MEMO# 32936

November 23, 2020

ICI Draft Comment Letters to CFTC and SEC on Portfolio Margining - Your Comments Requested by December 1

[32936]

November 23, 2020 TO: Derivatives Markets Advisory Committee
ICI Global Regulated Funds Committee
ICI Global Trading & Markets Committee RE: ICI Draft Comment Letters to CFTC and SEC on Portfolio Margining - Your Comments Requested by December 1

On October 22nd, the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC; together with the SEC, the "Commissions") issued a joint request for comment ("Request for Comment") seeking public feedback on potential ways to implement portfolio margining of uncleared swaps and non-cleared security-based swaps (SBSs).[1] On October 28th, the SEC issued a proposed order ("Proposed Order") that would grant conditional exemptions in connection with the portfolio margining of swaps and SBSs that are credit default swaps (CDSs).[2]

Comments on the Request for Comment and the Proposed Order are due to the Commissions on Monday, December 7th. In response, ICI has prepared the attached draft comment letters, which are summarized briefly below. Please provide your written comments on the draft letters to Sarah Bessin at sarah.bessin@ici.org no later than Tuesday, December 1st. We apologize for the review over Thanksgiving week, but we have only a 30-day comment period to respond. We appreciate your cooperation.

Draft Letter on Request for Comment

The Request for Comment solicits detailed feedback on all aspects of the portfolio margining of uncleared swaps and non-cleared SBSs, including on the merits, benefits, and risks of portfolio margining these types of positions, and on any regulatory and operational issues associated with portfolio margining them. The Request for Comment takes into account: (1) type of registration applicable to the entity holding the collateral and standing as dealer-counterparty in respect to the regulated fund or other counterparties on the applicable uncleared swaps and non-cleared SBS (i.e., broker-dealer (BD), OTC derivatives dealer, security-based swap dealer (SBSD), futures commission merchant (FCM), and swap dealer); (2) the account types (securities account, SBS account, swap account and FCM account) these registrants can maintain; and (3) the margin and segregation requirements that apply to products carried in these account types and what regime should apply in a combined asset, portfolio margined account.

ICI's draft comment letter explains that our members support the ability to engage in portfolio margining. Regulated funds and their advisers, however, are subject to strict requirements regarding the protection of fund assets that effectively limit the types of portfolio margining arrangements in which they may engage. We urge the Commissions to propose a portfolio margining regime for uncleared swaps and non-cleared SBSs that is consistent with these requirements.

Our letter outlines these requirements and discusses why regulated funds strongly favor portfolio margining in a swap account held by a regulated futures commission merchant (an "FCM Account") or a swap account held by a bank that is a registered swap dealer ("Swap Account;" together with an FCM Account, a "Portfolio Margining Account"), rather than in a securities account at a BD or an SBS account at a stand-alone SBSD that is not a bank.

We explain why the margining framework and requirements applied to a Portfolio Margining Account at a Swap Dealer/FCM or Bank/Swap Dealer should rely exclusively on the margining requirements of, respectively, the CFTC or the prudential regulators to margin uncleared swaps, non-cleared SBSs, futures, securities, and other instruments. We recommend that positions and transactions held in the Portfolio Margining Account be treated the same as other transactions and assets required to be carried in the account, and urge the Commissions to clarify the treatment of a Portfolio Margining Account upon the bankruptcy of the swap dealer (or dual swap dealer/SBSD or broker-dealer) carrying the account.

Finally, we urge the Commissions to address in any portfolio margining regime for uncleared swaps and non-cleared SBSs that they propose several inconsistencies between the CFTC's and SEC's regulation of swaps and SBSs. Such clarity is essential for market participants that wish to engage in portfolio margining.

Draft Letter on Proposed Order

The Proposed Order would provide relief from certain provisions of the Securities Exchange Act of 1934 ("1934 Act") in connection with a program to portfolio margin cleared swaps and SBSs that are CDSs. The draft letter explains that ICI supports the Proposed Order, which would supersede and replace the SEC's December 2012 exemptive order ("2012 Order"), which was issued in response to a request by ICE Clear Credit. The draft letter highlights the benefits of portfolio margining for regulated funds, including the benefits of the portfolio margining programs that have developed in reliance on the 2012 Order. It explains that ICI strongly supports efforts by the SEC and the CFTC to take a harmonized approach to portfolio margining that reflects the unique regulatory constraints to which regulated funds are subject.

We explain that ICI generally supports the SEC's modification in the Proposed Order of the conditions in the 2012 Order. In particular, ICI would not object to the SEC eliminating conditions in the 2012 Order that contemplated potentially expanding the CDS portfolio margining program to securities accounts. We explain that, under the 1940 Act, registered funds are limited in their ability funds to engage in portfolio margining arrangements in a securities account or an SBS account. Non-US regulated funds are subject to similar limitations. Our members therefore would not object to elimination of these conditions, as regulated funds typically do not engage in portfolio margining in these accounts.

The letter also explains that ICI supports the SEC's proposed modification of the conditions in the 2012 Order regarding the obligation of a BD/FCM to enter into a nonconforming subordination agreement. The modified conditions would clarify that the cleared swaps customer must affirm that claims to "customer property," as defined in Securities Investor Protection Act of 1970 (SIPA) or the stockbroker liquidation provisions of the US Bankruptcy Code, against the BD/FCM will be subordinated only to the claims of securities customers and SBS customers, not to the claims of general creditors.

Sarah A. Bessin
Associate General Counsel

Attachment No. 1

Attachment No. 2

endnotes

[1] *See Portfolio Margining of Uncleared Swaps and Non-Cleared Security-Based Swaps*, 85 Fed. Reg. 70536 (Nov. 5, 2020), *available at* https://www.govinfo.gov/content/pkg/FR-2020-11-05/pdf/2020-23928.pdf.

[2] *See Proposed Order Granting Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection With the Portfolio Margining of Swaps and Security-Based Swaps That Are Credit Default Swaps*, 85 Fed. Reg. 70657 (Nov. 5, 2020), *available at* https://www.govinfo.gov/content/pkg/FR-2020-11-05/pdf/2020-24612.pdf.

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