

April 22, 2024

Submitted electronically

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

**Re: Notice of Proposed Rulemaking
Regulations To Address Margin Adequacy and To Account for the Treatment of Separate
Accounts by Futures Commission Merchants (RIN 3038–AF21)**

Dear Mr. Kirkpatrick:

MFA¹ appreciates the opportunity to submit additional comments to the Commodity Futures Trading Commission (the “**CFTC**” or “**Commission**”) on the proposed amendments to the derivatives clearing organization (“**DCO**”) risk management rules that would permit futures commission merchants (“**FCMs**”) that are clearing members to treat the separate accounts of a single customer as accounts of separate entities for purposes of margining and other CFTC regulations (the “**Proposal**”).² The Proposal was subsequently withdrawn, and supplanted by the new, second proposal issued earlier this year that would require an FCM to ensure that a customer does not withdraw funds from its account with the FCM if the balance in such account after such withdrawal would be insufficient to meet the customer’s initial

¹ Managed Funds Association (MFA), based in Washington, DC, New York, Brussels, and London, represents the global alternative asset management industry. MFA’s mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 180 member fund managers, including traditional hedge funds, credit funds, and crossover funds, that collectively manage over \$3.2 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time.

² Derivatives Clearing Organization Risk Management Regulations To Account for the Treatment of Separate Accounts by Futures Commission Merchants, 88 Fed. Reg. 22934 (Apr. 14, 2023) (the “**Proposal**”) available at <https://www.govinfo.gov/content/pkg/FR-2023-04-14/pdf/2023-06248.pdf>.

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margin requirements, and relatedly, to permit an FCM to treat the separate accounts of a single customer as accounts of separate entities for margining purposes (the “**Second Proposal**”).³

MFA submitted a comment letter (“**MFA Comment Letter**”) to the Commission supporting the goals of the Proposal but recommending certain critical revisions to preserve the longstanding flexibility of FCMs to develop risk management practices for each customer that reflects its own risk assessment and common margining practices.⁴ We therefore support the Commission’s withdrawal of the Proposal and welcome the opportunity to comment on the Second Proposal.

MFA continues to support the Commission’s efforts to codify into regulation the limited no-action relief granted in CFTC Staff Letter 19-17 (“**Staff Letter 19-17**”)⁵ and provide additional clarity and certainty as to the scope of the relief provided. While the Second Proposal improves upon the Proposal, it still would pose risks of unintended consequences that could potentially upend longstanding practices of the FCMs and their customers. As we noted in the MFA Comment Letter, the risk management practices of FCMs have evolved considerably since the 2008 financial crisis, in part due to the strengthened regulatory environment around FCM margining practices generally, and have proven exceedingly resilient during episodes of considerable market stress during and since the 2008 financial crisis.

A. Executive Summary

While MFA appreciates the CFTC revising the “business day” definition to provide additional clarity to address scenarios where markets are open in the US but not in another jurisdiction where a counterparty or client is located, the definition of “ordinary course of business” is overly narrow and would impose considerable limitations on FCMs and customers to address operational or administrative challenges due to no fault of the FCM customer.

³ Regulations To Address Margin Adequacy and To Account for the Treatment of Separate Accounts by Futures Commission Merchants, 89 Fed. Reg. 15312 (Mar. 1, 2024) (the “**Second Proposal**”), available at <https://www.govinfo.gov/content/pkg/FR-2024-03-01/pdf/2024-040107.pdf>.

⁴ Letter from MFA to Christopher Kirkpatrick, Secretary, CFTC (June 30, 2023), available at <https://www.mfaalts.org/wp-content/uploads/2023/07/MFA-Comment-Letter-CFTC-Proposal-re-Margining-063023-FINAL.pdf> (“**MFA Comment Letter**”).

⁵ CFTC Letter No. 19-17, Advisory and Time-Limited No-Action Relief with Respect to the Treatment of Separate Accounts by Futures Commission Merchants (July 10, 2019), available at <https://www.cftc.gov/csl/19-17/download> (“**Staff Letter 19-17**”).

B. Discussion

1. MFA supports the improvements made to the proposed definition of “Business Day”

As an initial matter, MFA appreciates the efforts of the CFTC to consider comments received in response to the proposal. The definition of “business day” now provides appropriate extensions of time for circumstances where US markets are open, but the day is a holiday in a non-US jurisdiction, making it challenging to post variation margin or move collateral.

2. MFA continues to recommend additional flexibility to the one-business-day margin cut-off, provided that such flexibility is consistent with the FCM’s risk management controls and applicable law

MFA appreciates the Commission’s recognition of the importance of codifying into CFTC rules the limited no-action relief granted in CFTC Staff Letter 19-17 and supports efforts to provide regulatory certainty on the important issue. As the Commission considers amendments to regulation, however, we have concerns about the divergence in both the Proposal and the Second Proposal from the specific language of 19-17, for which both FCMs and investment managers already have developed effective controls.

The CFTC specifically stated in the Second Proposal that the CFTC is “proposing to codify” the relief Staff letter 19-17 to permit clearing FCMs to treat the separate accounts of a single customer as accounts of separate legal entities for margining purposes.⁶ MFA supports this goal but urges the Commission to avoid revising the conditions of Staff Letter 19-17 in the Second Proposal.

Staff Letter 19-17 states in relevant part that, for an account to be deemed to be operating in the ordinary course of business, the account, in relevant part:

Each such separate account must be on a one business day margin call.
Situations of administrative error or operational constraints which prevent the call from being met within a one-day period will not be considered a violation of this condition ...⁷ (emphasis added)

If the goal of the Commission, as stated, is to codify Staff Letter 19-17, MFA urges the Commission to revert to the above language in doing so when determining whether or not margining conduct by a customer with several accounts at a FCM is in the “ordinary course of business” and thus eligible to be

⁶ Second Proposal, at fn. 3 and accompanying text.

⁷ Staff Letter 19-17, at p. 4 (condition #5).

treated as separate accounts for margining purposes.⁸ FCMs and their customers, including private funds and other accounts managed by MFA member firms, have developed procedures and controls to implement the conditions of Staff Letter 19-17 and consistent with the FCMs' risk management practices.

The CFTC, in both the Proposal and the Second Proposal, has revised the conditions of Staff Letter 19-17 to narrow them considerably and render them all but unusable. As we pointed out in the MFA Comment Letter, the Proposal states that such an issue must be "unusual," a term that is subjective and very much in the eye of the beholder.⁹ The same can be said for the Proposal's requirement that unusual error or operational challenge "could not have been reasonably foreseen": with benefit of hindsight, any event could be argued to have been "reasonably foreseen."¹⁰

To avail themselves of relief from the rigid one-day margin requirement, the FCM must make a "determination" that the margin failure is due to administrative error or operational constraint. How are FCM's supposed to make this determination? Approved by whom? Is it expected that the FCM would be obligated to escalate a proposed recommendation that an error or constraint is unusual through its corporate governance infrastructure? Requiring the FCM to make a determination would add needless delay, complexity, and administrative burden to the FCM, creating a disincentive for the FCM to develop and present a record to support a "determination." Requiring this level of bureaucracy is a vast departure from the existing practices that have developed at FCMs in response to Staff Letter 19-17. The procedural labyrinth the Second Proposal would require would have the effect of incenting the FCM to take the path of least resistance, as it would be far easier for the FCM to simply declare that the event was outside of the ordinary course of business and seek to eliminate separate account margining for that client.

We furthermore are concerned that the FCM's determination be based on its "reasonable belief" that the administrative error or operational constraint was unusual at the time the issue arose.¹¹ Is the FCM expected to review the entire customer relationship to gauge the frequency of administrative errors or operational constraints before it is armed with the necessary data to form the basis of a determination? Staff Letter 19-17 included no such requirement and MFA again encourages the Commission to revert to the language of Staff Letter 19-17 and permit "situations" of administrative or operational issues to remain within the ordinary course of business.

⁸ The Reproposal seeks to define "ordinary course of business" as meaning the standard day-to-day operation of the FCM's business relationship with its separate account customer, a condition where there are no unusual circumstances that might indicate a materially increased level of risk that the separate account customer may fail promptly to perform its financial obligations to the FCM, or decreased financial resilience on the part of the FCM. Proposing Rule, at 15323.

⁹ MFA Comment Letter *supra* note 4.

¹⁰ *Id.* See also Proposed Rule 144(f)(5).

¹¹ Proposed Rule 144(f)(5).

The Commission historically has applied a more principles-based approach with respect to margin regulation to recognize differences in FCMs and other market participants and has therefore largely avoided the interpretive challenges created by the prescriptive nature of both the Proposal and the Second Proposal. We are concerned that the Second Proposal, as drafted, would impede the FCM from exercising reasonable risk management practices requiring it to undergo a complicated and time-consuming analysis before determining whether to provide some form of grace period to the underlying customer.¹²

MFA therefore recommends that Rule 1.44(f)(5) be revised, consistent with Staff Letter 19-17, to state that:

~~A failure with respect to a specific separate account to deposit, maintain, or pay margin or option premium that was called pursuant to paragraph (f)(1) of this section, due to unusual situations of administrative error or operational constraints which prevent the call from being met within a one-day period, will not be considered a violation of this condition unusual administrative error or operational constraints that a separate account customer or investment manager acting diligently and in good faith could not have reasonably foreseen, does not constitute a failure to comply with the requirements of this paragraph (f). For these purposes, a futures commission merchant's determination that the failure to deposit, maintain, or pay margin or option premium is due to such administrative error or operational constraints must be based on the futures commission merchant's reasonable belief in light of information known to the futures commission merchant at the time the futures commission merchant learns of the relevant administrative error or operational constraint.~~

* * *

MFA supports the Commission's stated goal of codifying earlier Commission Staff letters to provide additional certainty, but in doing so, the Proposal would have swept away long-standing established practices between FCMs and investment managers, on behalf of the manager's clients. MFA appreciates that the Commission's Second Proposal attempts to more closely preserve these long-standing practices but recommends that the Commission preserve the express language of Staff Letter 19-17 in the proposed "ordinary course of business" definition.

MFA appreciates the opportunity to comment on the Proposal and thanks the Commission for its consideration of our comments. If you have any questions about these comments, or if we can provide

¹² Second Proposal, *supra* note 3, at Appendix 3 (Statement of Support from Cmr. Caroline D. Pham).

additional information, please do not hesitate to contact Jeff Himstreet, Vice President and Senior Counsel, (jhimstreet@mfaalts.org) or the undersigned (jhan@mfaalts.org).

Respectfully Submitted,

/s/ Jennifer W. Han

Jennifer W. Han
Executive Vice President
Chief Counsel & Head of Regulatory Affairs

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