asset management group

April 22, 2024

Submitted electronically via CFTC Comments Portal

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

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

Dear Mr. Kirkpatrick:

The Asset Management Group of the Securities Industry and Financial Markets Association[1] ("**SIFMA AMG**") appreciates the opportunity to provide comments to the Commodity Futures Trading Commission's (the "**CFTC**" or the "**Commission**") withdrawal and proposal of a new rulemaking to provide for separate account treatment through amendments to the derivatives clearing organization ("**DCO**") risk management regulations.[2]

SIFMA AMG supports the Commission's proposal to codify the no-action position in CFTC Staff Letter No. 19-17[3] ("**Letter No. 19-17**") as we believe the no-action relief provided firms with an appropriate level of flexibility. We also appreciate that the Commission is proposing to include the requirements regarding separate account treatment in Part 1 of its regulations, as doing so clarifies that the regulatory obligations of the proposed regulation are the futures commission merchants ("**FCM**"), and not the DCO's obligation to evaluate and determine if the FCM's behavior was appropriate.

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[1] 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.

[2] Regulations To Address Margin Adequacy and To Account for the Treatment of Separate Accounts by Futures Commission Merchants, 89 FR 15312 (Mar. 1, 2024) (the "**Proposal**"); *available at* https://www.govinfo.gov/content/pkg/FR-2024-03-01/pdf/2024-04107.pdf.

[3] CFTC Staff Letter No. 19-17, Advisory and Time-Limited No-Action Relief with Respect to the Treatment of Separate Accounts by Futures Commission Merchants; *available at* https://www.cftc.gov/csl/19-17/download.

However, the overly prescriptive nature of the Proposal deviates from the spirit of Letter No. 19-17, and our members have concerns that the Proposal does not align with the longstanding practices of participants in today's futures markets. While we support the Commission's efforts to provide regulatory certainty, we believe that the approach described in the Proposal would not only be difficult to implement but would have a broad impact across buyside market participants by creating more risks and uncertainties due to the higher likelihood of margin and payment defaults and increased constraints in doing effective cash and risk management.

SIFMA AMG believes that the Commission can accomplish its regulatory objectives without implementing overly prescriptive requirements that ignore the realities of market participants' global operations and current margin practices across a broad span of products in the industry. If Proposed 1.44 is adopted as proposed, the additional operational complexities will unnecessarily increase costs for investors, diminish credit risk management capabilities of FCMs and result in greater market risks and uncertainty. This is particularly true with respect to margin calls, transfer timelines, and the treatment of global holidays.

Importantly, separate margining of separate accounts leads to more margin in the system than would otherwise exist due to the lack of netting across such accounts. Moreover, the margin from a separate account client is based on individual trading strategies and is therefore not diluted by less risky strategies. As a result, margin for a separate account customer is, at worst, reflective of their overall trading strategy, and is often overly margined. If Proposed 1.44 introduced operational complexities and uncertainties that led managers to move separate accounts to other FCMs where there is no overlap and the margin would not be subject to Proposed 1.44, that would lead to less transparency and available margin in a single FCM's system, which is contrary to the risk management goals of the CFTC's rules.

SIFMA AMG encourages the Commission to consider the difficulties of administering regulations that are overly prescriptive and therefore inconsistent with its longstanding principles-based approach to regulation. We believe that effective regulation focuses on behaviors that evidence an intent to evade the system, rather than technical deficits that can be resolved in the ordinary course of business through prudent risk management.

Executive Summary

1. **Redefine "Ordinary Course of Business" to Exclude Defined Events.** The proposed approach is too ambiguous and would be a challenge to operate and fails to recognize existing FCM risk management requirements.

2. **Rescind the Proscriptive, Binary One Business Day Margin Call Concept.** The proposal does not adequately appreciate the differences in operational workflows and risk management processes in place across the market and how they may differ depending on the markets, products, clients, custodians, and fund structures involved.

3. **Preserve the Flexibility of a Limited Discretionary Grace Period.** Consider permitting FCMs to continue having discretion to agree on a limited grace period, based on their own credit assessment and consistent with their risk management programs.

4. **Compliance Carve-outs Should Not Be Limited to "Unusual Administrative Errors or Operational Constraints".** This level of prescriptiveness is inconsistent with the Commission's successful principles-based approach to FCM risk management.

5. **Reconsider the Approach to Regulating Operational Complexities.** SIFMA AMG seeks confirmation that initiating a transfer on the same day would equally suffice to meet the requirement.

6. **Remove or Rework the 30-Day Reinstatement Period.** SIFMA AMG does not find the rationale for 30 days to be persuasive and does not believe there is any reason why 30 days should be considered an appropriate or "sufficient period of time."

For the reasons discussed below, we encourage the Commission to further consider the risk of unintended consequences if Proposed 1.44 were adopted as proposed.

Discussion

7. **Redefine "Ordinary Course of Business" to Exclude Defined Events**

Proposed 1.44 defines "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.[4] From an operational complexity perspective, the proposed definition of "ordinary course of business" poses regulatory compliance challenges.

[4] Proposal at 15323.

First, the definition does not sufficiently clarify what "standard day-to-day operation" might mean. FCMs and DCOs would be required to continuously monitor for a series of events, and some of which would not seem to rise to the level of significance to suggest they are not "ordinary course of business," such as the failure of a customer to make a maintenance margin payment. SIFMA AMG encourages the Commission to better define "ordinary course of business" and consider developing an approach that presumes operation in the "ordinary course of business," with clearly delineated events (such as default or bankruptcy) to be the limited instances that would not be considered "ordinary course of business."

Second, this framework fails to recognize that FCMs must, under Commission regulations, manage risk effectively. This is in addition to the obvious commercial incentives that require FCMs to effectively manage risk in order to conduct their business. We believe that this leads the Proposal to be inconsistent with an FCM's obligations, particularly in light of FCM Risk Management Program ("**RMP**") obligations being intentionally fluid ("the risks associated with the activities of the [FCM]") – and are designed to allow FCMs to customize the RMP to the specific activities of the FCM and its customers.[5]

8. Rescind the Proscriptive, Binary One Business Day Margin Call Concept

Proposed 1.44(f) contains a requirement that each separate account be on a "one business day margin call" where the futures an FCM's margin call for the separate account margin deficit, which must, by proposed regulation, "must be met by the applicable separate account customer no later than the close of the Fedwire Funds Service on the same business day."[6]

SIFMA AMG appreciates the Commission's efforts to provide flexibility beyond the 11:00 am proposed cutoff time for same-day margin calls contemplated in the now-withdrawn 2023 proposal. However, we believe the Proposal does not adequately appreciate the differences in operational workflows and risk management processes in place across the market and how they may differ depending on the markets, products, clients, custodians, and fund structures involved. The plain language of Proposed 1.44(f), if adopted, would require same-day margin calls to be met regardless of what time they are issued by the FCM.

For example, a 3:00 pm margin call would be required to be met the same day, which would not happen in the normal course of business. Depending on how late in the day an FCM issued the margin call, managers may not be capable of meeting the call on a same-day basis. This is partly due to the time needed for managers, as fiduciaries, to validate the margin calls and instruct payments from the separate account clients' custodians globally, who may impose earlier cut-off times in order to meet same day margin transfers (especially in non-cash collateral) or be subject to different time zones and business days. Accordingly, this requirement should account

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[5] 17 C.F.R. § 1.11(c).

[6] Proposal at 15317.

for the agreed call time in documents between FCMs and its customers. Proposing a prescriptive framework around timing and deadlines would eliminate the operational flexibility originally provided in Letter No. 19-17. We propose that the one business day margin call be met "so long as the margin call is issued by the cut-off time agreed upon between the FCM and its customer."

9. Preserve the Flexibility of a Limited Discretionary Grace Period

The Proposal would eliminate the flexibility provided by a limited grace period to address issues, such as ensuring the timely correction of shortfalls or identification of a customer's inability to meet a margin. We appreciate that the Commission clarifies that a "single," one-off error with respect to a single manager will not result in a reversion to margining on a customer basis if such error meets the criteria for an unusual and unforeseen administrative error, with "unusual" being based on a particular separate account, not the FCM's business with respect to separate accounts as a whole.[7] However, SIFMA AMG encourages the Commission to consider permitting FCMs to continue having discretion to agree on a limited grace period, based on their own credit assessment and consistent with their risk management programs.

Grace periods are consistent with the objectives of ensuring the timely correction of shortfalls or timely identification of a customer's inability to meet a margin call. Further, a contractual grace period provision is not only a separately managed account issue and can manifest in other scenarios depending on a fund's structure. For example, in instances where subadvisors are hired for a specific fund and the investment firm is managing the same fund with potentially the same FCM, removing the grace period means that a single "foot fault" with respect to a single manager can cause an FCM to revert to margining on a gross basis. This disrupts the ability of some SIFMA AMG members to get excess margin back and can cause a lack of awareness of a client's overall margin requirements. This would only incentivize moving to different FCMs, meaning less transparency and less opportunity for the existing FCMs to cover themselves if a client defaults.

Inability to rely on the return of excess margin because of foot faults at other managers could also cause further downstream failures and inadvertent consequences. For example, in the normal course, excess margin is expected to be returned based on data generated very early in the morning. Managers may anticipate that excess margin will be available to make additional investments or execute new transactions or to be used to cover other margin or payment obligations due. If, however, later that day, the excess margin unexpectedly is not returned due to a foot fault at a separate manager (which such manager cannot validate or challenge), there may not be time to either unwind the new trades or investments or meet the other margin or payment demands. This could lead to actual defaults on these other obligations and potentially trigger other cross-defaults thereafter. Moreover, some sub-advised funds or separate account clients are not able to hold cash as a buffer to this situation due to cash limits. This incentivizes managers to move sub-advised funds or separate account clients to FCMs where there is no

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7 *Id*. at 15334.

overlap across such sub-advised funds or separate account clients. This would result in less transparency and available assets to each FCM, thus, potentially impairing their credit risk management. Additionally, as described above, because separate account treatment results in more margin in the system, this is counter to risk management goals.

The discretionary grace period should be viewed from a risk management perspective, recognizing that there may be occasions when additional time is warranted to allow the customer to address delays that are not caused by administrative errors or operational constraints. Thus, we strongly believe that the Commission should reconsider its position regarding grace periods.

10. Compliance Carve-outs Should Not Be Limited to "Unusual Administrative Errors or Operational Constraints"

As stated in previous comments, SIFMA AMG respectfully requests that the Commission remove or repropose provisions like this that include subjective and ambiguous terms. Though the Commission states in the Proposal that that the further criteria for determining the existence of an administrative error or operational constraint provide a clearer definition of the meaning of these terms,[8] we do not believe it appropriately balances practicability and burden with risk management. We appreciate the Commission's attempt to clarify the meaning of "unusual", but it is insufficient, particularly when the meaning can and would be analyzed in any number of contexts, makes this regulation difficult to implement without factors or a determinative standard.

SIFMA AMG continues to believe that this level of prescriptiveness is inconsistent with the Commission's successful principles-based approach to FCM risk management.

11. Reconsider the Approach to Regulating Operational Complexities

The Proposal provides that the relevant deadline for payment of margin in fiat currencies other than USD may be extended by up to one additional business day and still be considered in compliance with the requirements if payment is delayed due to a banking holiday in the jurisdiction of issue of the currency.[9] For payments in EUR, either the separate account customer or the investment manager managing the separate account may designate one country within the Eurozone that they have the most significant contacts with for purposes of meeting margin calls in that separate account, whose banking holidays shall be referred to for such purpose.[10]

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[8] *Id*. at 15333.

[9] *Id*. at 15331-32.

[10] *Id*. at 15332.

We believe that the Commission's focus on currencies and jurisdiction is too narrowly tailored. SIFMA AMG believes it will be impractical to comply with the proposed regulation, as there does not appear to be data or analysis to support the Commission's position. Though the Commission considers technical margin deficit scenarios from global businesses that regularly navigate U.S. and non-U.S. bank holidays, it does not consider that firms may plan for expected events (e.g., Golden Week in Japan) by pre-funding accounts. Such an approach under the proposed framework would be unmanageable and unsustainable, and would impose a regulatory burden without a corresponding public policy benefit.

For example, when clients are posting cash margin in EUR, they choose a country in the Eurozone and follow their holiday schedule. In the event different managers for the same client choose different Eurozone countries, this would not only require the overhaul of agreements currently in place, but also burden FCMs with additional monitoring responsibilities. SIFMA AMG believes there should be more flexibility to allow for better risk management. By avoiding having to navigate the bank holidays of two different countries, the clearing member can appropriately manage its risk based on its business and its customers.

The base currency, the custodian, and overall global nature of investing complicate efforts to provide pre-funding ahead of known holidays. Typically, margin payments are made in the base currency of the fund or the client and the FCM effectuates single currency margining. The asset manager then engages in an active repatriation of foreign currency balances on a regular basis. This process has been successfully implemented and is designed to reflect and address the complexities of this member's global operations. The Commission's rules should not try to establish or require certain methods for achieving these goals.

We believe that the Commission's belief that firms might use holidays to gain margin is misguided and impractical. When a global holiday approaches, firms are asked by FCMs to pre-fund anticipated, expected initial and/or variation margin (i.e., asked to overcollateralize). Pre-funding margin is more operationally risky, particularly when scaled across multiple custodians and with a global client base. First, overcollateralizing places excess risk at the FCM. Second, it is impractical to attempt to estimate what other market moves will be in order to pro-actively overcollateralize and post. Third, different custodians have different cut-off times, which may not be met ahead of a holiday. Lastly, pre-funding leads to an inefficient process of having to be credited back payments as opposed to paying what is owed on a daily basis.

Pre-funding is not only a function of FCMs, but a function of SIFMA AMG's clients and custodians. With large, separate accounts, there is always margin on hand to meet volatile market movements. A default that requires pre-funding as a precaution may be unnecessary because of a firm's ability to pay cash when needed.

In addition, the Commission does not consider product and FX associated with a particular trade. A client might always be behind on margin as a function of the client's or fund's location, client custodian, product traded and clearinghouse. We believe proposed

regulations should consider all involved parties in a transaction, i.e., the FCM, asset manager, clearinghouse, product, and FX associated with a particular trade.

To the extent the Commission is considering that the relevant deadline for payment of margin in fiat currencies other than USD may be extended by up to one additional business day and still be considered in compliance with Proposed 1.44(f) if payment is delayed due to a banking holiday in the jurisdiction of issue of the currency,[11] SIFMA AMG seeks confirmation that initiating a transfer on the same day would equally suffice to meet the requirement. SIFMA AMG believes that FCMs should have discretion to consider a deposit as "pending" in a customer's account for the reasons set forth in Joint Audit Committee Regulatory Alert 14-03, which is the origin point of this policy initiative regarding separately managed accounts.[12] Primarily, if the FCM has a sufficient basis to believe that the wire was actually initiated, and based on its experience with the customer and its normal course of business and consistent with its risk management program, the FCM should have discretion to treat that margin as received and credited to a customer's margin equity. If this is not the case, we urge the Commission to consider the same-day initiation of a transfer as an alternative to the grace or cure period to demonstrate compliance with Proposed 1.44(f).[13]

Utilizing the time of initiation would effectively build in a notice that payment was not received, and the cure would be confirmation that the payment was initiated. For example, for transfers that are initiated and not received, the FCM communicates with the counterparty, and the counterparty provides evidence of the initiation afterwards. The initiation would thus be sufficient to show that the requirement is being met in a timely manner.

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[11] *Id*.

[12] *See* Joint Audit Committee, Regulatory Alert #14-03 (May 21, 2014), ("(i) the FCM assesses that it is prudent to do so based on the account's past history of satisfying margin calls and the operational and credit risk profile of the account owner, (ii) the account is on a 1-day wire transfer basis (i.e., the wire is initiated on day 1 of the margin call), (iii) the FCM has a sufficient basis that the wire was actually initiated, (iv) the FCM continues to age the pending non-U.S. Dollar receipts and retains the ability to recognize a failed deposit immediately upon occurrence, and (v) the FCM treats unsettled non-U.S. Dollar disbursements from the account in the same manner."); *available at* http://www.jacfutures.com/jac/jacupdates/2014/jac1403.pdf.

[13] We also note that Proposed 1.17 (c)(5)(viii) addresses margin calls ***outstanding for more than one business day***, which is inconsistent with the direction provided in Joint Audit Committee Regulatory Alert #14-03 with respect to "pending" non-US dollar margin deposits. The Commission should reconsider this provision to reflect longstanding industry practice and regulatory treatment.

12. Remove or Rework the 30-Day Reinstatement Period

Proposed 1.44(h)(4) sets forth that if separate account election is revoked, it may not be reinstated during the 30 days following such revocation. The Commission explains that this provision is intended to "ensure that FCMs will conduct a diligent and thorough review to confirm that the circumstances leading to cessation of separate account treatment have been cured, and to prevent the possibility that . . . an FCM could toggle its separate account treatment election for purposes other than serving customers' bona fide commercial purposes."[14]

First, SIFMA AMG members are not aware of instances where an FCM might "toggle" separate account treatment. In addition to significant regulatory obligations intended to protect customers, including stringent risk management provisions, FCMs who try to "game" a system to maintain separate account status would lose the trust necessary to maintain these competitive, longstanding commercial relationships.

Further, operationally, SIFMA AMG members would not give FCMs permission or contract authority for an FCM to "switch back and forth between separate and combined treatment for customer accounts in order to achieve more preferable margining outcomes or offset margin shortfalls in particular accounts."[15] This practice would be highly unusual and represent a significant deviation from industry practices.

Finally, SIFMA AMG does not find the rationale for 30 days to be persuasive and does not believe there is any reason why 30 days should be considered an appropriate or "sufficient period of time."[16] SIFMA AMG is concerned that a 30-day revocation could cause harm to our business activities, which would cause harm to our customers and their investments. We also believe that this could have a compounding effect on markets and liquidity, as well as risk management of FCMs and asset managers. The 30-day revocation period is unworkable in such a blunt fashion and should either be removed or fashioned in a more flexible manner.

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SIFMA AMG supports the Commission's efforts to withdraw the prior proposal and seek comment on the Proposal. We believe this Proposal has many positive attributes. However, there are also concerns that the Commission should address prior to finalizing the Proposal to ensure its implementation is a success.

On behalf of SIFMA AMG, we appreciate the opportunity to respond to the Proposal and your consideration of our comments and recommendations. If you have any questions or require

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[14] *Id*. at 15339.

[15] *Id*.

[16] *Id*.

additional information, please do not hesitate to contact us by calling William Thum at (202) 962-7381.

Sincerely,

William C. Thum
Managing Director
Associate General Counsel, SIFMA AMG

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