

# Managed Funds Association

The Voice of the Global Alternative Investment Industry

Washington, D.C. | New York



December 14, 2020

**Via Electronic Submission:** <https://comments.cftc.gov>

Mr. Christopher Kirkpatrick  
Secretary of the Commission  
Commodity Futures Trading Commission  
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Washington, D.C. 20581

**Via Electronic Mail:** [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Ms. Vanessa Countryman  
Secretary of the Commission  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

**Re: Request for Comment Regarding Portfolio Margining of Uncleared Swaps and Non-Cleared Security-Based Swaps [RIN 3038-AF07; SEC File No. S7-15-20]**

Dear Mr. Kirkpatrick and Ms. Countryman:

Managed Funds Association (“**MFA**”)<sup>1</sup> appreciates the opportunity to provide comment to the Securities and Exchange Commission (the “**SEC**”) and the Commodity Futures Trading Commission (the “**CFTC**,” and collectively with the SEC, the “**Commissions**”) in response to their joint request for comment on potential ways to implement portfolio margining of uncleared swaps and non-cleared security-based swaps (the “**Request for Comment**”).<sup>2</sup>

MFA supports the steps the Commissions are taking in relation to the implementation of portfolio margining of uncleared swaps, non-cleared security-based swaps (“**SBS**”) and related positions, and is supportive of, and encourages the Commissions to adopt, rules that facilitate this practice in a harmonized fashion.<sup>3</sup> MFA’s

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<sup>1</sup> MFA represents the global alternative investment industry and its investors by advocating for public policies that foster efficient, transparent, fair capital markets, and competitive tax and regulatory structures. MFA supports member business strategy and growth via proprietary access to subject matter experts, peer-to-peer networking, and best practices. MFA’s more than 140 member firms collectively manage nearly \$1.6 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has a global presence and is active in Washington, London, Brussels, and Asia, supporting a global policy environment that fosters growth in the alternative investment industry.

<sup>2</sup> Portfolio Margining of Uncleared Swaps and Non-Cleared Security-Based Swaps, 85 Fed. Reg. 70,536 (Nov. 5, 2020), [hereinafter Portfolio Margining Request for Comment].

<sup>3</sup> MFA has stated its support for portfolio margining in prior comment letters. See, e.g., MFA, Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers (Nov. 19, 2018), <https://www.sec.gov/comments/s7-08-12/s70812-4663165-176522.pdf>; MFA, Comment Letter on Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers (Feb. 22, 2013),

membership agrees with, and stands to benefit from, the many advantages of portfolio margining articulated by the Commissions: improved efficiencies in margin calculations with respect to offsetting positions; alignment of margining and other costs more closely with overall risks presented by a customer's portfolio by reducing aggregate amount of collateral required to meet margin requirements; facilitating availability of excess collateral that can be deployed for other purposes; alleviating excessive margin calls; improvements to cash flows and liquidity; and reduced volatility.<sup>4</sup>

MFA's membership also shares the concerns expressed by the Commissions that measures taken to facilitate portfolio margining must ensure that customer protection, financial stability and other regulatory objectives are appropriately addressed, including potential impacts on margin requirements, the segregation and bankruptcy treatment of uncleared swaps and non-cleared security-based swaps ("**SBS**") in different account types and entities.<sup>5</sup> Our members are customers to CFTC-regulated swap dealers ("**SDs**") and SEC-regulated security-based swap dealers ("**SBSDs**") and our members are fiduciaries to the investors whose money they manage. Therefore, it is critical that in implementing any portfolio margining regime the Commissions reduce the risks that our private fund manager members and their respective investors may encounter and strengthen the protections available to them.

## I. Executive Summary

As the Commissions consider portfolio margining of uncleared swaps and non-cleared security-based swaps, MFA makes the following recommendations:

- A. Preserve the important customer protection benefits afforded under the CFTC initial margin regulations with respect to uncleared swaps.
- B. Ensure that the Commissions, in adopting any portfolio margining regime, provide guidance to market participants on the applicable bankruptcy regimes, as well as require Dealers to disclose to customers how claims to recover assets may be treated in an insolvency.
- C. Provide clarity on the types of dealer entities eligible to offer portfolio margining.
- D. Require dealers to provide transparency on portfolio margining models to allow customers to independently plan, predict and calculate the margin needed under different market conditions as this will reduce systemic risk.
- E. Adopt a portfolio margining framework that allows offsetting exposures with respect to both variation margin and initial margin to enhance margining efficiency and customer protection.

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<https://www.sec.gov/comments/s7-08-12/s70812-28.pdf>; MFA, Comment Letter on Proposed Notice of Proposed Rulemaking on Margin and Capital Requirements for Covered Swap Entities (Nov. 26, 2012), <https://www.regulations.gov/contentStreamer?documentId=OCC-2011-0008-0118&attachmentNumber=1&contentType=pdf>.

<sup>4</sup> Portfolio Margining Request for Comment, 85 Fed. Reg. at 70,537.

<sup>5</sup> *Id.*

- F. Allow customers to opt-out of portfolio margining as some may prefer to margin positions on a standalone basis.
- G. Coordinate with U.S. Prudential Regulators to adopt, where possible, a consistent regulatory approach to portfolio margining, which will reduce regulatory complexity and facilitate compliance.
- H. Align the SEC's margin rule compliance date (currently, October 6, 2021) with the CFTC's and the U.S. Prudential Regulators' final (Phase 6) phase-in date for initial margin requirements, set for September 1, 2022, to facilitate compliance, ease regulatory burden, and provide the Commissions with additional time to consider their approach to offering portfolio margining solutions.

## II. MFA Comments

- A. Preservation of Customer Protection Benefits Under the CFTC's Initial Margin Regulations with respect to Uncleared Swaps

The Request for Comment highlights material differences in the margin regulations promulgated by the CFTC and the SEC.<sup>6</sup> Most notably, CFTC's margin rule for uncleared swaps (the "**CFTC Margin Rule**")<sup>7</sup> includes two key elements that are not contained in the SEC's parallel margin rule for non-cleared SBS (the "**SEC Margin Rule**")<sup>8</sup>: (i) the requirement for SDs to post initial margin to certain of their counterparties, and (ii) the requirement for initial margin posted to or by an SD to be held by an independent third-party custodian and not be rehypothecated. As a result of this distinction, the CFTC Margin Rule offers material advantages to MFA members over the SEC Margin Rule. The benefits of bilateral posting and third-party segregation for initial margin under the CFTC Margin Rules reduce a customer's counterparty risk with respect to initial margin posted in connection with uncleared swap transactions. In contrast, the SEC's one-way posting regime and the lack of an independent segregated account for initial margin, offer significant advantages to the SBS.<sup>9</sup>

As a result, MFA is concerned that any portfolio margining regime that does not preserve these important customer protections could increase the potential for counterparty risk. MFA therefore urges the

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<sup>6</sup> *Id.*

<sup>7</sup> Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016), <https://www.govinfo.gov/content/pkg/FR-2016-01-06/pdf/2015-32320.pdf>.

<sup>8</sup> Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers, 84 Fed. Reg. 43,872 (Aug. 22, 2019), <https://www.govinfo.gov/content/pkg/FR-2019-08-22/pdf/2019-13609.pdf> [hereinafter SEC Final Capital, Margin, and Segregation Release].

<sup>9</sup> As noted in the Request for Comment, when adopting the SEC Margin Rule the SEC stated that "[r]equiring nonbank SBSs to deliver initial margin could impact the liquidity of these firms" and that "[d]elivering initial margin would prevent this capital of the nonbank SBS from being immediately available to the firm to meet liquidity needs." The SEC further stated that, "[i]f the delivering SBS is undergoing financial stress or the markets more generally are in a period of financial turmoil, a nonbank SBS may need to liquidate assets to raise funds and reduce its leverage" and that "[a]ssets in the control of a counterparty would not be available for this purpose." Portfolio Margining Request for Comment, 85 Fed. Reg. at 70,537 (citing SEC Final Capital, Margin, and Segregation Release, 84 Fed. Reg. at 43,918).

Commissions to adopt a portfolio margining regime that requires bilateral posting and third-party segregation for initial margin with respect to any uncleared swaps included in a portfolio margined account. MFA does not believe that requiring these protections with respect to uncleared swaps would undermine the benefits of portfolio margining. Related to this, MFA does not support a portfolio margin regime that would potentially enable a SBS, broker-dealer (“**BD**”), SD, futures commission merchant (“**FCM**”) or other regulated entity (any such entity a “**Dealer**”) offering portfolio margining to have optionality with respect to the initial margin regime applicable with respect to uncleared swaps because this creates a risk that customers choosing to post to a portfolio margined account will only be able to do so if they sacrifice the benefits of the CFTC regime for their uncleared swap transactions.<sup>10</sup>

Accordingly, MFA recommends that the Commissions, in considering a harmonized portfolio margining regime, preserve the important customer protection benefits afforded under the CFTC initial margin regulations with respect to uncleared swaps.

#### B. Transparency on Applicable Bankruptcy and Customer Protection Regimes

In the Request for Comment, the Commissions inquire about the customer protection benefits of portfolio margining in various account types relative to other account types. While each of these different account types has its advantages, of paramount concern to MFA members is development of a portfolio margining regime that offers clarity and transparency on which bankruptcy and customer protection regimes apply to assets held in a particular portfolio margined account (whether a securities account, SBS account, a swap account or some other account) and full disclosure of how these assets will be treated in the event of a Dealer insolvency.

One potential risk to MFA members in posting collateral to a portfolio margined account is the risk that assets held in a portfolio margined account may be subject to multiple insolvency regimes, each with conflicting rules and procedures governing a customer’s ability to recover its assets in the event of an insolvency. Multiple layers of insolvency regimes make it very difficult for a customer to be able to understand and manage its counterparty insolvency risk with respect to collateral it has posted. For example, consider a customer with a portfolio of uncleared swaps, non-cleared SBS and cash market securities positions held in a securities account by a Dealer that is registered as an SB, SBS and BD. Would all of the collateral in such an account be subject to recovery under SIPA, or would the claims be apportioned among multiple insolvency regimes? If the latter, MFA would prefer a portfolio margining regime that enables a customer to track the portion of its assets which would be subject to a claim under SIPA versus any other applicable customer protection model. To the extent a portion of the collateral in a portfolio margined account constitutes uncleared swaps margin, MFA would appreciate regulatory guidance about whether or how a customer would be expected to take into account any applicable regulatory stay requirement with respect to making a claim for such collateral.

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<sup>10</sup> While MFA’s primary concern in the context of this letter is to preserve the benefits of bilateral margining and initial margin segregation under the CFTC’s Initial Margin Rules, we also want to highlight the operational and legal complexities created for swaps and SBS customers to accommodate the significant differences between the two initial margin regimes. MFA also notes that the SEC’s initial margin regime differs not only from the CFTC’s, but also from the global margin framework adopted by the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO).

Accordingly, MFA urges the Commissions to ensure that, in adopting any portfolio margining regime, they provide guidance to market participants on the applicable bankruptcy regimes, as well as require Dealers to disclose to customers how claims to recover assets may be treated in an insolvency.

C. Clarity regarding Dealer Entities Eligible to Offer Portfolio Margining

MFA also encourages the Commissions to provide clarity on the types of Dealer entities that will be eligible to offer portfolio margining. Specifically, MFA would like to understand whether the Commissions contemplate implementing a portfolio margining regime that may be offered by affiliated entities with differing regulatory statuses. For example, are the Commissions contemplating a regime that would allow for portfolio margining of cash market securities positions, uncleared swaps and non-cleared SBS where a customer's cash market securities positions are entered into under a prime brokerage agreement with a BD and its uncleared swaps and non-cleared SBS are entered into under an ISDA Master Agreement with an affiliate of the BD that is registered as both an SD and a SBS? Or, alternatively, are the Commissions contemplating only making portfolio margining available where a single entity is registered in multiple capacities? Regardless of the approach chosen, MFA reiterates and recommends that, in adopting a portfolio margining regime, it should be made clear to market participants which bankruptcy and customer protection regimes apply.

D. Transparent Portfolio Margining Models

MFA encourages the Commissions to require transparency about the inputs and other variables used for purposes of calculating the margin requirements under portfolio margining models. Importantly, this will allow fund management customers the ability to understand, plan and predict the amount of margin needed under different market conditions—especially during times of extreme market volatility, and collectively help to reduce systemic risk. A regulatory mandate that portfolio margin models be clear and independently verifiable for either party will enable a fund management customer to review the amount of margin it is posting to determine whether it has posted too much and whether it is getting sufficient credit for any positions that are in the money to it. In addition to ensuring both parties have an opportunity to check that any applicable portfolio margining formula is being applied correctly, a clear and transparent margin formula ensures a customer is always able to require excess margin to be returned promptly. Since any collateral posted in excess of applicable margin requirements is at risk of loss in the event of an insolvency, the ability to monitor and seek return of excess collateral is an important counterparty risk management tool for fund management customers. This is an especially important concern given a fund manager's role as a fiduciary to investors with respect to the assets it manages.

Thus, MFA recommends that the Commissions require dealers to provide transparency on portfolio margining models to allow customers to independently plan, predict and calculate the margin needed under different market conditions.

E. Clarity regarding whether Portfolio Margining covers Variation Margin, Initial Margin or Both

MFA notes that the Request for Comment does not specify whether it contemplates adopting a portfolio margin regime that encompasses initial margin, variation margin or both for uncleared swaps and non-cleared SBS. MFA strongly supports and recommends that the Commissions adopt a portfolio margining framework that allows offsetting exposures with respect to both variation margin and initial margin to enhance margining efficiency and customer protection.

#### F. Portfolio Margining to Apply at Customer Election

While MFA greatly appreciates the Commissions moving forward to implement portfolio margining, we note that portfolio margining may not be right for all customers. To that end, we recommend that any portfolio margining regime always be made available at a customer's election. Notwithstanding the many benefits of portfolio margining, there are certain customers who may prefer to margin positions on a standalone basis. Given the potential for lack of transparency about tracking whether customer is posting too much or too little to a portfolio margined account, combined with potential for conflicting customer protection regimes governing recovery of claims in an insolvency, some customers may prefer to have the ability to elect whether the benefits of portfolio margining outweigh the potential risks it presents. While MFA wholeheartedly endorses portfolio margining, we recommend that any portfolio margining framework offer a customer the ability to elect whether it wants to use portfolio margining or not.

#### G. Coordination with the U.S. Prudential Regulators

MFA commends the Commissions' efforts to make headway on the implementation of portfolio margining. Without impeding future progress on this effort, MFA encourages the Commissions to continue discussions with the U.S. Prudential Regulators as the Commissions move forward in developing a portfolio margin regime for uncleared swaps and non-cleared SBS, with the goal of finding opportunities to align the Commissions' approach to portfolio margining to any corollary programs adopted by the U.S. Prudential Regulators. A coordinated approach, where possible, will reduce regulatory complexity and facilitate compliance. We are optimistic that efforts to align regulatory approaches to portfolio margining will help to reduce infrastructure costs and operational burdens on customers who must accommodate requirements that vary, not based on the underlying product (be it swaps, SBS, cash equity position or something other) but instead based on the regulatory regime applicable to its Dealer counterparty. Accordingly, MFA recommends that the Commissions coordinate with U.S. Prudential Regulators to adopt, where possible, a consistent regulatory approach to portfolio margining, which will reduce regulatory complexity and facilitate compliance.

#### H. Alignment of Compliance Dates

As the Commissions collaborate to further develop a proposal for portfolio margining, we suggest the burdens of implementation for market participants will be greatly reduced if the SEC were to reconcile the compliance date of its margin rule (currently, October 6, 2021) with the final (Phase 6) phase-in date for the initial margin requirements of the CFTC and the U.S. Prudential Regulators on September 1, 2022. The significant operational and infrastructure challenges created for financial end users to comply with the initial margin rules are made even more burdensome as a result of multiple compliance deadlines. Having a single compliance date would facilitate compliance and ease regulatory burden. In addition, to the extent any final portfolio margining regime results in changes to the margin and segregation requirements for uncleared swaps and non-cleared SBS, this alignment would give market participants sufficient time to take these into consideration as they prepare documentation, infrastructure and other accounts to ensure their collateral

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Ms. Countryman  
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infrastructure to support derivatives trading is fully compliant with the various margin requirements across the three U.S. regulators. MFA also respectfully submits that if the Commissions were to align their compliance dates to the September 1, 2022 date, this would provide the Commissions with additional time to consider their approach to offering portfolio margining solutions.

Accordingly, MFA recommends that the SEC align its margin rule compliance date (currently, October 6, 2021) with the CFTC's and the U.S. Prudential Regulators' final (Phase 6) phase-in date for initial margin requirements, set for September 1, 2022, to facilitate compliance, ease regulatory burden, and provide the Commissions with additional time to consider their approach to offering portfolio margining solutions.

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We strongly support the Commissions' efforts to facilitate portfolio margining for uncleared swaps, non-cleared SBS and related positions, and thank the Commissions for the opportunity to provide comments on the Request for Comment. We welcome the opportunity to discuss our views in greater detail and provide additional color from a private fund manager's perspective that may be helpful to the Commissions as they work together to consider the complex and multifaceted issues raised by this important topic.

Please do not hesitate to contact me at (202) 730-2600 or [jhan@managedfunds.org](mailto:jhan@managedfunds.org) with any questions the Commissions or its Staff might have regarding this letter.

Respectfully submitted,

/s/ Jennifer W. Han

Jennifer W. Han  
Managing Director & Counsel,  
Regulatory Affairs

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