

November 24, 2014

Mr. Robert deV. Frierson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, D.C. 20551

Mr. Barry F. Mardock
Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Mr. Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA45
Federal Housing Financing Agency
Constitution Center (OGC Eighth Floor)
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Legislative and Regulatory Activities Division
Office of Comptroller of the Currency
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Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
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Washington, DC 20581

Re: *Margin and Capital Requirements for Covered Swap Entities, Proposed Rule; Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, Proposed Rule*

Ladies and Gentlemen:

The Investment Company Institute (“ICI”)¹ appreciates the opportunity to provide comments on the margin proposals recently reissued by, respectively, the Office of the Comptroller of the

¹ The Investment Company Institute (ICI) is the world’s leading association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public

Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency (together, the “Prudential Regulators”) and the Commodity Futures Trading Commission (the “CFTC,” and together with the Prudential Regulators, the “Agencies”), with respect to margin requirements for non-cleared swaps and security-based swaps. The proposal issued by the Prudential Regulators addresses margin requirements with respect to non-cleared swaps and security-based swaps (“PR covered swaps”) entered into by swap dealers, security-based swap dealers, major swap participants and major security-based swap participants regulated by a Prudential Regulator (“PR CSEs”),² and the proposal issued by the CFTC addresses margin requirements with respect to non-cleared swaps (“CFTC covered swaps,” and together with PR covered swaps, “covered swaps”) entered into by swap dealers and major swap participants for which there is no Prudential Regulator (“CFTC CSEs,” and together with PR CSEs, “CSEs”).³

Our members – investment companies that are registered with the Securities and Exchange Commission (the “SEC”) under the Investment Company Act of 1940 (the “ICA”) and subject to regulation under the ICA (such funds, “registered funds”) – find covered swaps, as well as other derivative instruments, particularly useful portfolio management tools that offer registered funds considerable flexibility in structuring their investment portfolios. Registered funds employ covered swaps and other derivatives in a variety of ways, including to hedge other investment positions, equitize cash that a registered fund cannot immediately invest in direct equity holdings, manage a registered fund’s cash positions more generally, adjust the duration of a registered fund’s portfolio or manage a registered fund’s portfolio in accordance with the investment objectives stated in the fund’s prospectus. To employ derivatives in the best interests of fund investors, our members have a strong interest in ensuring that the derivatives markets are highly competitive and transparent.

ICI members, as market participants representing millions of investors, generally support the goal of providing greater oversight of the derivatives markets. We appreciate the considerable revisions the Agencies have incorporated into the Reproposals to reflect the issuance by the Basel Committee on Banking Supervision (“BCBS”) and the International Organization of Securities Commissions

understanding, and otherwise advance the interests of funds, their shareholders, directors and advisers. ICI’s U.S. fund members manage total assets of \$17.2 trillion and serve more than 90 million U.S. shareholders.

² See *Margin and Capital Requirements for Covered Swap Entities; Proposed Rule*, 79 Fed. Reg. 57348 (Sept. 24, 2014), available at <http://www.gpo.gov/fdsys/pkg/FR-2014-09-24/pdf/2014-22001.pdf> (the “PR Proposal”).

³ See *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 79 Fed. Reg. 59898 (Oct. 2, 2014), available at <http://www.gpo.gov/fdsys/pkg/FR-2014-10-03/pdf/2014-22962.pdf> (the “CFTC Proposal”, and together with the PR Proposal, the “Reproposals”).

(“IOSCO”) of a final international framework on margin requirements for non-cleared swaps⁴ and additional public comments received with respect to the original proposals. We also commend the Agencies for closely coordinating their Reproposals.

However, we have a number of substantive comments and concerns that we would like to identify for the Agencies regarding the Reproposals. In addition, there must be even more extensive coordination between the Prudential Regulators and the CFTC on a number of substantive differences between the PR Proposal and the CFTC Proposal. Furthermore, it is essential also to ensure global consistency by conforming the Reproposals more closely to the 2013 International Framework. We discuss below our concerns on the substance of the margin requirements for covered swaps set forth in the Reproposals. For our comments on the proposed cross-border approaches of the Agencies to the application of the margin rules for covered swaps, please see the letter submitted by ICI Global, the international arm of ICI.⁵

EXECUTIVE SUMMARY

The following is a brief summary of our key recommendations:

- We support the Agencies’ proposed requirement that both counterparties to a covered swap be subject to equivalent two-way margin obligations.
- The Agencies should apply the €8 billion threshold that was established by international regulators, rather than the \$3 billion threshold the Agencies have proposed to determine material swaps exposure. If, however, the Agencies decide to apply the proposed lower \$3 billion threshold, the Agencies should exclude FX Swaps and Forwards, as defined below,⁶ from the calculation and should permit a counterparty to net its covered swaps positions for purposes of calculating the threshold.

⁴ See *Margin requirements for non-centrally cleared derivatives*, Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, September 2013, available at <http://www.bis.org/publ/bcbs261.pdf> (the “2013 International Framework”).

⁵ Letter from Dan Waters, Managing Director, ICI Global, to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation, Alfred M. Pollard, General Counsel, Federal Housing Financing Agency, Legislative and Regulatory Activities Division, Office of Comptroller of the Currency, and Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission, dated November 24, 2014.

⁶ See *infra* notes 10-11.

- Although we generally support the broad range of assets the Agencies propose to be permitted as eligible collateral for initial margin, we have significant concerns with the Agencies' approach to eligible collateral for variation margin, which is substantially more restrictive than the approach developed in the 2013 International Framework. We urge the Agencies to provide registered funds and their counterparties with the flexibility to negotiate the types of assets that each counterparty can post as collateral for both initial and variation margin, within the full set of eligible collateral that may be permitted for use under the 2013 International Framework. In addition, the Agencies should follow the CFTC's approach in requiring CSEs to specify to their non-CSE counterparties the methodology and data sources to be used to value positions and to calculate both initial and variation margin.
- The Agencies should require CSEs to segregate with third-party custodians excess amounts of initial margin collected, in the same manner as the required minimum amount of initial margin collected. Further, the Agencies should require CSEs to provide the option of third-party segregation to those non-CSE counterparties that are subject to third-party custody requirements with respect to their variation margin, such as registered funds.
- The Agencies should adopt the same phase-in period for variation margin that the Reproposals establish for initial margin. If the Agencies, however, decide not to apply a tiered phase-in period for variation margin, the Agencies should provide a minimum of 18 additional months from the effective date of the final rules for market participants to comply with the new variation margin requirements.
- The Agencies should adopt a consistent definition of an "eligible master netting agreement," and we recommend that they adopt the broader definition proposed by the Prudential Regulators. The Agencies should allow parties to utilize a single eligible master netting agreement that may also include legacy covered swaps, provided that the credit support documentation clearly differentiates legacy covered swaps and new covered swaps, for purposes of applying the initial margin requirements.

DISCUSSION

I. Two-Way Margin

We are pleased that, consistent with our prior comments,⁷ the Agencies propose to require two-way margin. Under this approach, CSEs would be required to post initial and variation margin to their non-CSE counterparties at the same level and in the same manner as the counterparty is required to post to the CSE with respect to covered swaps.⁸ This fundamental requirement is consistent with the 2013 International Framework, under which entities that engage in non-centrally cleared derivatives are required to exchange, on a bilateral basis, initial and variation margin in mandatory minimum amounts.⁹

Two-way margin is an essential component of managing risk for covered swaps and reducing systemic risk. The collection of two-way margin helps to protect both counterparties to a covered swap and ensures that counterparties can meet their financial obligations in respect of the covered swaps they enter into. The collection of two-way initial margin is the most effective risk reduction tool to protect against residual counterparty credit risk. Two-way exchange of initial margin provides to each counterparty protection against increases in the replacement cost of a covered swap during the expected liquidation timeframe following a counterparty default. Furthermore, requiring a CSE to post initial margin to a non-CSE counterparty promotes central clearing by removing an incentive – avoidance of posting initial margin – for a CSE to structure a transaction, where possible, so that it need not be cleared. It also fosters prudent risk management in the swaps market more generally by limiting a CSE's ability to build swaps portfolios that are unduly large by requiring the CSE to generally ensure that it has the resources to post margin to its counterparties.

The daily collection of variation margin serves to remove current exposure from the covered swaps markets for all participants and prevents exposures from accumulating. Two-way exchange of variation margin provides protection to all participants in the swaps market against the market value

⁷ See Letter from Karrie McMillan, General Counsel, ICI, to David A. Stawick, Secretary, CFTC, dated September 13, 2012, and Letter from Karrie McMillan, General Counsel, ICI, to Mr. Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, Mr. Gary K. Van Meter, Acting Director, Farm Credit Administration, Mr. Robert E. Feldman, Executive Secretary Federal Deposit Insurance Corporation, Mr. Alfred M. Pollard, General Counsel, Federal Housing Financing Agency and the Office of Comptroller of the Currency, dated November 20, 2012.

⁸ See PR Proposal at § 3(b) (with respect to initial margin) and § 4(a) (with respect to variation margin) and CFTC Proposal at § 23.152(b)(1) (with respect to initial margin) and § 23.153(a) (with respect to variation margin).

⁹ See Key Principle 2 of the 2013 International Framework.

losses that could otherwise build up at CSEs, which engage in a significant amount of covered swaps and could threaten systemic stability.

For these reasons, ICI strongly agrees with the Reproposals to require equivalent two-way margin obligations for both counterparties to a covered swap. We believe the objectives of the global regulators to reduce systemic risk and promote central clearing by imposing a two-way margin requirement are consistent with the requirements of Section 4s(e)(3)(A) of the Commodity Exchange Act (“CEA”) (with respect to swaps) and Section 15F(e)(3)(A) of the Securities Exchange Act of 1934 (“Exchange Act”) (with respect to security-based swaps), which require margin requirements that shall help ensure the safety and soundness of CSEs and be appropriate for the risk to the financial system associated with covered swaps entered into by CSEs.

II. Calculation and Application of Thresholds

A. Calculation of Material Swaps Exposure

Under the Reproposals, a CSE is required to exchange initial margin with a financial end user with “material swaps exposure” (“MSE”). MSE is defined to mean “that an entity and its affiliates have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps and foreign exchange swaps¹⁰ and foreign exchange forwards¹¹ with all counterparties for June, July and August of the previous calendar year that exceeds \$3 billion, where such amount is calculated only for business days.” As the Agencies are aware, the 2013 International Framework established a threshold of €8 billion or approximately US\$11 billion in gross notional outstanding amounts, below which entities would not be subject to initial margin requirements. The Agencies’ decision to deviate from the 2013 International Framework is troubling, as it would result in a lack of consistency internationally and may result in capturing certain financial end users, including many registered funds, despite the fact that some of those funds only enter into a limited notional amount of covered swaps.

Other jurisdictions have proposed thresholds that are consistent with the 2013 International Framework. For example, the €8 billion international threshold has been incorporated into the margin requirements for OTC derivatives contracts not cleared by a central counterparty proposed by European regulators pursuant to the European Market Infrastructure Regulation (“EMIR”) to determine whether particular counterparties would be subject to the margin requirements under the EMIR Proposal.¹² In the interest of international harmonization, we believe that it is critical that the

¹⁰ “Foreign exchange swap” is defined in Section 1a(25) of the CEA.

¹¹ “Foreign exchange forward” is defined in Section 1a(24) of the CEA. Foreign exchange swaps and foreign exchange forwards together are hereinafter referred to as “FX Swaps and Forwards.”

¹² Consultation Paper – Draft regulatory technical standards on risk-mitigation techniques for OTC-derivatives contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012, April 14, 2014, *available at*

Agencies adopt the €8 billion threshold, which was established and agreed to by international regulators, including U.S. regulators, in order to ensure coordination and consistency in the application of a MSE threshold globally.

For the same reasons, we urge the Agencies to conform to international standards with respect to the calculation of the MSE threshold. The MSE threshold under the Reproposals would be calculated based on the average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, and FX Swaps and Forwards for June, July and August of the previous calendar year, where such amount is calculated only for business days. Under the 2013 International Framework, however, the threshold is calculated based on the aggregate month-end average notional amount of non-centrally cleared derivatives for June, July, and August of the year. The Agencies have not explained why it is necessary to require a different calculation method for the MSE threshold than the calculation method established by the international regulators. Deviating from the 2013 International Framework would raise unnecessary operational complexities and additional compliance costs for firms. We therefore recommend the Agencies revise their definitions of “material swaps exposure” to include the calculation method from the 2013 International Framework.

The Agencies explain that the reason for proposing a \$3 billion MSE threshold is because “there are a significant number of cases in which a financial end user counterparty would have a material swaps exposure level below \$11 billion but would have a swap portfolio with an initial margin collection amount that significantly exceeds the proposed permitted initial margin threshold amount¹³ of \$65 million” and that therefore “[s]etting the material swaps exposure threshold at \$11 billion appears to be inconsistent with this intent.”¹⁴ We do not believe, however, that linking the IMTA, which is a minimum threshold below which parties need not exchange initial margin, to the level that constitutes material swaps exposure, was intended by the 2013 International Framework because these calculations are intended to measure very different things.¹⁵ Furthermore, the sample of cleared interest rate swap

<http://www.eba.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf> (the “EMIR Proposal”).

¹³ The initial margin threshold amount (“IMTA”) is a threshold below which a CSE need not collect or post initial margin from or to a counterparty that is also a CSE or a financial end user with a MSE. The Agencies have proposed that the IMTA would be set to \$65 million, which is consistent with the €50 million IMTA set forth in the 2013 International Framework.

¹⁴ PR Proposal at 57367. *See also* CFTC Proposal at 59905.

¹⁵ The BCBS/IOSCO appears to have adopted an IMTA threshold to alleviate concerns about the liquidity impact of the initial margin requirements rather than to determine the scope of entities that should be subject to the margin requirements. *See* 2013 International Framework at 8. (“One method for managing the liquidity impact associated with initial margin requirements – and one that has received broad support – is to provide for an initial margin threshold (threshold) that would specify an amount under which a firm would have the option of not collecting initial margin.”)

portfolios that the Agencies used to conclude that the lower threshold amount would be appropriate did not include the notional amount of FX Swaps and Forwards, which would not be subject to any margin requirements. Because the MSE threshold would apply to portfolios that include FX Swaps and Forwards, there would likely be a substantial number of portfolios that have an MSE between \$3 billion and \$11 billion that would not exceed the \$65 million IMTA threshold.

We believe that, at the \$3 billion level, it is significantly more likely than estimated by the Agencies for a non-CSE counterparty to exceed the MSE threshold due to the inclusion in the MSE of the notional amount of a counterparty's FX Swaps and Forwards yet nonetheless be below the IMTA. Findings from an informal survey of ICI members suggest that this is the case when a registered fund counterparty enters into a significant amount of FX Swaps and Forwards relative to covered swaps.¹⁶ These registered funds nonetheless would bear the ongoing compliance costs and burdens of monitoring the IMTA and calculating their aggregate credit exposure each time a registered fund enters into a new covered swap, even though the fund's aggregate credit exposure from covered swaps very well may be below \$65 million. Failure to exclude FX Swaps and Forwards at the lower MSE threshold for a fund that transacts in a significant volume of FX swaps and Forwards, but only limited covered swaps, would result in effectively setting the MSE threshold at the \$65 million IMTA, a level that the Agencies have not provided a basis for under the Reproposals.

Further, we see no policy reason to include FX Swaps and Forwards for purposes of determining when an entity is required to post and collect IM, when those FX Swaps and Forwards are not subject to margin requirements. Not counting FX Swaps and Forwards toward the MSE threshold would be consistent with the determination by the Department of the Treasury under the Dodd-Frank Wall Street Reform and Consumer Protection Act¹⁷ (the "Dodd-Frank Act") to exempt FX Swaps and Forwards from the definition of "swap" under the CEA.¹⁸ We therefore urge the Agencies to exclude FX Swaps and Forwards, at a minimum, for purposes of calculating the \$3 billion MSE threshold, for the reasons described above.

If, however, the lower MSE threshold is adopted, we strongly recommend that the Agencies permit a non-CSE counterparty, in calculating its MSE, to be able to net its positions. Under the Reproposals, counterparties are permitted to net in respect of their covered swaps the amount of initial

¹⁶ Based on our members' estimates of their margin requirements under the Reproposals, it appears that many funds with more than \$3 billion, but less than \$11 billion in MSE, would not meet the \$65 million initial margin threshold, where 85 percent or more of the registered fund's MSE would be due to exposure to FX Swaps and Forwards as a result of hedging activity, and only 15 percent or less would be due to exposure to covered swaps.

¹⁷ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

¹⁸ See Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act, 77 Fed. Reg. 69694 (Nov. 20, 2012) (the "Treasury Exemption").

margin required to be posted in connection with their covered swaps, and therefore similarly should be able to net the notional amounts of covered swaps, including delta adjustment of notional amounts of instruments involving optionality,¹⁹ for purposes of calculating the MSE. These techniques better reflect the economic realities of the non-CSE counterparty's portfolio, are consistent with ordinary course practices for covered swaps, and would therefore result in the MSE threshold more accurately reflecting the counterparty's covered swaps exposure.

B. Group Application of the IMTA and MSE Thresholds

The IMTA and the MSE thresholds are both proposed to be applied considering the positions of a counterparty along with its affiliates.²⁰ The Prudential Regulators take the view, consistent with the 2013 International Framework and the EMIR Proposal, that “[i]nvestment funds that are managed by an investment advisor are considered distinct entities that are treated separately when applying the threshold as long as the funds are distinct legal entities that are not collateralised by or are otherwise guaranteed or supported by other investment funds or the investment advisor in the event of fund insolvency or bankruptcy.”²¹ ICI supports this view regarding the treatment of investment funds.²² We expect the CFTC also to take this view, although it is not explicitly stated.²³

¹⁹ For covered swaps with optionality (such as interest rate swaptions, credit default swaptions and currency options), the notional amount of the covered swap generally will not reflect the market risk inherent in the covered swap. For example, the delta adjusted aggregate notional amount of a covered swap portfolio that includes deeply out of the money swaptions (to hedge tail risk) will likely be much lower than the absolute aggregate notional amount of those instruments by virtue of the fact that the swaption deltas will be close to zero (reflecting that a movement in the underlying rate has little impact on the market value of the swaption). *Cf.* 17 CFR 4.5 (permits delta adjustments of options for purposes of calculating aggregate net notional value of positions under Regulation 4.5).

²⁰ “Affiliate” is defined under the Reproposals as any company that controls, is controlled by, or is under common control with another company. “Control” of another company is defined under the Reproposals to include: (1) ownership, control, or power to vote 25 percent or more of a class of voting securities of the company, directly or indirectly or acting through one or more other persons; (2) ownership or control of 25 percent or more of the total equity of the company, directly or indirectly or acting through one or more other persons; or (3) control in any manner of the election of a majority of the directors or trustees of the company. *See* PR Proposal at §_2 and CFTC Proposal at § 23.151.

²¹ CFTC Proposal at 57364; 2013 International Framework at n.10; EMIR Proposal at 18-19.

²² *See, e.g.*, Letter from Karrie McMillian, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to Wayne Byres, Secretary General, Basel Committee on Banking Supervision, Bank for International Settlements, and David Wright, Secretary General, International Organization of Securities Commissions, dated March 14, 2013.

²³ This approach recognizes the unique structure of registered funds. For example, in creating funds, a sponsor may establish a “series company,” which has the ability to create multiple sub-portfolios. Each portfolio or “series” in a series company is a separate pool of securities with its own assets, liabilities, and shareholders. Series funds are effectively independent in economic, accounting, and tax terms but share the same governing documents and governing body. For example, liquidation of one portfolio in the series is isolated to that portfolio. Shareholders must look solely to the assets of their own portfolio for redemption, earnings, liquidation, capital appreciation, and investment results. Investment decisions,

The Prudential Regulators, however, go further to state that they intend to take the view that “advised and sponsored funds and sponsored securitization vehicles would not be affiliates of the investment adviser or sponsor unless the adviser or sponsor meets the definition of control . . .”²⁴ We do not believe it is necessary to apply an affiliation and control analysis to determine the applicability of the margin thresholds to registered funds. As agreed to by the international regulators, if a fund is not collateralized by or otherwise guaranteed or supported by other investment funds or the investment adviser in the event of an insolvency or bankruptcy, it should be treated separately when applying the thresholds. We urge the Prudential Regulators and the CFTC to take the same approach with respect to the treatment of investment funds as agreed upon in the 2013 International Framework, and not adopt an affiliation and control analysis for registered funds.

In addition, we request that registered funds that are managed in an adviser/subadviser or “multi-manager” arrangement may treat each separately managed “sleeve” of the fund as a separate registered fund for purposes of applying the IMTA threshold. In a multi-manager fund, different managers are responsible for managing different portions, or “sleeves,” of the registered fund’s portfolio that are invested according to different investment objectives. Because sleeves of multi-manager funds are managed separately on a day-to-day basis by each manager, subject to the overall management and supervision of the fund’s investment adviser, it would be extraordinarily difficult, if not impossible, for the fund to calculate and monitor the IMTA threshold across all of the sleeves of such a fund on an ongoing basis.

III. Currency Denominations

The currency used to calculate the IMTA and MSE thresholds in the Reproposals is U.S. Dollars. However, for market participants that do not normally deal in U.S. Dollars, or whose payment obligations are determined by reference to a foreign currency, denominating the threshold level in U.S. Dollars will cause operational difficulties. Further, the Agencies have noted that “over time, amounts that are denominated in different currencies in different jurisdictions may fluctuate relative to one another due to changes in exchange rates.”²⁵ In response to the Agencies’ request for comment on

including regarding the use of derivatives, are made at the portfolio level. The SEC and its staff generally apply the restrictions and requirements of the ICA to series funds as though each series were a separate registered fund while U.S. federal securities laws safeguard the assets in an individual portfolio from market or other risks that may negatively affect another portfolio, and consequently, protect the shareholders invested therein and the fund complex more broadly. *See Regulation of Series Investment Companies under the Investment Company Act of 1940*, Joseph R. Fleming, Business Lawyer, August 1989.

²⁴ PR Proposal at 57363.

²⁵ PR Proposal at 57353 and CFTC Proposal at 59900.

“whether and how fluctuations resulting from exchange rate movements should be addressed,”²⁶ we propose that an entity for which U.S. Dollars is not the entity’s common or transacting currency, or an entity whose payment obligations are determined by reference to a foreign currency, be permitted to rely on an average exchange rate between U.S. Dollars and such entity’s common currency calculated on a periodic (e.g., monthly or yearly) basis with the resulting amount rounded to the nearest 100,000.

IV. Margin Documentation

Under the Reproposals, a CSE is responsible for calculating the amounts of initial and variation margin that are required to be collected or posted when facing a non-CSE counterparty. In calculating the amount of initial margin required to be collected or posted, the CSE may rely on an internal risk-based model or on a standardized margin schedule. ICI fully supports providing a choice of margin methodologies, and permitting the use of models that have been developed by various entities that meet the criteria established by the Agencies. However, if a CSE utilizes a proprietary model, we believe the CSE should be required to provide full transparency of that model to its non-CSE counterparty so that the counterparty can determine that margin is being calculated appropriately and the counterparty may use the model to calculate its own initial margin requirements.

The Reproposals require initial approval of a proprietary model by the relevant Agency to confirm that it is sound and complies with the requirements of the Reproposal, and also would require that the CSE review the model periodically, but no less frequently than annually.²⁷ If the non-CSE counterparty’s initial margin requirements are calculated by reference to a proprietary model, it is critical to ensure that such counterparty is able to assess the integrity of the model on an ongoing basis. Thus, the non-CSE counterparty must have full transparency of the model, including the assumptions, limitations, and operational details of the model.

The CFTC Proposal addresses these concerns by proposing to require that the margin documentation between the parties specify the methodology and data sources to be used to value positions and to calculate both initial and variation margin for covered swaps entered into by the parties.²⁸ However, the PR Proposal only requires that margin documentation between the parties specify the methodology and data sources to be used to value positions and calculate only variation margin. As registered funds are non-CSE counterparties and will be bound by the calculations of initial and variation margin determined by the CSE, maximum transparency in the calculation of both initial and variation margin is necessary. Therefore, we strongly encourage the Prudential Regulators to take

²⁶ PR Proposal at 57353 and CFTC Proposal at 59901.

²⁷ PR Proposal at §.8(e) and CFTC Proposal at § 23.154(b)(4).

²⁸ See PR Proposal at §.10(a)(2)(i) and CFTC Proposal at § 23.157(b)(1) and (2).

the same approach as the CFTC and require CSEs to specify to their non-CSE counterparties the methodology and data sources to be used to value positions and to calculate both initial and variation margin.

V. Eligible Collateral

Although we generally support the broad range of assets the Agencies propose to be permitted as eligible collateral for initial margin, we have significant concerns with the Agencies' approach to eligible collateral for variation margin, which is substantially more restrictive than what was agreed upon in the 2013 International Framework. We believe this approach would be highly problematic and potentially costly for registered funds and their shareholders, as it may force registered funds to hold lower-yielding securities at an increased cost to fund shareholders. In order to conform the Agencies' approach to international standards and enable registered funds to reduce their costs in connection with posting collateral, we urge the Agencies to provide registered funds and their counterparties with the flexibility to negotiate the types of assets that each counterparty can post as collateral for both initial and variation margin, within the full set of eligible collateral that may be permitted for use as margin under the 2013 International Framework, subject to appropriate haircuts and the parties' determination that such assets are highly liquid.

The 2013 International Framework specifies the following non-exhaustive list of eligible collateral that a counterparty may post as both variation and initial margin: cash, high-quality government and central bank securities, high-quality corporate bonds, high-quality covered bonds, equities included in major stock indices, and gold.²⁹ In order for assets to qualify as eligible collateral for purposes of the 2013 International Framework, they must be "highly liquid and should, after accounting for an appropriate haircut, be able to hold their value in a time of financial stress."³⁰ Consistent with the 2013 International Framework, under the EMIR Proposal, eligible collateral for purposes of initial margin and variation margin may include a broader list of assets than permitted by the Agencies, such as corporate bonds, the most senior tranche of a securitization that is not a re-securitization, and certain convertible bonds. Adoption of a broader set of eligible collateral by the Agencies would also be consistent with requirements imposed by the ICA and the staff of the SEC with

²⁹ See Requirement 4.1 of the 2013 International Framework.

³⁰ See Key Principle 4 of the 2013 International Framework. This approach is generally followed by the EMIR Proposal. Additionally, "all collateral has to meet additional eligibility requirements such as low credit, market and FX risk." EMIR Proposal at 9.

respect to a registered fund's use of derivatives, under which a fund is permitted to use any type of liquid asset to segregate against (or "cover") its potential obligations under the derivative.³¹

A. Initial Margin

Under the Reproposals, initial margin would be limited to: U.S. dollars; cash in a variety of major currencies or a currency in which payment obligations under the swap is required to be settled; debt securities that are issued or guaranteed by the U.S. Treasury, another government agency, the Bank for International Settlements, the International Monetary Fund, the European Central Bank and multilateral development banks; certain U.S. government-sponsored enterprises' debt or asset-backed securities; certain foreign government debt securities; certain corporate debt securities; certain equity securities contained in major indices; and gold.³² Except for U.S. dollars and the currency in which the payment obligation of the swap is required, assets posted as initial margin would be subject to haircuts specified in the Reproposals. We support a broad choice of collateral for initial margin but recommend that the Agencies provide registered funds and their counterparties the flexibility to negotiate as initial margin the types of assets that each counterparty can post as collateral, within the full set of eligible collateral permitted under the 2013 International Framework.

B. Variation Margin

Under the Reproposals, a CSE would be required to collect from and post to its non-CSE counterparty variation margin only in the form of immediately available cash denominated in U.S. Dollars or the currency in which payment obligations under the related covered swap are required to be settled.

The limitation of variation margin to cash and the currency in which payment obligations under the relevant covered swap are required to be settled under the Reproposals would be highly problematic for registered funds as they rarely post cash as variation margin. Restricting variation margin to just cash, or even a narrow range of permitted assets beyond cash (such as only U.S. Treasury securities as originally proposed by the CFTC or any obligation that is a direct obligation of, or fully guaranteed as to principal and interest by, the United States as originally proposed by the Prudential Regulators) may force these funds to hold lower-yielding securities at an increased cost to fund shareholders. This could result in registered funds being compared unfavorably to a benchmark because it may force funds to hold assets in which they otherwise would not typically invest. For example, an

³¹ See *Merrill Lynch Asset Management, L.P.*, SEC Staff No-Action Letter (Jul. 2, 1996) and *Securities Trading Practices of Registered Investment Companies*, Investment Company Act Release No. 10666 (Apr. 18, 1979).

³² In addition, certain assets would be prohibited from being used as initial margin, including any asset that is an obligation of the party providing such asset or an affiliate of that party, and instruments issued by bank holding companies, depository institutions, and market intermediaries.

equity fund generally would not hold government securities other than for collateral purposes, and holding such securities may result in the performance of such a fund lagging behind its relevant benchmarks. In addition, a restrictive collateral requirement may cause a registered fund to hold more cash than would otherwise be necessary or desirable to meet its investment objectives and policies.

Additionally, although the Agencies note that 2013 ISDA Standard Credit Support Annex (the "SCSA") "provides for the sole use of cash as eligible collateral for variation margin,"³³ the use of the SCSA between registered funds and CSEs is quite limited. We believe this lack of use likely reflects the commercial reality that registered funds, in pursuing their investment objectives and strategies, seek to remain as fully invested in securities as possible.

Finally, we note that Section 4s(e)(3)(C) of the CEA (with respect to swaps) and Section 15F(e)(3)(C) of the Exchange Act (with respect to security-based swaps) specifically require that the Agencies and the SEC, in prescribing margin requirements for covered swaps, "permit the use of noncash collateral" (emphasis added) as the relevant Agency or the SEC determines to be consistent with "(i) preserving the financial integrity of the markets trading swaps; and (ii) preserving the stability of the United States financial system." We believe that allowing a broader range of non-cash assets to be used as eligible collateral for variation margin would be consistent with these requirements, especially where the Agencies have already recognized the availability of a broad range of noncash collateral that may be used as initial margin.

We therefore recommend, consistent with the language of the statutory text, that the Agencies provide registered funds and their counterparties with the flexibility to negotiate the types of assets that can be posted as initial and variation margin in respect of covered swaps, in consideration of the non-exclusive list of eligible collateral that may be permitted for use as margin under the 2013 International Framework, provided that the parties determine that such assets are "highly liquid and should, after accounting for an appropriate haircut, be able to hold their value in a time of financial stress."³⁴

VI. Custodial Arrangements

A. Segregation of Margin

Under the CFTC Proposal, a CSE that posts or collects the required minimum amount of initial margin with respect to a covered swap ("Required IM") must segregate the Required IM at one or more custodians that are not affiliates of either the CSE or the counterparty.³⁵ Under the PR

³³ PR Proposal at 57371 and CFTC Proposal at 59913.

³⁴ See Key Principle 4 of the 2013 International Framework.

³⁵ See CFTC Proposal at § 23.157(a) and (b).

Proposal, a CSE that posts any collateral other than variation margin (which would include both Required IM and amounts in excess of Required IM, or “Excess IM”) with respect to a covered swap, or collects Required IM from its counterparty similarly must segregate that collateral at one or more custodians that are not affiliates of either the CSE or the counterparty.³⁶ We fully support the requirement to segregate a counterparty’s Required and Excess IM from proprietary assets of the CSE and the restrictions on rehypothecation. For the reasons described below, however, we recommend that: (1) the Prudential Regulators extend the third-party segregation requirement they have proposed for Excess IM posted by a CSE to Excess IM collected by a CSE; (2) the CFTC revise its proposed rules to require third-party segregation for Excess IM on a bilateral basis; and (3) the Agencies require CSEs to provide the option of third-party segregation to those non-CSE counterparties that are subject to third-party custody requirements with respect to their variation margin, such as registered funds.

Registered funds must maintain their assets with a custodian in accordance with specific custody provisions of the ICA that require, among other things, that fund assets be held with qualified custodians and generally prohibit fund assets held in custody from being rehypothecated.³⁷ Registered funds treat Required IM, Excess IM and variation margin as fund assets subject to the ICA custody requirements, and nearly all registered funds use a U.S. bank custodian for domestic securities although the ICA permits other limited custodial arrangements.³⁸ For non-centrally cleared derivatives transactions, registered funds generally enter into tri-party collateral control agreements (“CCAs”) with their custodian and applicable counterparty to post collateral to satisfy their margin obligations. Under these arrangements, a registered fund is able to post margin for the benefit of the counterparty with its own custodian consistent with the custody requirements under Section 17(f) of the ICA. These types of agreements create a security interest for the benefit of the counterparty in the collateral posted by the registered fund.

We recommend that CSEs be required to segregate Excess IM with third-party custodians in the same manner as Required IM, both with respect to Excess IM they post, and Excess IM they receive from their counterparties. With respect to the PR Proposal, we believe it would be inequitable to not provide Excess IM of CSE counterparties with the same level of custodial protection that is provided to the CSE’s own collateral. With respect to the CFTC Proposal, we recommend that the third-party

³⁶ See PR Proposal at §_7(a) and (b).

³⁷ See Section 17 of the ICA. The ICA also contains six separate custody rules for the different types of possible custody arrangements: Rule 17f-1 (broker-dealer custody); Rule 17f-2 (self-custody subject to strict conditions); Rule 17f-4 (securities depositories); Rule 17f-5 (foreign banks); Rule 17f-6 (futures commission merchants); and Rule 17f-7 (foreign securities depositories). Foreign securities are required to be held in the custody of a foreign bank or securities depository.

³⁸ See *id.*

segregation requirements proposed for Required IM also be extended to Excess IM. We further recommend that CSEs be required to provide the option of third-party segregation to those non-CSE counterparties that are subject to third-party custody requirements with respect to their variation margin.

Without these changes to the Reproposals, registered funds will find it difficult to comply with the custody requirements under the ICA. Moreover, registered funds that seek third-party custody arrangements when entering into covered swaps with CSEs would be significantly disadvantaged in negotiating segregation arrangements for registered funds because CSEs possess significant market and bargaining power. We also request that the Agencies provide confirmation that they would not impose any capital or other charges on CSEs in connection with segregating Required IM, Excess IM, or variation margin for non-CSE counterparties that are subject to third-party custody requirements, as such charges could lead to increased costs for CSEs that would invariably be passed along to their non-CSE counterparties.

B. Definition of Affiliate

The Reproposals would require that the custodian that holds Required IM not be an affiliate of the CSE or the counterparty.³⁹ This proposed requirement is based on the requirement in Section 4s(1)(3)(A) of the CEA (with respect to swaps) and Section 3E(f)(3)(A) of the Exchange Act (with respect to security-based swaps) that initial margin posted with respect to covered swaps must be segregated at an “independent third-party custodian.”⁴⁰ The CFTC has explicitly recognized, however, that this statutory language does not require that affiliates of a counterparty be prohibited from serving as the custodian for segregated funds; instead, all that is required is that the custodian and the CSE be separate entities.

Specifically, the CFTC’s final rule regarding the segregation requirements in respect of non-cleared swaps⁴¹ (the “Seg IA Rule”) requires that the custodian of collateral posted in respect of covered swaps that is segregated pursuant to the right to elect to segregate such margin, “must be a legal entity

³⁹ PR Proposal at § 7(a) and (b) and CFTC Proposal at § 23.157(a) and (b).

⁴⁰ Section 763(d) of the Dodd-Frank Act added Section 3E(f) to the Exchange Act, and Section 724(c) of the Dodd-Frank Act added Section 4s(1) to the CEA. Sections 763 and 724 of the Dodd-Frank Act both set forth the requirements regarding the rights of counterparties to CSEs to elect segregation with respect to money, securities, or other property that serves as collateral for uncleared swaps, and require that the segregated account be carried by an independent third-party custodian and designated as a segregated account for and on behalf of the counterparty.

⁴¹ Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy, 78 Fed. Reg. 66621 (Nov. 6, 2013).

independent of both the swap dealer or major swap participant and the counterparty.”⁴² In the commentary to the Seg IA Rule, the CFTC stated explicitly that the CEA does not prohibit affiliates of a counterparty from serving as the custodian for segregated funds because affiliates are “third-parties in that they are separate legal entities, and therefore fall within the terms of the statute.”⁴³

As discussed above, registered funds utilize third-party custody arrangements, typically tri-party agreements, when entering into covered swaps with CSEs. It is not unusual, however, for a registered fund to enter into covered swaps with an affiliate of its custodian because registered funds typically use banks as custodians. For example, a registered fund may segregate its margin with a bank and enter into one or more swaps with an affiliate of the bank that is a CSE.

Consistent with the CFTC’s prior interpretations of this statutory language and the fact that the CFTC did not modify this position in re-proposing certain aspects of § 23.701 in the CFTC Proposal,⁴⁴ ICI recommends that the Agencies revise their proposed rule text to be consistent with the CFTC’s prior interpretations and industry practice and provide that the custodian of segregated funds must be a legal entity that is separate of both the CSE and the counterparty. This position would appropriately recognize well established, ordinary course custody and trading practices of market participants, including registered funds.

C. Restrictions on Rehypotheication

Under the Reproposals, the funds or other property held by the custodian may not be rehypothecated, repledged, reused or otherwise transferred.⁴⁵ We fully support these restrictions on rehypothecation, which are consistent with the restrictions to which registered funds are subject under the ICA.⁴⁶

VII. Compliance Dates

The Reproposals would require CSEs to comply with the minimum margin requirements for covered swaps entered into on or after (a) for variation margin, December 1, 2015, and (b) for initial

⁴² § 23.701(a)(2).

⁴³ Seg IA Rule at 66627.

⁴⁴ We note that this approach is also consistent with the approach set forth in the EMIR Proposal. *See* EMIR Proposal at 42.

⁴⁵ *See* PR Proposal at §_7(c)(1) and CFTC Proposal at § 23.157(c)(1). We note that it is typical for a bank maintaining custody of customer cash, including margin posted in the form of cash, to invest that cash in assets held on the bank’s balance sheet. We request confirmation that this standard industry practice would not be considered to constitute a prohibited “reuse” under the Reproposals.

⁴⁶ *See supra* note 37 and accompanying text.

margin, (i) December 1, 2015, where both the CSE combined with its affiliates and the counterparty combined with its affiliates have an average daily aggregate notional amount of covered swaps⁴⁷ for June, July and August of 2015 that exceeds \$4 trillion; (ii) December 1, 2016, where both the CSE combined with its affiliates and the counterparty combined with its affiliates have an average daily aggregate notional amount of covered swaps for June, July and August of 2016 that exceeds \$3 trillion; (iii) December 1, 2017, where both the CSE combined with its affiliates and the counterparty combined with its affiliates have an average daily aggregate notional amount of covered swaps for June, July and August of 2017 that exceeds \$2 trillion; (iv) December 1, 2018 where both the CSE combined with its affiliates and the counterparty combined with its affiliates have an average daily aggregate notional amount of covered swaps for June, July and August of 2018 that exceeds \$1 trillion; and (v) December 1, 2019, for all covered swaps with any other counterparty.

Because existing collateral documentation between counterparties will have to be amended to reflect the new margin requirements, there will be an extraordinary number of agreements that will have to be renegotiated and executed before December 1, 2015, which would likely not be an adequate period of time for market participants to amend all the necessary agreements and adapt supporting collateral systems. We also are concerned that a short time period may result in registered funds and other counterparties being pressured to sign agreements with unfavorable terms to complete the process before the compliance deadline. We therefore recommend that the Reproposals adopt the same phase-in period for variation margin requirements that the Reproposals include for initial margin (with compliance beginning the earliest for the largest derivative market participants). If, however, the Agencies decide not to include a tiered phase-in period, we urge the Agencies to provide a minimum of 18 additional months from the date of publication of the final rules in the Federal Register for market participants to comply with the new variation margin requirements.

We also urge the Prudential Regulators to coordinate compliance dates with the SEC. A failure to coordinate may lead to the anomalous result that, until the final compliance dates are reached by both the Prudential Regulators and the SEC, the same non-cleared security-based swap may or may not be subject to margin requirements depending whether the CSE counterparty is regulated by a Prudential Regulator or the SEC. This result, in turn, could easily lead to regulatory arbitrage, as non-CSE counterparties transacting in non-cleared security-based swaps may have an incentive to transact with CSEs not subject to regulation by a Prudential Regulator. Therefore, it is essential that the Prudential Regulators coordinate the timing of effectiveness of the rules with the SEC to limit regulatory arbitrage in the selection of CSEs as counterparties for non-cleared security-based swaps.

⁴⁷ In all cases, amounts are calculated only for business days.

VIII. Eligible Master Netting Agreements

A. Definition of Eligible Master Netting Agreement

The proposed definition of an “eligible master netting agreement” (“EMNA”) is largely consistent between the Reproposals. However, the PR Proposal would deem a broader range of agreements to meet the definition of an EMNA upon an event of default following a stay than would the CFTC Proposal. Specifically, the PR Proposal would define an EMNA to include agreements that provide that a CSE’s exercise of rights under the agreement will not be stayed or avoided, in pertinent part, “under applicable law in the relevant jurisdictions, other than: (i) in receivership, conservatorship, resolution under the Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.), Title II of the Dodd-Frank Act (12 U.S.C. 5381 et seq.), the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 as amended (12 U.S.C. 4617), or the Farm Credit Act of 1971 (12 U.S.C. 2183 and 2279cc), or similar laws of foreign jurisdictions that provide for limited stays to facilitate the orderly resolution of financial institutions, or (ii) in a contractual agreement subject by its terms to any of the laws referenced in (i)” (emphasis added). This underlined language is not included in the CFTC Proposal. We believe that the Agencies should adopt the broader definition of EMNA included in the PR Proposal.

B. Portfolio Margining Arrangements

The Reproposals permit a CSE to calculate initial margin requirements for covered swaps under an EMNA for a counterparty on a portfolio basis using an initial margin model. However, the Reproposals would require that a CSE comply with the margin requirements with respect to all covered swaps governed by the EMNA, regardless of the date on which they were entered into. A CSE would need to enter into a separate EMNA for covered swaps entered into after the relevant compliance date in order to exclude covered swaps entered into with a counterparty prior to such compliance date from the margining requirements of the Reproposals.⁴⁸ We believe that it is unnecessary to have a separate EMNA to accomplish the Agencies’ goals and, further, that such an approach may have additional unforeseen negative consequences.

First, having multiple EMNAs is unnecessary to separate pre-and post-compliance date covered swaps. Counterparties could readily document under a single credit support arrangement separate portfolio margining arrangements for both pre- and post-compliance date covered swaps without needing to enter into a wholly separate master agreement to govern the post-compliance date covered swaps. Instead, permitting a single EMNA that clearly delineates pre- and post-compliance date covered swaps would result in greater administrative efficiencies and lower costs than negotiating entirely separate swap trading relationship documentation, as would be required under the Reproposals.

⁴⁸ PR Proposal at 57359; CFTC Proposal at 59909.

Further, we believe that to the extent the parties already call for variation margin on legacy covered swaps, as is standard market practice, they should be able to net variation margin between legacy and new covered swaps.

Second, to require that counterparties enter into multiple EMNAs may defeat the primary objective of having a single EMNA under the insolvency laws in certain jurisdictions, because those jurisdictions only permit, or provide safe harbors for, close-out netting under all covered swaps entered into by a defaulting party under a single master netting agreement. Parties may therefore have to review all of their netting opinions in order to ensure that close-out netting is still permitted in relevant jurisdictions based on the new arrangement, including cross-product netting or set-off provisions. Revisiting these opinions, and reviewing the law of the relevant jurisdiction, if necessary, would require the parties to expend significant time and resources. To the extent the answer is unclear, unnecessary uncertainty would be created in the derivatives market, as well as potentially significant increase in counterparty credit risk. It is also unclear whether such an arrangement would result in increased capital charges for CSEs that are prudentially regulated if the resulting netting arrangement does not constitute a “qualifying master netting agreement.”

We therefore request that the Agencies not require that parties enter into multiple EMNAs in order to ensure that pre- and post-compliance date covered swaps may be subject to separate portfolio margining arrangements under a single EMNA, as such a requirement is unnecessary to accomplish the Agencies’ stated regulatory goals. We further request that the Agencies confirm that pre- and post-compliance date covered swaps need only be margined separately on a portfolio basis with respect to initial margin and not variation margin.

IX. Legal Requirements for EMNA/Custodial Arrangements

Both Reproposals require that any EMNA or custodial agreement for the segregation of margin in respect of covered swaps must be “legal, valid, binding and enforceable under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding.”⁴⁹ As proposed, this language could lead some CSEs to believe that legal opinions may be required when utilizing an EMNA in connection with portfolio margining arrangements. We understand that obtaining such legal opinions would be difficult and costly. Furthermore, there is significant ambiguity regarding the intended scope of the phrase “all relevant jurisdictions.” Instead, we believe that requiring counterparties to ensure that the EMNA or the custodial arrangement meets the conditions of the Reproposals by “appropriate means” should be sufficient. We therefore recommend that the Agencies confirm that a legal opinion in respect of an EMNA or a custodial agreement for the segregation of margin is not necessary.

⁴⁹ PR Proposal at §§_.2 and _.7(c)(2) and CFTC Proposal at §§ 23.151 and 23.157(c)(3).

* * *

We appreciate the opportunity to provide further comments on the Reproposals issued by the Agencies in light of the work by international regulators in developing the 2013 International Framework. We believe that the Agencies should incorporate the recommendations discussed above and further harmonize the Reproposals consistent with the 2013 International Framework. If you have any questions on our comment letter, please feel free to contact me at (202) 326-5815, Sarah Bessin at (202) 326-5835, or Jennifer Choi at (202) 326-5876.

Sincerely,

/s/ David W. Blass

David W. Blass
General Counsel

cc: The Honorable Timothy G. Massad
The Honorable Mark Wetjen
The Honorable Sharon Bowen
The Honorable J. Christopher Giancarlo

The Honorable Mary Jo White
The Honorable Luis A. Aguilar
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November 24, 2014

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Re: *Margin and Capital Requirements for Covered Swap Entities, Proposed Rule; Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, Proposed Rule*

Ladies and Gentlemen:

ICI Global¹ appreciates the opportunity to provide comments on the margin proposals recently reissued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal

¹ The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US\$18.7 trillion. ICI Global seeks to

Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency (together, the “Prudential Regulators”) and the Commodity Futures Trading Commission (“CFTC”) with respect to margin requirements for uncleared swaps and security-based swaps.² The Prudential Regulators Proposal addresses margin requirements with respect to uncleared swaps and security-based swaps entered into by swap dealers (“SDs”), security-based swap dealers (“SBSDs”), major swap participants (“MSPs”), and major security-based swap participants (“MSBSPs”) regulated by a Prudential Regulator.³ The CFTC Proposal addresses uncleared swaps entered into by CSEs for which there is no Prudential Regulator. Although the CFTC and the Prudential Regulators (together the “Agencies”) have proposed substantially similar margin rules for uncleared swaps, the Prudential Regulators have proposed one approach and the CFTC has proposed three alternative approaches as to how their respective margin rules would apply to cross-border transactions. We have significant concerns that, if the Agencies do not further coordinate their approaches, a cross-border transaction would be treated differently depending on whether a CSE involved in the transaction was regulated by a Prudential Regulator or the CFTC. We do not believe that this result would be sound policy and urge the Agencies to develop approaches that at least would produce the same or similar outcomes.

Our members – US funds that are regulated under the Investment Company Act of 1940 (“ICA”) and similar non-US regulated funds publicly offered to investors, such as UCITS (collectively, “Regulated Funds”) – use swaps and other derivatives in a variety of ways. Derivatives are a particularly useful portfolio management tool in that they offer Regulated Funds considerable flexibility in structuring their investment portfolios. Uses of swaps and other derivatives include, for example, hedging positions, equitizing cash that a Regulated Fund cannot immediately invest in direct equity holdings, managing a Regulated Fund’s cash positions more generally, adjusting the duration of a Regulated Fund’s portfolio, or managing a Regulated Fund’s portfolio in accordance with the investment objectives stated in a Regulated Fund’s prospectus. To employ uncleared swaps in the best interests of fund investors, our members strongly support ensuring that the derivatives markets are efficient, highly competitive, and transparent.

ICI Global members, as market participants representing millions of investors, generally support the goal of providing greater oversight of the derivatives markets. Given that many derivative

advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

² See *Margin and Capital Requirements for Covered Swap Entities; Proposed Rule*, 79 Fed. Reg. 57348 (Sept. 24, 2014), available at <http://www.gpo.gov/fdsys/pkg/FR-2014-09-24/pdf/2014-22001.pdf> (“Prudential Regulators Proposal”); *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 79 Fed. Reg. 59898 (Oct. 2, 2014), available at <http://www.gpo.gov/fdsys/pkg/FR-2014-10-03/pdf/2014-22962.pdf> (“CFTC Proposal”).

³ For ease of reference, SDs, SBSDs, MSPs, and MSBSPs will be referred to in this letter as “covered swap entities” or “CSEs” although the CFTC Proposal would apply only to SDs and MSPs.

transactions are conducted across multiple jurisdictions, we support efforts for real and meaningful coordination among regulators on how these regulations will be applied to market participants that engage in derivatives transactions on a cross-border basis. In this letter, ICI Global focuses on the cross-border application of the proposed rules issued by the Agencies. We discuss below our concerns if the Prudential Regulators and the CFTC take approaches that would produce different results for similar cross-border transactions and offer our recommendations for modifications to the Agencies' proposed approaches. For comments on the substance of the Prudential Regulators Proposal and the CFTC Proposal, please refer to the letter submitted by the Investment Company Institute.⁴

Greater Coordination among International Regulators is Critical to Workable Application of Margin Rules to Cross-Border Transactions

We support the work of the Basel Committee on Banking Supervision ("BCBS") and International Organization of Securities Commissions ("IOSCO") in developing international margin standards for non-centrally cleared derivatives.⁵ This effort to harmonize margin standards will greatly alleviate burdens on market participants and eliminate inefficiencies in the derivatives markets, which are global in nature. Although market participants may more easily comply with margin rules in different jurisdictions when margin rules are harmonized internationally, there may nevertheless be some differences among the jurisdictions (as can be seen already with the proposals by the European Union⁶ ("EU") and the Agencies). Therefore, it is imperative that international regulators coordinate if more than one jurisdiction's requirements could apply to a cross-border transactions to avoid duplicative and/or potentially conflicting regulations.

During the BCBS/IOSCO consultations, we had cautioned that regulatory coordination will be complex and that the proposed framework did not adequately address numerous questions on how the margin requirements would apply to cross-border transactions.⁷ We recommended that the BCBS and

⁴ See letter from David W. Blass, General Counsel, ICI, to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation, Alfred M. Pollard, General Counsel, Federal Housing Financing Agency, Legislative and Regulatory Activities Division, Office of Comptroller of the Currency, and Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission, dated November 24, 2014.

⁵ See *Margin Requirements for Non-Centrally Cleared Derivatives*, Basel Committee on Banking Supervision and Board of the Intentional Organization of Securities Commissions, September 2013, *available at* <http://www.bis.org/publ/bcbs261.pdf> ("2013 International Framework").

⁶ Consultation Paper – Draft regulatory technical standards on risk-mitigation techniques for OTC-derivatives contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012, April 14, 2014, *available at* <http://www.eba.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf> ("EU Margin Consultation Paper").

⁷ Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to Wayne Byres, Secretary General, Basel Committee on Banking Supervision, Bank for International Settlements, and David Wright, Secretary General, International Organization of Securities Commissions, dated March 14, 2013, *available at* <http://www.ici.org/pdf/27111.pdf>; Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing

IOSCO develop a more detailed framework for how margin requirements will apply to transactions conducted across borders. Regrettably, the 2013 International Framework ultimately did not contain sufficient detail regarding the circumstances that trigger the application of the laws of a particular jurisdiction and which law would apply (and to which aspects of the transaction) when the laws of more than one jurisdiction could apply to a transaction. As a result, the Agencies are now proposing different approaches regarding how they would apply their margin rules to cross-border transactions. Given the global market for derivatives, we request that the Agencies work with the Securities and Exchange Commission and regulators abroad, particularly EU regulators, to achieve greater coordination in developing a global approach for cross-border derivatives transactions.

In the remainder of this letter, we focus on how the Prudential Regulators and the CFTC should address the cross-border application of their margin rules to avoid duplicative and/or potentially conflicting regulations and the opportunity for regulatory arbitrage.

Agencies Must Harmonize Cross-Border Approaches to Produce Similar Outcomes

With respect to the cross-border application of the margin requirements, the Prudential Regulators proposed one approach (“Prudential Regulators Approach”)⁸ and the CFTC proposed three alternative approaches – Prudential Regulators Approach, Guidance Approach,⁹ and Entity Approach.¹⁰ There are significant differences in the three cross-border approaches that have been

Director, ICI Global, to Wayne Byres, Secretary General, Basel Committee on Banking Supervision, Bank for International Settlements, and David Wright, Secretary General, International Organization of Securities Commissions, dated September 27, 2012, *available at* <http://www.ici.org/pdf/26529.pdf>.

⁸ Under the Prudential Regulators Approach, a “foreign non-cleared swap” or a “foreign non-cleared security-based swap” of a “foreign covered swap entity” would not be subject to the Prudential Regulators’ margin requirements. In addition, CSEs whose obligations under their uncleared swaps or security-based swaps are not guaranteed by an entity organized under the laws of the United States or any State and that is (1) a foreign covered swap entity, (2) a foreign bank or US branch or agency of a foreign bank or (3) a foreign subsidiary of a depository institution, Edge corporation, or agreement corporation may be eligible for substituted compliance.

⁹ Under the Guidance Approach, the CFTC’s margin requirements would not apply to an uncleared swap between a non-US CSE and a non-US person that is not guaranteed by, or an affiliate conduit of, a US person. Where the counterparty to such CSE is (a) a foreign branch of a US bank that is an SD/MSP or (b) a non-US person that is guaranteed by, or an affiliate conduit of, a US person, the CFTC Proposal would apply but substituted compliance would be available. Substituted compliance also would be available where the CSE is a foreign branch of a US bank and the counterparty is (a) also a foreign branch of a US bank that is an SD/MSP or (b) a non-US person. Finally, and notwithstanding the foregoing, the margin requirements would apply with no substituted compliance available if (a) the counterparty to the CSE is a US person (other than a foreign branch of a US bank that is an SD/MSP) or (b) the CSE is a US CSE. It is not entirely clear whether the margin requirements would apply or whether substituted compliance would be available if the CSE is a non-US CSE that is acting out of a US branch. *See infra* note 18.

¹⁰ Under the Entity Approach, the margin requirements would apply to all of the uncleared swaps of a CSE on a firm-wide level, with substituted compliance available in certain instances. Whether substituted compliance is available and how it would apply to the margin requirements (*e.g.*, for posting of initial margin, collection of initial margin, and/or posting

proposed by the Agencies that relate not only to how and when the margin requirements would apply (including under what circumstances substituted compliance may be available and how it should apply) but also with respect to the persons that would be subject to the relevant requirements. For example, the CFTC uses the concept of a “US person” to determine whether the CFTC Proposal would apply to a particular transaction, but the definition of a US person is not relevant to the application of the Prudential Regulators Proposal. Instead, the determination of whether to apply the Prudential Regulators’ margin rules would depend on whether the transaction is a “foreign non-cleared swap” or “foreign non-cleared security-based swap” and whether a covered swap entity is a “foreign covered swap entity.”

Although it may be the easiest for market participants if the Agencies use the same category of market participants or persons to whom the margin rules would apply, we recognize that it may be difficult for the CFTC and the Prudential Regulators to agree to adopt a single rule text for the cross-border application of the margin rules.¹¹ At a minimum, we believe, however, that it is essential that the approaches ultimately adopted by the Agencies impose the margin rules consistently to each category of market participants to avoid regulatory arbitrage. The Agencies could achieve similar outcomes by making substituted compliance available in more instances. We believe substituted compliance is particularly workable in the margin rules area where international standards already have greatly harmonized the requirements. We illustrate below how substituted compliance can greatly alleviate the potential concern for duplicative and/or potentially conflicting margin rules.

Agencies Must Consider Effects of Margin Rules on Global Regulated Funds

We are concerned that, because the margin rules technically apply to CSEs regulated by the Agencies and only indirectly to their counterparties (including financial end users, such as Regulated Funds), there has not been sufficient attention given to the cross-border effect of the proposed rules on Regulated Funds. As the Agencies are fully aware, a majority of derivatives transactions are conducted on a cross-border basis. If the Agencies do not find a solution to address the potential for duplicative and/or potentially conflicting margin rules on cross-border transactions, there will be significant negative effects on Regulated Funds.

To assist the Agencies to understand fully the scope of the concerns of Regulated Funds, we describe below the typical cross-border transactions of Regulated Funds, analyze how the Agencies’ margin rules would apply, and consider whether the European Market Infrastructure Regulation (“EMIR”) would apply to such transactions to illustrate the potential for overlapping and/or conflicting regulations when more than one jurisdiction’s laws could apply to a transaction. We then provide some recommendations on how the Agencies’ approaches should be modified to avoid

and collection of variation margin) would, *inter alia*, depend on whether the CSE and/or the counterparty is a US person and whether the CSE and/or the counterparty is guaranteed by a US person.

¹¹ Because the Prudential Regulators have proposed rules for their cross-border approach and the CFTC has issued an advanced notice of proposed rulemaking, it may be even more difficult for the Agencies to adopt a common text.

duplicative (and/or potentially conflicting) margin requirements. In general, we urge the Agencies to make substituted compliance available in a greater number of situations.

Scenario 1: Swap transaction between a CSE that is organized in the European Union (“EU Dealer”)¹² and a UCITS¹³

- The Prudential Regulators Proposal would not apply US margin rules to this transaction.
- Under the Guidance Approach, a UCITS would generally not be considered a US person¹⁴ and US margin rules would not apply to this transaction. Under certain limited situations, a UCITS, however, may be considered a US person¹⁵ and the Guidance Approach would apply US margin rules to this transaction and substituted compliance would not be available.
- The Entity Approach would apply US margin rules to this transaction, but substituted compliance would be available.
- EMIR margin requirements would apply because both entities are established in the European Union.

¹² The EU Dealer is organized in the European Union but is registered or required to be registered with the relevant US regulator as an SD or SBSB. The EU Dealer also is not controlled by a US entity.

¹³ UCITS, or “undertakings for collective investment in transferrable securities,” are collective investment schemes established and authorized under a harmonized EU legal framework, currently EU Directive 2009/65/EC, as amended (“UCITS IV”), under which a UCITS established and authorized in one EU Member State (“Member State”) can be sold cross border into other Member States without a requirement for an additional full registration. Detailed requirements applicable to UCITS include those related to disclosure and custody as well as investment restrictions and limitations. See UCITS IV (requirements regarding simplified disclosure (key investor information document) (Art. 78), annual and semi-annual reports (Art. 68), appointing a depositary bank as a custodian and its responsibilities (Art. 22), redemption (Art. 76), diversification and issuer concentration (Art. 52 and Art. 56), permitted assets, including limitations relating to derivatives and leverage (Art. 50 and Art. 52)).

¹⁴ The CFTC provides that “a collective investment vehicle that is publicly offered only to non-US persons and not offered to US persons generally would not fall within any of the prongs of the interpretation of the term ‘US person.’” *Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations*, 78 FR 45292, 45314 (emphasis added) (July 26, 2013) available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-17958a.pdf> (“Guidance”).

¹⁵ Under the Guidance, non-US Regulated Funds that are publicly offered to only non-US persons but offered privately to US persons under Section 3(c)(1) or Section 3(c)(7) of the ICA and non-US Regulated Funds authorized to make a public offering but that elect only to offer privately to non-US institutional investors are not carved out of the definition of US person. These funds must analyze whether they are US persons under the CFTC’s definition of US person.

In the scenario described above, because the definition of US person can treat certain entities that are established in a foreign jurisdiction (such as some UCITS) as US persons, applying the margin requirements without making substituted compliance available will result in imposing duplicative and/or potentially conflicting requirements on the transaction. We recognize that the CFTC may be limiting the use of substituted compliance to non-US persons under the Guidance Approach to ensure that the full panoply of US derivatives regulations apply (and their protections are provided) to US persons. We believe, however, that the CFTC may not have fully considered situations in which regulations of another jurisdiction apply to those “US persons.”

We therefore strongly urge the CFTC to extend substituted compliance to situations in which the CSE is transacting with an entity that may be considered a US person but also is established in a foreign jurisdiction and subject to that jurisdiction’s margin regime. Providing for substituted compliance in these circumstances may greatly alleviate the problem of duplicative and/or potentially overlapping margin requirements for cross-border swap transactions. Moreover, as noted above, with respect to the margin rules, the CFTC could achieve its regulatory objectives with substituted compliance because international regulators, including the CFTC, have already agreed, pursuant to the 2013 International Framework, to minimum standards and have greatly harmonized the specific requirements.

Scenario 2: Swap transaction between an EU branch of a US CSE and a UCITS

- The Prudential Regulators Approach would apply US margin rules to this transaction, but substituted compliance would be available with respect to the CSE’s obligation to post initial margin.¹⁶
- Under the Guidance Approach, if the UCITS is not a US person, the US margin rules would apply to this transaction but substituted compliance would be available. If the UCITS was considered a US person, the Guidance Approach would apply US margin rules to this transaction and substituted compliance would not be available.
- The Entity Approach would apply US margin rules to a transaction with a UCITS that is not considered a US person, but substituted compliance would be available with respect to the CSE’s obligation to post initial margin.¹⁷ The Entity Approach would apply US margin

¹⁶ US margin rules would apply to variation margin and collection of initial margin by the CSE. According to the Prudential Regulators, if a US bank that is a CSE enters into a swap with a foreign fund that is subject to a foreign regulatory framework for which the Prudential Regulators have made a comparability determination, the US bank must collect the same amount of margin as required under the US rule but need post only the amount of margin that the foreign fund is required to collect under the foreign regulatory framework. The Prudential Regulators do not explain the rationale for not permitting substituted compliance for variation margin.

¹⁷ US margin rules would apply to variation margin and collection of initial margin by the CSE. The CFTC does not provide an explanation for why it would not permit substituted compliance for variation margin.

rules to a transaction with a UCITS that is considered a US person and substituted compliance would not be available.

- EMIR margin requirements would apply to the UCITS because it is established in the European Union.

To avoid imposing duplicative and/or potentially conflicting requirements on this transaction, for reasons similar to those described in our discussion of Scenario 1, the Agencies should provide for substituted compliance (including with respect to variation margin) where a foreign branch of a US CSE transacts with a counterparty that is subject to the margin requirements of a foreign jurisdiction. In addition, as described above, the CFTC's US person definition does not appear to contemplate that the US person also may be subject to the requirements of another jurisdiction. Because such an entity may be subject to more than one jurisdiction's margin requirements, the CFTC should adopt an approach that provides for substituted compliance in situations in which the CSE is transacting with a counterparty that may be considered a US person but also is established in a foreign jurisdiction and subject to that jurisdiction's margin rules.

Scenario 3: Swap transaction between a US branch of an EU Dealer and a UCITS

- The Prudential Regulators Approach would apply US margin rules to this transaction, but substituted compliance would be available.
- Under the Guidance Approach, the margin rules would apply if a US branch of an EU Dealer transacts with a UCITS regardless of whether it is considered a US person and substituted compliance would not be available.¹⁸
- The Entity Approach would apply US margin rules to this transaction, but substituted compliance would be available.
- EMIR margin requirements would apply because both entities are established in the European Union.

To avoid duplicative and/or potentially conflicting requirements on this transaction, the CFTC should provide for substituted compliance regardless of whether the UCITS is considered a US person for the reasons described above for Scenarios 1 and 2.

¹⁸ See Guidance, *supra* note 14, at n.513 ("a U.S. branch of a non-US swap dealer or MSP would be subject to Transaction-Level requirements, without substituted compliance available"). *But see* CFTC Proposal, *supra* note 2, at 59916 (Under the Guidance Approach, the margin rules would not apply if an EU Dealer transacts with a non-US person but would apply if an EU Dealer transacts with a US person and substituted compliance would not be available).

Scenario 4: Swap Transaction between an EU Dealer and a US Registered Investment Company (“RIC”)

- The Prudential Regulators Approach would apply US margin rules to this transaction, but substituted compliance would be available.
- The Guidance Approach would apply US margin rules to this transaction with no substituted compliance available.
- The Entity Approach would apply US margin rules to this transaction, but substituted compliance would be available.
- EMIR margin requirements would apply in this scenario.¹⁹

We are concerned that in the scenario described above a transaction will be subject to both US and EU margin rules. We appreciate that the US and the EU may each have an interest in applying their respective rules to this transaction. US and EU regulators, however, must coordinate and determine which rules should apply to avoid duplicative and/or potentially conflicting margin requirements. We understand that the CFTC may have greater interest in ensuring the application of its margin rules when a CSE transacts with a US person, such as a RIC, than with a non-US person, such as a UCITS, but the CFTC should recognize the practical concerns of (and attempt to avoid) having more than one set of margin rules apply to the same transaction.

One way to avoid duplicative and/or potentially conflicting margin requirements would be for the EU Commission to make an equivalence determination with respect to US margin rules, and then both counterparties would follow the US margin rules. Given the procedural difficulties in making an equivalence determination, the CFTC could choose to provide itself with the tool of substituted compliance to avoid this consequence if the EU does not make an equivalence determination. Alternatively, the CFTC could permit the parties to a transaction for which the margin requirements of multiple jurisdictions would apply to elect or agree between themselves the regime with which they will comply. As noted previously, because the 2013 International Framework has greatly harmonized the margin rules, there should be no concern regarding regulatory arbitrage.

Scenario 5: Swap Transaction between a US branch of an EU Dealer and a RIC

- The Prudential Regulators Approach would apply US margin rules to this transaction, but substituted compliance would be available.

¹⁹ The EU Dealer would be required to collect margin from the US RIC. *See* EU Margin Consultation Paper, *supra* note 6.

- The Guidance Approach would apply US margin rules to this transaction with no substituted compliance available.
- The Entity Approach would apply US margin rules to this transaction, but substituted compliance would be available.
- EMIR margin requirements would apply in this scenario.²⁰

As in the previous scenario, we understand that the CFTC has a stronger interest in applying the US margin rules to this type of transaction because of the involvement of a US person (*i.e.*, the US RIC) and the EU regulators have an interest in applying their margin rules to an entity established in the European Union (*i.e.*, the EU Dealer). US and EU regulators, however, must coordinate and determine which rules should apply to avoid duplicative and/or potentially conflicting margin requirements. We recommend the alternatives discussed for Scenario 4 as possible options to address the overlapping and/or potentially conflicting obligations.

Impact of Guarantees on Margin Rules on Global Regulated Funds Must be Fully Considered

We note that cross-border guarantees present significant challenges with respect to the application of a given regime's margin requirements and whether substituted compliance should be available. Under the Prudential Regulators Approach, the US margin requirements would apply and no substituted compliance would be available if the CSE is guaranteed by an entity organized under the laws of the United States or any State regardless of the counterparty's domicile.²¹ This treatment of guarantees may cause issues where, for example, the CSE is organized in the European Union and subject to the EMIR margin requirements. Where a non-US Regulated Fund, such as a UCITS, transacts with an EU entity guaranteed by an entity organized under the laws of the United States, both US and EU margin regulations would apply without the availability of substituted compliance. Therefore, we recommend that the Agencies consider broadening the availability of substituted compliance where the CSE has a US guarantor under the Prudential Regulators Approach.²²

²⁰ The EU Dealer would be required to collect margin from the US RIC. *See* EU Margin Consultation Paper, *supra* note 6.

²¹ Prudential Regulators Proposal at §_9(b) and §_9(d)(3).

²² We understand that the OTC Derivatives Regulatory Group ("ODRG") is working on developing approaches to address issues related to the treatment of guaranteed affiliates. *See* Report of the OTC Derivatives Regulators Group (ODRG) to G20 Leaders on Cross-Border Implementation Issues (November 2014), *available at* http://www.cftc.gov/ucm/groups/public/@internationalaffairs/documents/file/oia_odrgreportg20_1114.pdf. As illustrated in this letter, a practical approach must be developed to avoid duplicative or potentially conflicting margin requirements on cross-border transactions. We urge the CFTC, which is a part of the ODRG, to discuss the work of the ODRG with the Prudential Regulators, which are not ODRG members.

Finally, the Prudential Regulators seek comment on whether the margin rules should clarify and define the concept of a “guarantee” to better ensure that those swaps that pose risks to US insured depository institutions would be included within the scope of the rule. According to the Prudential Regulators, many swaps agreements contain cross-default provisions that give swaps counterparties legal rights against certain “specified entities.” The Prudential Regulators state that, in these arrangements, a swap counterparty of a foreign subsidiary of a US CSE may have contractual rights to close out and settle its swap positions with the US entity if the foreign subsidiary of the US entity defaults on its own positions with the counterparty. The Prudential Regulators believe that, although not technically a guarantee of the foreign subsidiary’s swaps, these provisions may be viewed as reassuring counterparties to foreign subsidiaries that the US bank stands behind its foreign subsidiaries’ swaps.

We believe the Prudential Regulators’ description and analysis of these cross-default provisions do not accurately reflect commercial reality. As a technical matter, a cross-default provision involving a “specified entity” would not generally give a swap counterparty any direct right against the specified entity. The cross-default provision would give the swap counterparty the right to terminate its swaps with its direct counterparty if certain events involving the specified entity (such as the US CSE in the Prudential Regulators’ example) are triggered. These provisions are intended to alert counterparties to situations in which credit deterioration of an affiliate of a direct counterparty may indicate a credit issue within the corporate group that may ultimately adversely affect the performance of the direct counterparty (foreign subsidiary of the US CSE) to the swap counterparty.

Absent other factors, the swap counterparty would not be able to close out its swap positions with the specified entity (*i.e.*, the US CSE) if the foreign subsidiary defaults on its own positions with the counterparty. Moreover, in a cross-default situation involving a “specified entity,” there are no contractual provisions that would provide an implicit or explicit guarantee by the US CSE of the foreign subsidiary’s obligations. In fact, in the scenario described by the Prudential Regulators, if the foreign subsidiary defaults on its obligations with the counterparty, it would appear that the US CSE is not guaranteeing the foreign subsidiary’s contract or providing assistance to the foreign subsidiary.

* * *

We appreciate the opportunity to respond to the margin proposals of the Agencies. If you have any questions on our comment letter, please feel free to contact the undersigned, Susan Olson at +1-202-326-5813, Sarah Bessin at +1-202-326-5835, or Jennifer Choi at +1-202-326-5876.

Sincerely,

/s/ Dan Waters

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