The Asset Management Industry
SERVING INDIVIDUAL INVESTORS

INVESTMENT COMPANY INSTITUTE

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May 21, 2014

ICI Comment Letter on Protection of Collateral for Cleared Security-Based Swaps under SEC's Proposed Standards for "Covered Clearing Agencies"

[28134]

May 21, 2014

TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 19-14
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 37-14
INVESTMENT ADVISER MEMBERS No. 19-14
SEC RULES MEMBERS No. 19-14 RE: ICI COMMENT LETTER ON PROTECTION OF COLLATERAL FOR CLEARED SECURITY-BASED SWAPS UNDER SEC’S PROPOSED STANDARDS FOR “COVERED CLEARING AGENCIES”

On May 21, 2014, ICI submitted a comment letter to the Securities and Exchange Commission (“SEC”) in response its proposed standards for the operation and governance of registered clearing agencies that meet the definition of a “covered clearing agency.” [1] Covered clearing agencies would include registered clearing agencies that (1) have been designated as systemically important by the Financial Stability Oversight Council (“FSOC”) and for which the SEC is the supervisory agency; [2] (2) provide central counterparty (“CCP”) services for security-based (“SB”) swaps or are involved in activities the SEC determines to have a more complex risk profile, where in either case the Commodity Futures Trading Commission (“CFTC”) is not the supervisory agency for such clearing agency; or (3) are otherwise determined to be covered clearing agencies by the SEC pursuant to procedures under proposed Rule 17Ab2-2.

Under the Proposal, the SEC proposes to establish requirements for covered clearing agencies with respect to general organization, financial risk management, settlement, central securities depositories and exchange-of-value-settlement systems, default management, segregation and portability, general business risk and operational risk management, access, efficiency, and transparency. For these requirements, the SEC generally proposes to require a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures in the enumerated areas.

The comment letter expresses significant and serious concerns with the Commission’s approach in the Proposal particularly for the requirements on segregation and portability. The Commission does not define how the clearing regime and posting of margin are expected to operate, both in the normal course of business and in the event of a clearing member bankruptcy. Rather, the Commission delegates these important decisions and the determination of the type of protections provided by asset segregation and related safeguards to clearing agencies that clear SB swaps. The letter disagrees with the Commission that risks posed by covered clearing agencies can be sufficiently mitigated by providing them with broad discretion to adopt policies and procedures in these areas.

The letter requests that the Commission propose to adopt minimum structural and operational requirements for clearing agencies that are tailored to the way in which the SB swaps market operate. Specifically, with respect to the protection of cleared SB swaps collateral posted by customers, the letter urges the Commission to propose to require SB swap clearing agencies to provide, at a minimum, the protection provided by the model adopted by the CFTC for cleared swaps collateral. The letter also provides some comments with regard to the tools that covered clearing agencies should be permitted to use to "recover" during times of stress and the governance of covered clearing agencies.

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Senior Associate Counsel Securities Regulation

Attachment

endnotes

[1] Standards for Covered Clearing Agencies, 79 FR 16865 (Mar. 26, 2014), available at http://www.gpo.gov/fdsys/pkg/FR-2014-03-26/pdf/2014-05806.pdf ("Proposal"). For a summary of the Proposal, see ICI Memorandum No. 27991 (March 27, 2014), available at http://www.ici.org/my_ici/memorandum/memo27991.

[2] In 2012, FSOC designated as systemically important the following clearing agencies: the Chicago Mercantile Exchange, Inc. ("CME"), The Depository Trust Company ("DTC"), Fixed Income Clearing Corporation ("FICC"), ICE, National Securities Clearing Corporation ("NSCC"), and the Options Clearing Corporation ("OCC"). The SEC is the supervisory agency for DTC, FICC, NSCC and OCC.

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