MEMO# 32969

December 8, 2020

ICI Files Comment Letters with CFTC and SEC on Portfolio Margining

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December 8, 2020 TO: ICI Members
ICI Global Members
Derivatives Markets Advisory Committee
ICI Global Regulated Funds Committee
ICI Global Trading & Markets Committee
Investment Advisers Committee SUBJECTS: Derivatives
Investment Advisers
Trading and Markets RE: ICI Files Comment Letters with CFTC and SEC on Portfolio Margining

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] On December 7th, ICI filed comment letters on the Request for Comment and the Proposed Order. Our comment letters are attached and are summarized briefly below.

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 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 (a "Portfolio Margining Account") held by a non-bank CFTC registered swap dealer that is also registered with the SEC as an SBSD (a "Non-Bank SD/SBSD"). We explain that SBSs held in the Portfolio Margining Account should be treated for margin and all other applicable purposes as though the SBSs were swaps, subject to the rules of the CFTC.

We further explain why a Portfolio Margining Account held by a Non-Bank SD/SBSD should be subject exclusively to the margining requirements of the CFTC to margin collectively on a portfolio basis uncleared swaps and non-cleared SBSs. We recommend that transactions held in the Portfolio Margining Account be treated the same as other transactions and assets required to be carried in a CFTC-regulated swap account, and urge the Commissions to clarify the treatment of a Portfolio Margining Account upon the bankruptcy of the Non-Bank SD/SBSD carrying the account.

Finally, in light of the short comment period and the many complex legal and operational issues raised by portfolio margining, we urge the Commissions to provide further opportunities for public feedback on the important issues raised in the Request for Comment before issuing a regulatory proposal.

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. Our comment 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 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 providing customers with the option to portfolio margin cleared CDSs in an SBS account subject to SEC regulation. We explain that regulated funds are limited in their ability to engage in portfolio margining arrangements in a securities account or an SBS account. We therefore would not object to elimination of these conditions, as regulated funds typically do not engage in portfolio margining in these accounts.

We also support 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. We request that the SEC confirm, however, that the revised language in the proposed modified conditions would be required to be included in affirmations only on a going-forward basis for new cleared swap customers, and that existing cleared swap customers would not need to amend their agreements to provide the revised affirmations.

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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.