October 10, 2023

Submitted electronically via comments.cftc.gov.

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 American Council of Life Insurers[1] appreciates the opportunity to submit comments on the U.S. Commodity Futures Trading Commission ("CFTC" or "Commission")'s proposed amendments (the "Proposal") to its margin requirements for uncleared swaps applicable to swap dealers and major swap participants for which there is no prudential regulator (the "Rule").[2] ACLI broadly supports the Proposal, but as detailed below, requests revisions on several points to reflect the realities of marketplace activity and further align U.S. regulations with those of global regulators.

Life insurers are significant end-users of derivatives for prudential asset-liability management. Unlike many other financial institutions, life insurers have unusually long-term liabilities that must be matched with assets of equivalent duration. Derivatives allow life insurers to prudently manage the credit and market risk of their portfolios and to fulfill their long-dated obligations to policy and contract owners. As long-term and significantly experienced hedgers, life insurers have a strong interest in a stable and robust global financial system, and we strongly encourage coordinated domestic and international approaches to derivatives regulation that will achieve desired stability of

[1] The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 95 percent of industry assets in the United States.

[2] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants ("The Proposal"), 88 Fed. Reg. 53409 (Aug. 8, 2023), available here: https://www.federalregister.gov/documents/2023/08/08/2023-16572/margin-requirements-for-uncleared-swaps-for-swap-dealers-and-major-swap-participants.

the global financial system while enabling cost-effective compliance and discouraging regulatory arbitrage.

We welcome the Commission's willingness to review its rules for common-sense adjustments where the practical costs of compliance outweigh the marginal benefits and we hope the Commission will consider our comments in fine-tuning the relief to better calibrate the proposed exemption to the risk posed by funds seeded by a sponsor with material swaps exposure (as defined in the Rule, "MSE").

I. Background

ACLI is an active participant in the dialogue surrounding the regulation of domestic and international financial markets and has provided constructive input on a myriad of proposed rulemaking, including the implementation of Title VII of the Dodd Frank Wall Street Reform; Consumer Protection Act; and specifically, the subject of uncleared swap margin rules.[3]

ACLI has consistently advocated for an amendment to provide relief for seeded funds from the requirement to post and collect initial margin ("IM") based solely on the funds' receipt of seed money from a sponsor with MSE. In our letter dated September 23, 2019 ("2019 Letter"), we requested the relief on the basis that the inclusion of seeded funds placed an undue operational burden on insurance companies and similar entities with MSE that provide seed capital to certain affiliated investment funds at their inception while the funds establish a performance track record, with little benefit in reduced systemic risk.

Four years later, and more than two years after the Rule began to apply to Phase 5 entities, the need for regulatory relief remains and has been demonstrated. We applaud the Commission's willingness to review its rules for common-sense adjustments where the practical costs of compliance outweigh the marginal benefits. In our 2019 Letter, we argued that the inclusion of seeded funds in the requirement to post and collect IM under the Rule would increase monitoring and compliance costs with limited benefits to systemic risk reduction. Today, more than two years beyond the first compliance dates for life insurers that use derivatives, we find that this concern is still true.

Life insurers that have MSE have negotiated documentation and developed operational capability to meet the IM requirements for their main insurance businesses. At the same time, many life insurance industry participants have also been required to spend significant resources building out complex systems for monitoring a small number of seeded funds with limited derivatives usage. The process of building out these complex systems requires significant effort. These efforts include setting up IM documentation, custody accounts, operational ability, and monitoring the accounting status of seeded funds from inception to the point where they are no longer consolidated under GAAP accounting principles. In addition, monitoring the accounting status of seeded funds is further complicated where, by nature of derivatives in the insurance industry, some insurers utilize the National Association of Insurance Commissioners ("NAIC")'s statutory accounting principles rather than GAAP. Further, as new accounts are set up and old accounts are removed from the pool of consolidated entities with MSE, documents must be amended to reallocate IM thresholds

[3] ACLI provided support for the CFTC's Global Markets Advisory Committee: Margin Subcommittee's 2020 Report ("GMAC Report"), available here: https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download.

across all the trading relationships in the corporate group with each swap counterparty and its in-scope affiliates. This process requires significant effort and expense to chase exceptionally small amounts of derivatives exposure. We therefore support the Commission's Proposal, but we request a number of changes that we feel are necessary to make the proposed relief meaningful.

II. Observations of Regulation in Practice

As experienced hedgers working under the current regime and considering the Proposal, ACLI members offer three overarching reflections:

- Existing regulatory safeguards, along with several of the limitations included in the proposed definition of an "Eligible Seeded Fund" are sufficient to prevent sponsors from evading margin requirements;
- Seeded funds pose minimal risk during the seeding period; and
- Fund sponsors and trading counterparties face significant operational burdens associated with requirements that seeded funds post regulatory IM during the seeding period.

Therefore, the Proposal's exclusion of seeded funds from the requirement to post and collect regulatory IM with our recommended adjustments described in more detail below, would align with global regulations while also better aligning the costs of compliance with the risks of such entities to the broader financial system.

III. Recommended Changes to the Proposal

We understand the Commission's concern for striking the right balance between providing relief to seeded funds to ensure the compliance burden is more commensurate with any risk posed to financial stability and ensuring that the relief comes with sufficient guardrails. However, several features of the Proposal limit the relief in ways that greatly diminish its utility. In particular, we urge the Commission to reconsider these elements:

(1) Eligible Seeded Funds should not be considered margin affiliates of any entity.

The Proposal provides that eligible seeded funds would not be deemed to have margin affiliates for purposes of calculating the fund's MSE and its IM threshold amount during the first three years after the fund's trading begins; however, we strongly encourage the Commission to revise the proposal so that eligible seeded funds would also not be deemed to be margin affiliates for purposes of calculating any entity's MSE and IM threshold amount. Requiring members of the seeded fund's corporate group to deduct the funds' IM from their shared IM threshold would require significant operational support, sharing of information across affiliates in ways that are difficult to achieve, and frequent amendments of trading documents to account for the funds' trading behavior, which is outside the control of the other corporate entities in the group. In addition, this approach would deviate significantly from those of international regulators' approaches to seeded funds.

(2) **Where a seeded fund is managed by an affiliated asset manager, such asset manager should not be treated as a margin affiliate of the fund.**

The Proposal's definition of "Eligible Seeded Fund" requires the seeded fund's asset manager to have independence, "such that no sponsor entity or any of the sponsor entity's margin affiliates controls... trading of the seeded fund." This language would severely limit the relief, as most seeded funds are managed, and therefore their trading is controlled by, investment managers that are margin affiliates of the funds' sponsor. We accordingly ask that the Commission exempt the seeded fund's asset manager from the category of margin affiliates for purposes of this limitation.

(3) **Seeded funds should not be subject to the inflexible requirement of a written plan for reducing ownership interest.**

The Proposal's definition of an "Eligible Seeded Fund" includes a requirement that the fund have a written plan for reducing each sponsor's ownership interest in the seeded fund 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. We think this requirement limits flexibility in important ways and is unnecessary to incentivize divestment, as other factors –including the three-year limit—provide ample incentive on their own.

(4) **Seeded funds should not be required to have a margin affiliate that is a Covered Swap Entity ("CSE").**

The Proposal requires that one or more of the seeded fund's margin affiliates is required to post and collect IM pursuant to Section 23.152. We ask the Commission to clarify that this element does not require the seeded fund to have a margin affiliate that is a CSE. Most insurance companies do not have a CSE in their corporate group, but they post and collect IM as a result of their counterparties' requirement under the Rule. We also ask the Commission to expand this requirement to include relief for seeded funds whose margin affiliates post and collect IM as a result of their trading activity with dealers subject to comparable rule sets, including the uncleared margin rules adopted by Prudential Regulators.[4]

IV. Exclusion of seeded funds from the requirement to post and collect regulatory IM aligns with global regulations and better aligns the costs of compliance with the risks of such entities to the broader financial system.

A. Multiple contractual, structural, fiduciary, and regulatory safeguards prevent sponsors from using seeded funds to avoid or evade the margin requirements for the sponsor's own obligations.

As described in the GMAC Report and recognized by the Proposal[5], seeded funds are:

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[4] References to "Prudential Regulators" in this letter refers generally to the following U.S. federal administrative agencies: the Office of the Comptroller of the Currency, the Federal Reserve, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency.

[5] *See* GMAC Report, available here: https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download.

- Separate legal entities, created for a bona fide business and economic purpose;
- Typically overseen by an independent board (or equivalent);
- Managed by an investment advisor having fiduciary duties to the entity in accordance with a specified, written, investment program; and
- Not collateralized by or otherwise supported by the fund sponsor or any other entity beyond the initial seed capital contribution.

While a sponsor to a seeded fund has influence on the fund beyond that of a passive, unaffiliated investor, a seeded fund is not the same as a corporate affiliate in many respects. For example, seeded funds that are registered as management companies under the Investment Company Act of 1940 (the "ICA") (e.g., mutual funds) are overseen by an independent board of directors/trustees and managed by a registered investment advisor that has fiduciary duties of care and loyalty to the fund and all investors in the fund. Similar features are present for unregistered funds (e.g., hedge funds and private equity funds) relying on an exemption from registration under Section 3(c)(1) or 3(c)(7) of the ICA.

Further, most seeded funds are pooled investment vehicles and rely on one of two de minimis usage exemptions from registration as a commodity pool under the U.S. Commodity Exchange Act – Rule 4.5 with respect to registered investment funds and Rule 4.13(a)(3) with respect to unregistered investment funds.[6] To the extent that a seeded fund's use of derivative products exceeds the de minimis thresholds set forth in these two rules, the fund must register with the Commission as a commodity pool and report additional information to the Commission with respect to the relevant pool's use of commodity interests (thus giving the Commission even greater capabilities to ensure that the seeded fund is not being used to evade the requirements of the Rule).

Finally, in the case of seeded funds sponsored by and consolidated with life insurance companies, NAIC risk-based capital requirements[7] provide ample financial incentive for insurance companies to divest any significant equity interests in seeded funds over the long term. NAIC risk-based capital requirements on invested assets are structured to promote investment in high quality fixed income investments that are hallmarks of the safety and soundness of the life insurance industry and its long-term obligations. At the same time, risk-based capital requirements discourage substantial investment in higher risk and higher volatility asset classes, such as equities. Accordingly, risk-based capital charges on equity interests held by a life insurance company, including equity interests in seeded funds, can range from 22.5% to as much as 45% depending on the weighted average beta of the interest.

We recognize that many of these contractual, structural, fiduciary, and regulatory safeguards are reflected in the eight elements of the Proposal's definition of "Eligible Seeded Fund" and we support including most of these elements; however, we request that the Commission revise element (4)[8] of the definition by adding the underlined language, as follows:

[6] 17 C.F.R. §§ 4.5, 4.13(a)(3), available here: https://www.ecfr.gov/current/title-17/chapter-I/part-4.

[7] *See generally*, NAIC Risk-Based Capital Requirements (Last Updated June 1, 2023), available here: https://content.naic.org/cipr-topics/risk-based-capital.

[8] The Proposal at 53427.

> (4) The seeded fund's asset manager has independence in carrying out its management responsibilities and exercising its investment discretion, 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, <u>except for the seeded fund's duly appointed asset manager,</u> controls or has transparency into the management or trading of the seeded fund.

Insurance companies typically seed funds managed by their affiliated asset managers. The trading decisions of those affiliated asset managers are generally independent of the sponsoring entity and subject to the asset manager's investment discretion, a written investment strategy, and an independent fiduciary duty to the fund. Accordingly, the seeding entity and its margin affiliates that are not managing the fund have little or no control or transparency into the management or trading of the seeded fund. The manager itself is likely to be a margin affiliate[9] of the sponsoring entity. In practice, in most cases, it is the affiliate relationship between the sponsor and the asset manager that leads to the consolidation of the seeded fund under GAAP accounting principles in the first instance.

If the language in clause (4) of the definition of "Eligible Seeded Fund" is not adjusted to exclude the asset manager, the scope of this exemption will be limited to an exceptionally narrow pool of funds, thus diminishing the value of the relief to insurance companies. Additionally, the language as is would increase the discrepancy between the Commission's treatment of seeded funds and their treatment by global regulators.

<u>B. Seeded funds pose no systemic risk to the financial system during the seeding period.</u>

Investment funds at the seeding phase tend to be small and, as a result, do not typically have uncleared swaps exposure that would present significant risk to a swap counterparty or the financial system. Despite not being guaranteed by their life insurance company-affiliated plan sponsor, such funds are treated under the Rule as having MSE as if they did pose a systemic risk to the financial system simply because of corporate structure and not actual financial risk. In contrast, funds seeded by sponsors that do not belong to corporate groups with MSE, but that otherwise are of similar size and pursue similar strategies during the seeding period, would not be subject to these IM posting requirements.

As an odd result, when such funds grow larger and have more of a market impact, the sponsor's percentage ownership in them drops; they cease to be margin affiliates; and they no longer must post IM unless their individual notional amount of uncleared derivatives crosses the MSE threshold.

<u>C. The operational burden of requiring seeded funds to post and collect regulatory IM during the seeding period poses a challenge to both fund sponsors and their trading counterparties; eligible seeded funds should not be considered margin affiliates of any entity.</u>

Under the Rule, seeded funds must negotiate and complete complex margin documentation and develop compliance infrastructure to handle the posting and receiving of IM at a cost not commensurate with their risk to the financial system.

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[9] The manager is unlikely to engage in any trading for its own account.

Investors in the seeded funds bear the costs of IM because of affiliation with uncleared OTC derivatives activity in other entities and funds in a control group they did not invest in (without corresponding benefits). We appreciate the Commission's recognition that these operational burdens are significant compared to the funds' contribution to systemic risk. However, the narrow scope eligible seeded fund exception, as proposed, would create its own significant operational burden as long as eligible seeded funds continue to be included in their margin affiliates' calculations of MSE and IM amount.

A requirement for eligible seeded funds' margin affiliates to include the seeded funds in their calculation of IM threshold would require extensive monitoring of affiliates' trading activity across distinct legal entities within the corporate group and constant adjustment of IM thresholds with counterparties that is largely unworkable.

- Under the Rule, IM threshold allocations are typically negotiated into the IM CSA document between each entity and its dealer counterparty. Amending that threshold allocation requires a stand-alone amendment.
- If seeded funds' trading activity must be considered in allocating the IM threshold across all other margin affiliates, those IM thresholds would need to change on a frequent basis and in a way entirely outside the control of the other margin affiliates.
- Seeded funds would need to be able to build the capacity to calculate the IM usage arising from their trading activity and also be able to communicate it on a frequent basis to all other margin affiliates in the group. Many corporate groups have significant information barriers in place that typically make this kind of information sharing difficult and potentially problematic.
- In the case of companies that are consolidated for financial purposes but remain distinct operationally, these difficulties are compounded. As a result, they may not have the ability to easily share the exposure information required to manage the shared margin threshold. Even if they are able to share in the IM threshold amount, the ongoing renegotiation of documentation to support the allocation of the IM threshold amount between an ever-changing group of seeded funds with hard to predict trading activity imposes a significant burden on seeded funds, their margin affiliates, and their trading counterparties without any material reduction in risk.

For all these reasons, and to promote additional harmony between the Commission's approach to seeded funds and those of other regulators, we urge the Commission to provide that eligible seeded funds will not be deemed to have any margin affiliates for purposes of calculating any entity's MSE and the IM threshold amount.

V. Responses to Proposal Prompts[10]

Q1: *Is the Seeded Funds Proposal appropriate in light of the resulting potential uncollateralized swap risk?*

Yes, limited relief for seeded funds from the requirement to post and collect IM during a three-year seeding period is appropriate because the potential uncollateralized swap risk is already minimized

[10] This section paraphrases or shortens the questions Commission staff posed. The Proposal, 88 Fed. Reg. 53415-53416 (Aug. 8, 2023), available here: https://www.federalregister.gov/documents/2023/08/08/2023-16572/margin-requirements-for-uncleared-swaps-for-swap-dealers-and-major-swap-participants.

by variation margin requirements and represents no new risks because it is a risk that has been successfully underwritten by funds and CSEs for decades. From the fund perspective, in addition to receiving variation margin that covers the fund for the preponderance of market risk of a trade, funds and investment managers managing such funds mitigate uncollateralized swap risk by undertaking counterparty credit risk analysis to help ensure that brokers/swap counterparties to which the seeded fund will have exposure both to short term market risk (that IM aims to address) and the uncollateralized exposures represented by minimum transfer amounts, will have the ability to cover the obligations represented by such exposures.

However, many of the limitations the Commission has included in the proposed exemption overly circumscribe the relief and we suggest a few additional changes to better calibrate the exemption's conditions with the risk posed by these funds. As described in section IV.C above, we believe eligible seeded funds should be deemed not to be margin affiliates of any entity for purposes of calculating MSE and IM threshold. Section IV.A. explains why part (4) of the "Eligible Seeded Fund" definition is too narrow unless an exception is made for the seeded fund's affiliated asset manager having trading control, without disqualifying the fund under the current language. As described in our answer to Question 7 below, we do not think the relief should include a requirement for fund documents to include a written plan for reducing each sponsor entity's ownership interest in the seeded fund that stipulates divestiture targets over the three-year period of the proposed relief. Finally, our answer to Question 6 suggests certain clarifications and changes to the requirement that one or more of a seeded fund's margin affiliates be required to post and collect IM pursuant to the Rule.

Q2: *Should only the eligible seeded fund, and not its CSE counterparty, be relieved of the IM obligation?*

Bilateral relief makes sense and is consistent with the application of the Rule generally. Consistent bilateral application of the IM requirements or exemptions are hallmarks of the Rules. More specifically, for end user control groups that are below the AANA threshold, the exemption from IM applies to both the end user group affiliates and the CSEs that they have as trading counterparties, notwithstanding the fact that CSE's typically exceed the AANA threshold unilaterally. Neither the projected size nor volume of seeded funds would represent enough additional incremental market risk to warrant unilateral application that would constitute a deviation from the existing framework of the Rule.

In addition, one of the key reasons life insurers seek relief for seeded funds from the IM obligation is because the documentation and operational costs involved in meeting that obligation are significant. If CSE counterparties are not included in the relief, seeded funds would still need to negotiate IM Credit Support Annex agreements and build and maintain the operational infrastructure (e.g., middle and back office staffing requirements, setting up tri-party custody accounts with each CSE, licensing or outsourcing SIMM model calculations, etc.) to call for and manage the IM of their counterparties. Many of these represent fixed costs that are mitigated only through scale, which is generally lacking in the typical small dollar sized seeded fund accounts. Accordingly, it is our view that these burdens outweigh any perceived counterparty credit risk reduction benefits of unilateral application of the exemption only to seeded funds, and the exemption should therefore apply bilaterally.

Q3: *Should the Commission impose any additional limits or conditions to the proposed eligible seeded funds exception?*

For the reasons we have described in more detail above, additional limits or conditions beyond those already proposed in the Proposal are unnecessary to further mitigate systemic risk. Based on the multiple contractual, structural, fiduciary, financial and regulatory safeguards already in place, we believe a time-limited exception for seeded funds to remain outside the requirement to post IM will not create opportunities for the funds' sponsors (which are otherwise subject to the Rule) to avoid or evade its requirements in any material respect. Moreover, the seeded funds themselves tend to be small in size, with low levels of uncleared swap exposure. In addition, seeded funds would remain subject to the variation margin requirements of the Rule, thus mitigating any risks these funds pose to the overall financial system. Finally, life insurers have typically held few seeded funds that would fall into this exemption at any given time so no formal cap on the number of seeded funds should be necessary.

The examples of different limits or conditions spelled out in the Proposal come at a cost of additional operational monitoring. Life insurance companies support exempting seeded funds from the IM requirements of the Rule not just because the cost of setting up IM documents and operational processes is high relative to the risk they pose, but also because the cost of identifying and monitoring exposures for these funds is also high.

We request that the Commission, in providing one form of relief, not make the relief contingent on factors with their own monitoring and calculation burden. If additional requirements for relief are necessary, we ask that such requirements be simple to implement.

Q4: *What are the costs associated with a seeded fund calculating IM and establishing a relationship with a custodian to transfer IM?*

We support exempting seeded funds from the IM requirements of the Rule. We support the exemption not only because the cost of setting up IM documents and operational processes is high relative to the risk they pose, but because the cost of identifying and monitoring exposures for these funds is also high. Exposures across entire U.S. corporate groups must be constantly monitored, and collateral thresholds amended to adjust for the launch and termination of new funds as a result of U.S. IM requirements. The burden of monitoring the GAAP accounting consolidation status of myriad affiliates – particularly for insurance companies, many of which do not prepare GAAP accounting statements – constitutes an additional burden. IM custodial account charges with a seeded fund can also add significant fixed and variable costs if they are required to post and collect IM. In addition, the time spent establishing the IM documentation and operational set-up across all of a seeded fund's counterparties can become quite substantial at considerable cost and resources.

The costs of setting up legal and operational support for one or more seeded funds can be substantially higher where the fund or funds are managed by an affiliated investment manager that does not already manage IM for other entities subject to the IM requirements. In that case, the inclusion of seeded funds in the obligation to post and collect IM requires not just adding an additional entity to a system already built to support the IM requirements of the entity in the group with MSE, but rather an entirely new build for the management of its seeded funds.

Q5: *Do the requirements in the proposed definition, "eligible seeded fund" (and other requirements in the proposed amendments to 23.151) contain sufficient safeguards to achieve the goal of ensuring relevant funds are independently risk-remote from sponsor entities and other affiliates?*

Provided sponsor entities or the asset manager may be incentivized to expend additional limit systemic or contagion resources to financially distressed seeded funds, what measures should the Commission take to limit contagion and systemic risk?

We do not think additional measures are necessary to protect other entities in a control group subject to the Rule and the financial system. Seeded funds do not pose widespread systemic risk, at least no risks that the posting of IM can mitigate in any material respect, or which would be exacerbated by the proposed exemption.[11] With or without the proposed exemption, seeded funds using derivatives will be posting variation margin, which would mitigate the bulk of any systemic risk resulting from uncollateralized positions. The Rule and the exemption are not intended to address other financial risks from seeded fund investment strategies, but neither should the risk of a sponsor entity's potential bail-out of a seeded fund be a material concern given its extremely low probability. By design, seeded funds are only just large enough to adequately seed a particular investment strategy and small enough to minimize the costs associated with the sponsor entity's outlay of capital. Market and regulatory disincentives for additional outlays are sufficient since successful strategies attract third party investments (and ensuing divestment by the sponsor) and underperforming strategies incentivize redemptions. In the latter circumstance, liquidation of seed investments is the far more likely economic incentive for a sponsor entity for a failed strategy than an additional outlay or bail-out. Asset managers and sponsor entities of seeded funds have little or no economic incentive to prop up underperforming strategies and may have a secondary economic, fiduciary, or regulatory obligation not to do so. Thus, additional measures would add complexity and no clearly defined meaningful risk mitigation.

Q6: *The Commission proposes to limit the relief to eligible seeded funds that have one or more margin affiliates that are required to post and collect IM pursuant to Commission Regulation 23.152. Is this condition appropriate? Should the condition be amended to ensure that the Commission is appropriately circumscribing the proposed treatment of eligible seeded funds?*

If the Commission determines that it is necessary to limit the relief to seeded funds that have one or more margin affiliates that is required to post and collect IM, then we urge the Commission to adjust this requirement in two ways.

First, we ask the Commission to clarify that this relief is not limited to seeded funds that include a CSE as a margin affiliate. Most insurance companies are end users of derivatives and do not include a CSE in their corporate structure. However, the insurance company (and any margin affiliates) are subject to the requirement to post and collect IM as a result of their trading relationships with CSEs. Though they are not subject to the Rule directly, their obligation to post and collect IM is "pursuant" to the Rule and its applicability to CSE trading counterparties.

Second, the Commission's proposed language would exempt only seeded funds that include a margin affiliate that is required to post and collect IM pursuant to the Rule. We believe this relief should also extend to seeded funds whose margin affiliates are required to post and collect IM as a result of their trading relationships with dealers subject to substantially similar margin rules established by the prudential and other regulators. In addition, for avoidance of doubt we ask the Commission to clarify that the exemption is also available to seeded funds that have a margin affiliate that is in scope for the Rule but may not be required to post and collect IM currently due to the availability of applicable margin thresholds.

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[11] The Proposal acknowledges that seeded funds pose minimal risk in these situations. *Id.* at 53421.

Q7: *The Commission also proposes a requirement for a seeded fund's investment strategy to follow a written plan for reducing each sponsor entity's ownership interest in the seeded fund that stipulates divestiture targets over the three-year period of the proposed relief. Should the Commission include more specific requirements in connection with the written plan?*

We disagree that the three-year exemption period for a seeded fund should also encompass a written plan for divestiture of a sponsor entity's ownership in the fund. There are already sufficient incentives for the sponsor of a seeded fund to divest its ownership interest over the near term that make this additional requirement burdensome and unnecessary. First, the well understood purpose of a seeded fund is for it to ultimately become a non-seeded fund that is funded predominantly if not exclusively by external, and in most cases, retail investors. Second, seeded funds are an administrative and financial burden to a sponsor as long as they are consolidated on the books of the sponsor or otherwise are deemed as affiliates of the sponsor entity. Such burdens include (i) accounting consolidation compliance requirements, (ii) capital charges on the equity ownership interest in a seeded fund, (iii) in the case of investment companies, regulatory compliance with affiliate rules under the Investment Company Act, and (iv) in the case of insurance companies, compliance with affiliate reporting requirements under holding company act statutes, punitive risk-based capital requirements, and the potential need (and associated expense) for hedging programs at the sponsor entity level to reduce balance sheet volatility or if unhedged, otherwise assuming incremental balance sheet volatility resulting from equity ownership of the seeded fund. Thus, there are already sufficient market incentives for sponsors to exit their majority ownership interest without the need and associated burden of developing a written divestment plan. The primary incentive for a sponsor entity to divest is based on the investment inflows from external investors to a point where the seed investment is no longer needed. Divestment cannot be readily prescribed or scheduled in a plan since the timing of external investments or market events that may impact divestment cannot be known at the time of launch. Divestment must also be flexible and managed so as to not materially impact the NAV or trigger NAV-based early termination events. Accordingly, adherence to a written plan could undermine the needed flexibility in seeded fund investments. Moreover, we believe the proposed three-year limit of the exemptive relief will provide ample incentive for divestment by the sponsor entity even without a more granular written plan.

Q8: *Should the Commission proceed to adopt the proposed amendments to its uncleared margin rule if the Prudential Regulators do not adopt similar regulatory changes?*

We support the Commission's adoption of the Seeded Funds Proposal even in the absence of parallel action by the Prudential Regulators. As participants in a global marketplace, life insurers transact with counterparties that are subject to multiple rule sets. As the CFTC's Global Markets Advisory Committee notes in its Margin Subcommittee Report, global regulators – including those in Australia, Canada, the European Union, and Japan - have adopted uncleared margin rules based on the BCBS/IOSCO[12] Framework that exclude seeded funds from being treated as margin affiliates of their sponsoring entities.[13] We encourage all regulators to aim for global consistency and we believe that the adoption of the Proposal would further that goal even in the absence of

[12] Basel Committee on Banking Supervision ("BCBS") and the International Organization of Securities Commissions ("IOSCO")

[13] CFTC's Global Markets Advisory Committee ("GMAC") Margin Subcommittee's 2020 Report, available here: https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download.

similar action by the Prudential Regulators. We think the exemption is an important precedent that other regulators should emulate.

Q9: *The Commission intends that the final rule will become effective 30 days after its publication in the Federal Register. With respect to the Seeded Funds Proposal, are there any comments on the effective date?*

We support the Commission's adoption of the Seeded Funds Proposal at the earliest possible date to achieve consistent regulatory frameworks.

IV. Conclusion

In summary, ACLI supports the Commission's efforts to align with global regulators but recommends changes to the Proposal that would provide meaningful relief. This relief is necessary because this letter has demonstrated that existing regulatory safeguards (including those in the proposed definition of "Eligible Seeded Fund") are sufficient to prevent sponsors from evading margin requirements, and that seeded funds pose minimal risk during the seeding period. The letter also highlights that fund sponsors and trading counterparties face significant operational burdens that accompany the requirements for seeded funds to post and collect regulatory IM during the seeding period.

We carefully reviewed and responded to all questions posed in the Proposal and recommend the following adjustments to the Proposal:

(1) Eligible Seeded Funds should not be considered margin affiliates of any entity.

(2) Where a seeded fund is managed by an affiliated asset manager, such asset manager should not be treated as a margin affiliate of the fund.

(3) Seeded funds should not be subject to the inflexible requirement of a written plan for reducing ownership interest.

(4) Seeded funds should not be required to have a margin affiliate that is a CSE.

ACLI appreciates the Commission's attention to this matter and encourages Commission staff to meet with life insurers to discuss the practical, operational, and risk implications (or lack thereof) of providing exemptive relief for life insurers and others with affiliated seeded funds.

Sincerely,

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