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SEC Adopts Final Rules on Capital, Margin, and Segregation for Security-Based Swap Dealers and Major Security-Based Swap Participants

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July 3, 2019 TO: ICI Members
ICI Global Members
Derivatives Markets Advisory Committee
ICI Global Trading & Markets Committee SUBJECTS: Derivatives
International/Global
Investment Advisers
Trading and Markets RE: SEC Adopts Final Rules on Capital, Margin, and Segregation for Security-Based Swap Dealers and Major Security-Based Swap Participants

The SEC recently adopted final capital, margin, and segregation requirements for security-based swap dealers (SBSDs) and major security-based swap participants (MSBSPs), and amended the capital and segregation requirements for broker-dealers.[1] The SEC's rules:

- Establish minimum capital requirements for SBSDs and MSBSPs for which there is not a prudential regulator (nonbank SBSDs and MSBSPs). They also increase the minimum net capital requirements for broker-dealers that use internal models to compute net capital ("ANC broker-dealers"). In addition, the rules establish capital requirements tailored to security-based swaps ("SB swaps") and swaps for broker-dealers that are not registered as an SBSD or MSBSP to the extent they trade these instruments.
- Establish margin requirements for nonbank SBSDs and MSBSPs with respect to non-cleared SB swaps.
- Establish segregation requirements for SBSDs and stand-alone broker-dealers for cleared and non-cleared SB swaps.
- Amend the Commission's existing cross-border rule to provide a means to request substituted compliance with respect to the capital and margin requirements for foreign SBSDs and MSBSPs, and provide guidance discussing how the Commission will evaluate requests for substituted compliance.

We have summarized below those aspects of the final rules that are most relevant to regulated funds. We have also attached a chart, as an appendix to this memorandum, that compares ICI's key recommendations to the SEC's final rules.

Background

Last fall, the SEC reopened the comment period and requested additional comments on several proposals relating to capital, margin, and segregation requirements for uncleared SB swaps.[2] The Reopened Proposing Release related to three different proposals the SEC issued in 2012, 2013, and 2014, respectively, that addressed capital and margin requirements for nonbank SBSDs and MSBSPs and segregation requirements for SBSDs.

ICI and its members have engaged in significant advocacy efforts since 2013 urging the SEC to make its final margin rules consistent with both the 2013 international framework governing margin requirements for uncleared derivatives, including SB swaps, and the final rules on margin for uncleared swaps that have already been adopted and implemented by the CFTC and the US prudential regulators (together, "Swap Margin Rules").[3] We are pleased that the SEC's final rules achieve much greater consistency with the Swap Margin Rules than did the SEC's proposals.

Net Capital Requirements

The SEC's final rules address minimum net capital requirements for, among others, nonbank SBSDs and MSBSPs. The SEC amended the net capital rule, Rule 15c3-1 under the Securities Exchange Act of 1934 ("Exchange Act"), to subject nonbank SBSDs that are also registered as broker-dealers (other than registered OTC derivatives dealers) to minimum net capital requirements.[4] Other nonbank SBSDs, including stand-alone SBSDs that are also registered as OTC derivatives dealers, will be subject to capital requirements in new Rule 18a-1.

These rules prescribe minimum net capital requirements for nonbank SBSDs that are the greater of a fixed-dollar amount and an amount derived by applying a financial ratio. Only SBSDs that are so-called "alternative net capital" or ANC broker-dealers are permitted to use models to calculate market and credit risk changes instead of applying standardized haircuts to their positions. Under Rule 18a-2, nonbank MSBSPs must maintain a positive tangible net worth at all times. Both nonbank SBSDs and MSBSPs must comply with internal risk management control requirements under Rule 15c3-4 with respect to their SB swap and swap activities.

Margin Requirements for Nonbank SBSDs and MSBSPs

Rule 18a-3 establishes margin requirements for nonbank SBSDs' and MSBSPs' SB swap transactions. The rule addresses eight key areas relevant to regulated funds and other end-users of derivatives: (1) the process SBSDs and MSBSPs must use to calculate margin; (2) the ability of an SBSD or MSPSB to use models to calculate margin requirements; (3) requirements for SBSDs and MSBSPs to collect and post margin; (4) exceptions to margin requirements; (5) the use of netting agreements; (6) margin thresholds; (7) permitted collateral; and (8) holding of collateral. As described in more detail below, the SEC has made significant progress in harmonizing its final rules with the Swap Margin Rules.

Calculation of Margin. Under Rule 18a-3, a nonbank SBSD must determine its margin exposure with respect to each account of a counterparty as of the close of business each day by calculating: (1) the amount of variation margin (current exposure in the account); and (2) the initial margin amount for the account. Variation margin must be calculated by marking the position to market. Initial margin must be calculated by applying standardized haircuts, as prescribed in Rules 15c3-1 or 18a-1, as applicable, or certain SBSDs may apply a margin model.

Use of Models. A nonbank SBSD may apply to the Commission for authorization to use a model, including an industry standard model, to calculate initial margin. The models are subject to quantitative and qualitative requirements and the firms' use of, and governance over, the models is subject to ongoing oversight. Broker-dealer SBSDs must use standardized haircuts to compute initial margin for noncleared equity SB swaps, however, even if the firm is approved to use a model to calculate initial margin. Stand-alone SBSDs (including firms registered as OTC derivatives dealers) may use a model to calculate initial margin for non-cleared equity SB swaps, provided the account of the counterparty does not hold other equity securities.

SBSD and MSBSP Collection and Posting of Margin. Under Rule 18a-3, a nonbank SBSD must collect initial and/or variation margin from a counterparty if the margin calculations result in a requirement for the counterparty to post margin. As recommended by ICI and others, a nonbank SBSD or MSBSP is subject to the requirement to post variation margin (i.e., the SEC's rules require bilateral exchange of variation margin for most parties). Unlike the Swap Margin Rules, however, the SEC's rules do not require a nonbank SBSD or MSBSP to post initial margin to counterparties (although the rules do not prohibit this practice if the parties agree to exchange initial margin).

Exceptions to Margin Requirements. Rule 18a-3 includes exceptions from the requirement for a nonbank SBSD to collect and post margin. A nonbank SBSD is not required to collect or deliver variation, or collect initial, margin from a commercial end user, an SB swap legacy account (i.e., an account holding SB swaps entered into prior to the compliance date of the rule), or a counterparty that is the Bank for International Settlements (BIS), the European Stability Mechanism, or certain multilateral development banks.[5] A nonbank SBSD also is not required to collect initial margin from an affiliate, although bilateral exchange of variation margin still is required.[6] These exemptions generally are consistent with provisions of the Swap Margin Rules. The SEC, however, deviated from the Swap Margin Rules by declining to require nonbank SBSDs to collect initial margin from counterparties that are financial market intermediaries, such as SBSDs, swap dealers, futures commission merchants, and domestic and foreign broker-dealers and banks.[7] A nonbank SBSD that relies on any of these exemptions must take a capital charge equal to the amount by which the counterparty's account is under-margined.

Use of Netting Agreements. The final rules clarify that an SBSD or MSBSP can use netting agreements to calculate initial and variation margin, if they satisfy certain conditions.[8] The Commission believes that in most cases a counterparty entering into a non-cleared SB swap transaction with a nonbank SBSD will be a direct counterparty of the SBSD, and that the SEC's margin rules are sufficiently comparable to the Swap Margin Rules to facilitate the ability of parties to engage in close-out netting.[9]

Thresholds. As ICI recommended, the SEC revised certain thresholds regarding the obligation to collect and post margin, generally consistent with the Swap Margin Rules. The SEC's final rules provide that a nonbank SBSD need not collect initial margin if the initial margin amount, aggregated with other SB swap and swap exposures of the nonbank SBSD and its affiliates to the counterparty and its affiliates, does not exceed $50 million. A nonbank SBSD may defer collecting the initial margin amount for up to two months following the month in which a counterparty no longer qualifies for the $50 million threshold for the first time. The rules also provide for a minimum transfer amount, for both SBSDs and MSBSPs, of $500,000. Under this exception, if the combined amount of margin required to be collected from or delivered to a counterparty is less than or equal to $500,000, the nonbank SBSD or MSBSP need not collect or deliver the margin. An SBSD or

MSBSP that does not collect margin pursuant to either the $50 million threshold for initial margin or the $500,000 minimum transfer amount exception for initial and variation margin must take a capital deduction.

ICI also urged the SEC to align the margin requirements for SBSDs and MSBSPs with the Swap Margin Rules by adopting a material swaps exposure threshold, which would exempt SB swap transactions from initial margin requirements if the nonbank SBSD's or MSBSP's counterparty has an average aggregate notional exposure to swaps and SB swaps (and similar instruments) of $8 billion or less.[10] The SEC declined, however, to adopt a material swaps exposure exception to its initial margin requirements. Thus, nonbank SBSDs and MSBSPs and their counterparties will be required to monitor their compliance with the $50 million initial margin threshold, even if they otherwise have only modest exposures to SB swaps and similar instruments.

Permitted Collateral. In a change from the proposal, the SEC expanded collateral nonbank SBSDs or MSBSPs may accept with respect to margin, to include collateral that: (i) has a "ready market;" (ii) is readily transferable; (iii) consists of cash, securities, money market instruments, a major foreign currency, the settlement currency of the non-cleared security-based swap, or gold; and (iv) is subject to a legally enforceable agreement between the SBSD or MSBSP and the counterparty. The collateral may not consist of securities and/or money market instruments issued by the counterparty or a party "related" to the nonbank SBSD or MSBSP, or the counterparty.[11]

A nonbank SBSD must "haircut" collateral using the standardized haircuts in the Commission's net capital rules or the CFTC's margin rules, as long as it applies them consistently with respect to the counterparty (to avoid cherry picking). Collateral must be collected or delivered by the close of business on the next business day following the day of the calculation, except that the collateral can be collected or delivered by the close of business on the second business day following the day of the calculation if the counterparty is located in another country and more than four time zones away.

Holding of Collateral. Collateral posted to an SBSD or MSBSP must either be: (1) subject to the physical possession or control of the SBSD or MSBSP and must be able to be liquidated promptly by the SBSD or the MSBSP without intervention by any other party; or (2) carried by an independent, third-party custodian that is a bank, registered US clearing organization, or depository that is not affiliated with the counterparty. Under the SEC's proposal, nonbank SBSDs would have been required to take a capital charge for collateral held at third-party custodians. In response to comments from ICI, however, the SEC's final rules appear to provide a workable means for SBSDs and MSBSPs to avoid this capital charge, as described below.[12]

Segregation Requirements for SBSDs

Section 3E(b) and 3E(c) of the Exchange Act provide for omnibus segregation of collateral for cleared SB swaps. Pursuant to this authority, the SEC adopted omnibus segregation requirements for broker-dealers and broker-dealer SBSDs (other than firms registered as OTC derivatives dealers) in Rule 15c3-3, and for all other SBSDs in Rule 18a-4.[13] Omnibus segregation means that a broker-dealer or SBSD must segregate money, securities, and property of an SB swap customer relating to a cleared or non-cleared SB swap, but in a manner that permits the assets to be commingled with money, securities, or property of other customers. The omnibus segregation requirements are the "default" requirement if the counterparty does not elect individual segregation or waives segregation (if permitted to do so).

Under the omnibus segregation requirements, an SBSD or broker-dealer must maintain: (1) possession or control over excess securities collateral (i.e., securities and money market instruments that are not being used to meet a variation margin requirement of the counterparty); and (2) an SB swap customer reserve account to segregate cash and/or qualified securities in an amount equal to the net cash owed to SB swap customers, calculated on a weekly basis. Standalone or bank SBSDs (other than OTC derivatives dealers) are exempt from the requirements of Rule 18a-4 if the firm does not clear SB swap transactions for other persons and meets certain other conditions.

Section 3E(f) of the Exchange Act provides that a counterparty to a non-cleared SB swap with an SBSD or MSBSP can elect to have its initial margin held at an independent third-party custodian. The SBSD or MSBSP must notify the counterparty of this right at the beginning of a non-cleared SB swap transaction. An SBSD must obtain a subordination agreement from a counterparty that affirmatively elects to have initial margin held at a third-party custodian or that waives segregation. Unlike the Swap Margin Rules, the SEC's final rules do not require that initial margin be held at an independent third-party custodian.

While the SEC declined to accept ICI's recommendation that SBSDs not be subject to capital charges when their counterparties exercise their right to have collateral held at an independent third-party custodian, the Commission did adopt a revised exception to this requirement. Under Rules 15c3-1 and 18a-1, an SBSD need not take a deduction if collateral for initial margin is held by an independent third-party custodian under the following conditions:

- The custodian must be a US bank, registered clearing organization, or depository not affiliated with the counterparty.[14] If the collateral consists of foreign securities or currencies, the custodian can be a supervised foreign bank, clearing organization, or depository if not affiliated with the counterparty and the custodian customarily maintains custody of such foreign securities or currencies;
- The collateral must be held under an account control agreement governing the terms under which the custodian holds and releases the pledged collateral. The account control agreement must be a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding, and provide the SBSD with the right to access the collateral to satisfy the counterparty's obligations to the SBSD; and
- The SBSD maintains written documentation of its analysis that in the event of a legal challenge (including in the event of receivership, conservatorship, insolvency, liquidation, or similar proceedings), the relevant court or administrative authorities would find the custodial agreement to be legal, valid, binding, and enforceable under the law.[15]

Alternative Compliance Mechanism

As ICI recommended, the SEC adopted an alternative compliance mechanism for SBSDs that do not engage in a significant amount of SB swaps business. Under Rule 18a-10, an SBSD may comply with the CFTC's capital, margin, and segregation requirements, instead of Rules 18a-1, 18a-3, and 18a-4, if:

- The firm is registered with the SEC as a stand-alone SBSD (i.e., not also registered as a broker-dealer or OTC derivatives dealer) and is registered with the CFTC as a swap dealer;

- The firm is exempt from the segregation requirements of Rule 18a-4 (including that it does not clear SB swaps for other persons); and
- The aggregate gross notional amount of the firm's outstanding SB swap positions does not exceed the lesser of (as of the most recently ended fiscal year quarter):
    - $250 billion for the first three years of the rule, decreasing to $50 billion unless the SEC issues an order to maintain or lower the maximum fixed-dollar amount to less than $250 billion but greater than $50 billion, or
    - 10% of the combined aggregate gross notional amount of the firm's open SB swap and swap positions.

An SBSD operating under the alternative compliance mechanism must disclose in writing to each counterparty to an SB swap that it is operating under Rule 18a-10 and is complying with the applicable capital, margin, and segregation requirements of the CFTC. A firm must meet the conditions of Rule 18a-10 at all times. If a firm no longer can comply with any condition of 18a-10, it must immediately notify the SEC and CFTC, and has a period of two months to comply with the SEC's rules for SBSDs, unless it obtains an order from the SEC permitting a longer compliance period. A currently registered SBSD can elect to rely on Rule 18a-10 by providing written notice to the SEC and continuing to comply with Rules 18a-1, 18a-3, and 18a-4 for two months or a shorter time granted by the SEC, before the firm begins operating pursuant to the alternative compliance mechanism.

Cross-Border Transactions

The SEC's final rules address the applicability of the capital, margin, and segregation rules to foreign SBSDs and MSBSPs and the potential for foreign registrants to meet their obligations under these rules through substituted compliance—i.e., by complying with the capital, margin, and segregation rules of a foreign jurisdiction.

Applicability to Foreign SBSDs and MSBSPs. SEC rules on the cross-border application of the Title VII provisions distinguish between entity-level and transaction-level requirements. Entity-level requirements primarily address concerns relating to the entity as a whole, with a particular focus on safety and soundness of the entity to reduce systemic risk in the US financial system. In contrast, transaction-level requirements focus on specific transactions.

The SEC has determined that its capital and margin requirements are entity-level requirements for the SBSDs and MSBSPs that are subject to those rules. As a result, the capital requirements in the final rules will apply with respect to the entirety of a nonbank SBSD's or MSBSP's business and the margin requirements will apply to all of its SB swap transactions, regardless of whether the SBSD or MSBSP or its counterparty is a US or a foreign person.

The segregation requirements, in contrast, are transaction-level requirements, meaning they will not apply to all SB swap transactions of foreign SBSDs and MSBSPs. In general, a foreign SBSD[16] that is a foreign bank (or similar entity) must comply with Section 3E of the Exchange Act with respect to a SB swap customer that is a US person and with respect to a SB swap customer that is not a US person if the foreign SBSD holds funds or property arising out of a transaction "had by such a person with a branch or agency . . . in the United States" of the foreign SBSD. A foreign SBSD that is not a bank must comply with Section 3E of the Exchange Act with respect to all cleared SB swap transactions, if the foreign SBSD has received, acquired, or holds funds or other property for at least one SB swap customer that is a US person with respect to a cleared SB swap with that person. For non-cleared SB swaps, a foreign, nonbank SBSD must comply with Section 3E of the Exchange Act with respect to funds or other property the foreign SBSD has received, acquired, or holds for a

SB swap customer that is a US person.[17]

Substituted Compliance. The SEC has determined that substituted compliance may be available for foreign SBSDs and MSBSPs to meet their capital and margin requirements. The SEC states that it will endeavor to take a holistic approach in determining the comparability of foreign requirements for substituted compliance purposes, focusing on regulatory outcomes as a whole, rather than on requirement-by-requirement similarity. The SEC, however, may attach any conditions that it deems appropriate to a substituted compliance determination. The SEC has determined that the segregation requirements of Section 3E of the Exchange Act are not available for substituted compliance determinations. The application process for substituted compliance determinations will be governed by Rule 3a71-6 under the Exchange Act, which the SEC adopted as part of a prior rulemaking.

Compliance Dates

The final rules will become effective 60 days after publication in the Federal Register. The compliance date for the rule amendments and new rules is 18 months after the later of: (1) the effective date of the final rules establishing recordkeeping and reporting requirements for SBSDs and MSBSPs; or (2) the effective date of the final rules addressing the cross-border application of certain SB swap requirements.

Appendix: Comparison of Key ICI Recommendations with Final SEC Capital, Margin, and Segregation Rules for SBSDs and MSBSPs

ICI Recommendation

SEC Final Rules

Permit SBSDs that are not SEC-regulated broker-dealers to satisfy the SEC's rules on capital and margin by complying with the CFTC's rules on capital and margin.

SEC adopted Rule 18a-10 as an alternative compliance mechanism that allows an SBSD to satisfy the SEC's rules by complying with the CFTC's capital, margin, and segregation requirements if:

1. The firm is registered with the SEC as a stand-alone SBSD (not also registered as a broker-dealer or OTC derivatives dealer) and is registered with the CFTC as a swap dealer;
2. The firm is exempt from the segregation requirements of Rule 18a-4 (including that it does not clear SB swaps for other persons); and
3. The aggregate gross notional amount of the firm's outstanding SB swap positions must not exceed the lesser of (as of the most recently ended FY quarter):
    - $250 billion for the first 3 years of the rule, decreasing to $50 billion unless the SEC issues an order to maintain or lower the maximum fixed-dollar amount to less than $250 billion but greater than $50 billion, or
    - 10% of the combined aggregate gross notional amount of the firm's open SB swap and swap positions.

Conditions of Rule 18a-10 must be met at all times. If firm no longer can comply with any condition of 18a-10, 2-month compliance period unless SEC issues order for longer period. A registered SBSD can elect to rely on Rule 18a-10 by providing written notice to the SEC and continuing to comply with Rules 18a-1, 18a-3, and 18a-4 for two months or a shorter

time granted by the SEC.

Require bilateral exchange of collateral by SBSDs and MSBSPs and their counterparties in connection with SB swaps.

Nonbank SBSDs and MSBSPs must exchange bilateral variation margin (VM) with most parties, and collect initial margin (IM) from most parties (i.e., no requirement for SBSD or MSBSP to post IM).

Ensure that final rules enable counterparties to close out and net positions, using posted collateral, upon the insolvency of an SBSD.

Rules provide for close-out netting: SEC revised Rule 18a-3 to clarify that qualified netting agreements may be used in the calculation of initial margin, as well as variation margin, provided certain conditions are satisfied.

Require only those counterparties that have “material swaps exposure” to post IM, consistent with the Swap Margin Rules.

SEC declined to adopt a material swaps exposure threshold for IM.

Provide for a threshold for exchange of IM and raise the minimum transfer amount, both consistent with the Swap Margin Rules.

Final rules include an IM threshold amount ($50 million) and minimum transfer amount ($500,000) that are generally consistent with the Swap Margin Rules. An SBSD is required to collect IM 2 months after a counterparty exceeds the $50 million threshold.

Do not impose capital charges on SBSDs and MSBSPs when their counterparties elect to have their collateral held at a third-party bank custodian or ensure that any exception from the capital charge is workable.

Final rules require an SBSD to deduct, for purposes of determining its net capital, margin held at a third-party custodian. SEC adopted an exception, under amended Rules 15c3-1 and 18a-1, under which an SBSD does not need to take a deduction if collateral for IM is held by an independent third-party custodian subject to several modified conditions:

1. Custodian must be a US bank, registered clearing organization or depository not affiliated with the counterparty; if the collateral consists of foreign securities or currencies, custodian can be a supervised foreign bank, clearing organization, or depository if not affiliated with the counterparty and the custodian customarily maintains custody of such foreign securities or currencies.
2. Collateral must be held under an account control agreement governing the terms under which the custodian holds and releases the pledged collateral that is a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding, and provides the SBSD with the right to access the collateral to satisfy the counterparty’s obligations to the SBSD.
3. SBSD must maintain written documentation of its analysis that in the event of a legal challenge (including in the event of receivership, conservatorship, insolvency, liquidation, or similar proceedings), the relevant court or administrative authorities would find the custodial agreement to be legal, valid, binding, and enforceable under the law.

Revise the segregation requirements for omnibus segregation to prohibit SBSDs from using funds in the customer reserve account held for one customer to benefit another customer.

The SEC declined to accept this recommendation, noting that doing so "would not be consistent with the omnibus segregation requirements, which are designed to permit the commingling of customer assets in a safe manner."[18]

Expand permitted collateral to allow funds to post shares of registered investment companies and ETFs issued by an affiliate of the fund.

Under amended Rule 18a-3, SBSDs or MSBSPs may accept collateral that:

- Has a ready market;
- Is readily transferable;
- Consists of cash, securities, money market instruments, a major foreign currency, the settlement currency of the non-cleared SB swaps, or gold;
- Does not consist of securities and/or money market instruments issued by the counterparty or a party related to the nonbank SBSD or MSBSP, or the counterparty; and
- Is subject to a legally enforceable agreement between the SBSD/MSBSP and the counterparty.

The SEC does not define "related" and it is unclear whether this provision would preclude the use of affiliated funds as collateral.

Do not adopt rules on portfolio margining without first issuing a proposal that provides significantly more detail and analysis regarding the legal implications of these arrangements.

On June 27th, the Chairmen of the SEC and CFTC issued a joint statement pledging that the agencies will work together to further explore portfolio margining of uncleared swaps with SB swaps and explore expanding portfolio margining to futures and cash equity positions. The statement provides that the staffs of the agencies will be seeking further public input on these issues.[19]

Work with the CFTC, Prudential Regulators, and global regulators to develop a uniform "substituted compliance" framework approach that would apply to swaps and to SB swaps.

The SEC's final rules permit substituted compliance by a foreign SBSD to satisfy the SEC's capital and margin requirements, but not for segregation, which is a transaction-level requirement. The adopting release suggests that the SEC believes many aspects of its final capital and margin rules are comparable to the requirements in place in other jurisdictions, but we will need to see how the substituted compliance framework is applied in practice.

Provide a sufficiently long period for industry compliance (12-24 months).

The compliance dates will be 18 months after the later of: (1) the effective date of final rules establishing recordkeeping and reporting requirements for SBSDs and MSBSPs; or (2) the effective date of final rules addressing the cross-border application of certain SB swap requirements.

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endnotes

[1] *See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-based Swap Participants and Capital and Segregation Requirements for Broker-Dealers, available at* https://www.sec.gov/rules/final/2019/34-86175.pdf ("Adopting Release").

[2] *Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers*, Exchange Act Release No. 84409 (Oct. 11, 2018), 83 FR 53007 (Oct. 19, 2018) *available at* https://www.gpo.gov/fdsys/pkg/FR-2018-10-19/pdf/2018-22531.pdf ("Reopened Proposing Release").

[3] *See, e.g.,* Letter from Susan M. Olson, General Counsel, Investment Company Institute, to Mr. Brent J. Fields, Secretary, Securities and Exchange Commission, dated Nov. 19, 2018, *available at* https://www.ici.org/pdf/31492a.pdf; Letter from Paul Schott Stevens, President and CEO, Investment Company Institute, to the Honorable Mary Jo White, Chair, Securities and Exchange Commission, dated May 11, 2015, *available at* https://www.ici.org/pdf/28969.pdf; Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Ms. Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated Dec. 5, 2013, *available at* https://www.ici.org/pdf/27742.pdf; *See* Letter from Karrie McMillan, General Counsel, Investment Company Institute, and Dan Waters, Managing Director, ICI Global, to Ms. Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated Aug. 21, 2013, *available at*https://www.ici.org/pdf/27482.pdf; Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Ms. Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated Feb. 4, 2013, *available at*https://www.ici.org/pdf/26967.pdf. For a summary of the Swap Margin Rules, please see ICI Memorandum No. 29587 (Dec. 22, 2015), *available at* https://www.ici.org/my_ici/memorandum/memo29587 and ICI Memorandum No. 29484 (Nov. 12, 2015), *available at* https://www.ici.org/my_ici/memorandum/memo29484.

[4] Rule 15c3-1 also will apply to the SB swaps activities of stand-alone broker-dealers.

[5] A nonbank SBSD also is not required to collect initial margin from a counterparty that is a sovereign entity if the SBSD has determined the sovereign entity counterparty only has a minimal amount of credit risk. The nonbank SBSD still must exchange variation margin with the sovereign entity counterparty.

[6] Nonbank MSBSPs are also subject to exceptions under Rule 18a-3 for commercial end users, legacy accounts, and counterparties including the BIS, the European Stability Mechanism, or certain multilateral development banks.

[7] A nonbank SBSD or MSBSP still must exchange variation margin with a financial market intermediary counterparty.

[8] *See* Rule 18a-3(c)(5). Specifically, (i) the netting agreement must be legally enforceable in each relevant jurisdiction, including in insolvency proceedings; (ii) the gross receivables and gross payables that are subject to the netting agreement with a counterparty must be determinable at any time; and (iii) for internal risk management purposes, the SBSD or MSBSP monitors and controls its exposure to the counterparty on a net basis.

[9] Adopting Release, at 155.

[10] Under the Swap Margin Rules, a financial end user, including a regulated fund, is defined to have "material swaps exposure" if the entity, together with its affiliates, has an average daily aggregate notional amount of uncleared swaps, SB swaps, FX forwards and FX swaps with all counterparties on business days during June, July, and August of the previous year that exceeds $8 billion.

[11] The Adopting Release acknowledges ICI's recommendation that fund be able to post shares of affiliated funds as collateral. The SEC does not define "related" in the final rules, however, and it is unclear whether shares of affiliated funds would be permitted as collateral under the final rules. *See* Adopting Release, at 172.

[12]*See* paragraph (c)(2)(xv)(C)(*2)* of Rule 15c3-1, as amended.

[13] The omnibus segregation requirements do not apply to MSBSPs, although they apply to broker-dealers dually registered as MSBSPs.

[14] The custodian may, however, be an affiliate of the SBSD.

[15] In response to ICI's comments, the SEC made two significant changes to this exception from the proposal, by eliminating the requirements that (i) the account control agreement provide the SBSD with "the same control over the collateral as would be the case if the SBSD controlled the collateral directly," and (ii) the SBSD obtain a written opinion from outside counsel regarding the validity and enforceability of the account control agreement. *See* Reopened Proposing Release, at 53012.

[16] A "foreign security-based swap dealer" is a security-based swap dealer, as defined in Section 3(a)(71) of the Exchange Act, that is not a US person. See Rule 3a71-3(a)(7) under the Exchange Act. The term "US person" is defined in Rule 3a71-3(a)(4) as, subject to certain exceptions: (1) a natural person resident in the United States; (2) a partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States or having its principal place of business in the United States; (3) an account (whether discretionary or non-discretionary) of a US person; or (4) an estate of a decedent who was a resident of the United States at the time of death.

[17] Section 3E of the Exchange Act also will apply to a foreign MSBSP with respect to a counterparty that is a US person. In addition, segregation-related disclosure requirements for SBSDs will apply only with respect to US person counterparties.

[18] Adopting Release, at 247.

[19] *See Joint Statement on CFTC-SEC Portfolio Margining Harmonization Efforts* (June 27, 2019), *available at* https://www.sec.gov/news/public-statement/joint-statement-cftc-sec-portfolio-margining-harmonization-efforts.