA AMG by calling William Thum at (202) 962-7381, SIFMA by calling Kyle Brandon at (212) 313-1280, ISDA by calling Tara Kruse at (212) 901-6045, or calling Deborah North of Cleary Gottlieb Steen & Hamilton, counsel for the Associations, at (212)225-2039.

Sincerely,

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cc: The Honorable Rostin Behnam, Chairman
The Honorable Kristin Johnson
The Honorable Christy Goldsmith Romero
The Honorable Summer Mersinger
The Honorable Caroline Pham