MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

April 29, 2011

Via Electronic Submission: http://www.sec.gov/rules/proposed.shtml

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: RIN No. 3235-AL13: Notice of Proposed Rulemaking on Clearing Agency Standards for Operation and Governance

Dear Ms. Murphy:

Managed Funds Association ("**MFA**")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission (the "**Commission**") on its proposed rules on "Clearing Agency Standards for Operation and Governance" (the "**Proposed Rules**")[2] related to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").[3] MFA supports enhancing the regulatory framework for the supervision of clearing agencies. In this regard, MFA respectfully offers the following suggestions on the Proposed Rules to assist the Commission with adopting final rules that will advance the Commission's goals of facilitating prompt and accurate clearing and settlement of security-based swap ("**SBS**") transactions while enhancing accountability and transparency.[4]

I. Proposed Rule 17Ad–22(b): Standards for Clearing Agencies

A. General

Proposed Rule 17Ad–22(b) sets forth standards applicable to clearing agencies that provide central counterparty services ("**CCP CAs**"), including with respect to measurement and management of credit exposures, margin requirements, financial resources and annual

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.9 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

[2] 76 Fed. Reg. 14472 (Mar. 16, 2011) (the "**Proposing Release**").

[3] Pub. L. 111-203, 124 Stat. 1376 (2010).

[4] Proposing Release at 14474.

evaluations of the performance of CCP CA margin models.[5] MFA generally supports the Commission's proposed standards because we agree that they establish reasonable, objective, risk-based criteria for fair and open access to CCP CAs.

Moreover, we would like to emphasize that, in addition to requiring CCP CAs to adopt policies and procedures strictly determined by objective, risk-based criteria, we strongly urge the Commission to require annual audit and transparency to the market of CCP CA policies, procedures and processes, in particular regarding the setting of margin requirements, guaranty fund obligations and minimum net capital requirements. Lack of transparency in these areas could lead to CCP CAs implementing their policies and procedures in a manner that is not responsive to the risk objective they intended the policies or procedures to address, thereby embedding competitive barriers to CCP CA access. For instance, risk management structures for scaling net capital requirements, if not applied in an objective and transparent manner, could have the same restrictive effect as an excessive net capital threshold, which would hinder competition and undermine the open access goals of the Dodd-Frank Act and the Proposed Rules. Transparency furthers the Commission's policy objectives by permitting all market participants to evaluate the risk management strengths of clearing offerings, and make informed choices. In addition, transparency of reserve calculation requirements will also provide a useful benchmark for future regulation of margin and capital calculations for non-cleared trades.

B. Proposed Rule 17Ad–22(b)(2): Margin Requirements

Proposed Rule 17Ad–22(b)(2) sets forth standards regarding CCP CA policies and procedures related to margin requirements.[6] MFA supports standardizing the manner in which CCP CAs set margin requirements. In addition, we recommend that in the final rules the Commission require each CCP CA to make available to its customers its methodology for setting margin, so that customers can calculate with precision the margin they will need to post with respect to any given transaction. Mandating transparency will enable market participants to anticipate when a CCP CA may require additional margin and be prepared to respond to CCP CAs margin calls, thereby increasing market stability and decreasing the likelihood that a market participant will experience a liquidity shortage due to an unexpected increase in margin by a CCP CA. Provided the market has such transparency, we agree that CCP CAs should have flexibility to modify margin requirements as necessary (including by imposing special margin requirements or requiring intraday posting of margin).

In addition, in the Proposing Release, the Commission asks whether Proposed Rule 17Ad–22(b)(2) would create the risk that CCP CAs will lower margin standards to compete for business.[7] First, MFA believes that this risk is unlikely because a CCP CA's primary (and

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5 *Id.* at 14538.

6 *Id.* Specifically, proposed Rule 17Ad–22(b)(2) would require CCP CAs to establish, implement, maintain and enforce written policies and procedures reasonably designed to: (i) use margin requirements to limit its credit exposures to participants in normal market conditions; (ii) use risk-based models and parameters to set margin requirements; and (iii) ensure at least monthly review of the models and parameters.

7 *Id.* at 14479.

perhaps sole) focus is the management of counterparty credit risk, and margin protects CCP CAs in the event of a clearing member default or other credit event. CCP CAs do not alter margin requirements based on the identity of individual counterparties; therefore, strict regulatory supervision of CCP CA margin methodologies will establish the conditions for margin discipline. Second, a CCP CA would suffer significant reputational and financial harm if it risks using the guaranty fund to cover margin deficiencies. Thus, CCP CAs have substantial incentivizes to maintain reasonable margin standards. Finally, we believe that robust and consistent margin standards, coupled with adequate transparency, also reduce any risk that CCP CAs will lower margin standards for competitive reasons.

C. Proposed Rule 17Ad–22(b)(7): Net Capital Restrictions

Proposed Rules 17Ad–22(b)(5), (6) and (7) seek to increase access to CCP CA membership by: (i) requiring such agencies to provide persons that do not perform any dealer or SBS dealer services with the opportunity to obtain membership; (ii) prohibiting use of minimum portfolio size and minimum volume transaction thresholds as a condition for membership; and (iii) mandating that such agencies allow persons with net capital equal to or greater than $50 million to obtain membership.[8] MFA agrees that proposed Rule 17Ad– 22(b) will help to ensure that CCP CAs' rules, policies and procedures "will be designed to promote fair and open access, to promote the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds that are in the custody or control of the clearing agency or for which it is responsible."[9]

In particular, we agree that $50 million is a reasonable maximum net capital requirement because it signifies a threshold level of financial expertise. While some market participants support a higher net capital requirement, arguing that it will decrease the risk that a clearing member could not meet its obligations to the CCP CA (*e.g.*, in the event of a margin call or default), we believe that ability to meet a higher minimum net capital requirement does not necessarily equate to posing less risk. For example, a large entity with significant net capital may have exposures and be extended in a variety of different ways that result in it posing greater systemic risk than a smaller entity with less net capital and less exposure such that the smaller

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8 *Id.* at 14538.

9 *Id.* at 14477. In particular, we agree that proposed Rule 17Ad-22(b)(7), which would prohibit CCP CAs from imposing restrictions on membership based on minimum net capital requirements of $50 million or more, would introduce unnecessary barriers to clearing access.

MFA also supports the Commission's inclusion in proposed Rule 17Ad– 22(a)(5) of a definition for "net capital", which would have the same meaning as set forth in Rule 15c3–1 under the Securities Exchange Act of 1934, as amended, for broker-dealers or any similar risk adjusted capital calculation for all other prospective clearing members, in this context. As discussed in the Proposing Release at 14477, we agree that inclusion of a definition will ensure that clearing agencies use a consistent calculation methodology as to the level of capital required for clearing membership rather than allowing clearing agencies to choose different and potentially less standardized calculations that could have the effect of making it difficult for certain types of otherwise eligible entities to qualify for clearing membership. We note, however, that for institutions other than banks and broker-dealers "net capital" is not as clearly defined a concept and we respectfully suggest that the Commission consider clarifying in the proposed definition what the equivalent concept would be for non-bank or broker-dealer institutions.

entity is better positioned to meet its obligations in a default scenario. Therefore, an entity's ability to meet assessments or margin calls in a default scenario is not a matter of size or net capital, but rather of whether the entity has appropriate resources measured against its contingent obligations, including call risk. Consequently, we agree that the Commission's inclusion in the Proposed Rules of the option for a CCP CA to scale requirements applicable to each clearing member in a way that reflects the exposure that the particular entity would bring to the CCP CA as a clearing member is the most appropriate way to allow CCP CAs to manage the risk that a clearing member will not be able to meet its obligations.[10]

In addition, we respectfully request that the Commission's final rules require that CCP CAs determine such scaling by objective, risk-based methodologies that are based on reasonable stress and default scenarios and consistently applied to all clearing members. In the Proposing Release, the Commission references the Fixed Income Clearing Corporation's tiered membership standards as an example of capital-related requirements that differentiate between types of participants.[11] Although we believe that it is appropriate to permit CCP CAs to develop scalable membership standards to address their risk management concerns, we are generally opposed to "tiers" in CCP CA membership, which we believe could have discriminatory or anti-competitive effects. Also, CCP CAs should ensure that they base any cap they impose on similarly determined scaled, objective, risk-based criteria (in order to avoid limits that are anti-competitive) and that any such cap is sufficient to allocate risk sharing appropriately among clearing members.

Further, MFA notes the Commission's proposal to retain flexibility for risk management purposes by allowing CCP CAs to mandate a higher net capital requirement as a condition for membership upon demonstrating to the Commission that such a requirement is necessary to mitigate risks that could not otherwise be effectively managed by other measures.[12] This proposal diverges from the Commodity Futures Trading Commission (the "**CFTC**") proposed rules on "Risk Management Requirements for Derivatives Clearing Organizations", which do not allow for divergence from the $50 million net capital requirement for membership.[13] We believe

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[10] We note that proposed Rule 17Ad– 22(b)(7) permits CCP CAs to develop scalable membership standards along these lines. Specifically, under the proposed rule, net capital requirements would be scalable so that they are proportional to the risks posed by the participant's activities.

As noted in the Proposing Release at 14482, this language means that while a clearing agency could not restrict access solely because a participant does not have a net capital level above $50 million, the clearing agency's policies and procedures could be reasonably designed to limit the activities of the participant in comparison to the activities of other participants that maintained a higher net capital level (*e.g.*, by restricting the maximum size of the portfolio a participant is permitted to maintain at the clearing agency).

[11] *Id*. at 14482, footnote 49.

[12] *Id*. at 14482-83. Proposed Rule 17Ad– 22(b)(7) permits clearing agencies to provide for a higher net capital requirement (*i.e.*, higher than $50 million) as a condition for membership at the clearing agency if it demonstrates to the Commission that such a requirement is necessary to mitigate risks that could not otherwise be effectively managed by other measures, such as scalable limitations on the transactions that the participants may clear through the clearing agency, and the Commission approves the higher net capital requirements as part of a rule filing or clearing agency registration application.

[13] Notice of Proposed Rulemaking on "Risk Management Requirements for Derivatives Clearing Organizations", 76 Fed. Reg. 3698 (Jan. 20, 2011). Under proposed Section 39.12(a)(2)(iii), the CFTC limits the

that the rules for derivatives clearing organizations ("**DCOs**") and CCP CAs should be consistent on this point. Accordingly, we recommend that the Commission eliminate CCP CAs' ability to increase the net capital requirement from the final rules. As noted above, we believe allowing CCP CAs to scale net capital requirements proportionate to the risk posed by the participant to the CCP CA should be sufficient.

If the Commission retains CCP CAs' ability to increase the net capital requirement in the final rule, we respectfully submit that before a CCP CA may increase the net capital requirement, the Commission:

(1) should require the CCP CA to meet a higher burden of proof than currently proposed and the CCP CA's rationale should be subject to the Commission's enhanced review;

(2) should require the CCP CA to demonstrate not only that it could not effectively manage the risk using other measures, but also that raising the minimum capital requirement is the least restrictive means by which to address the risk posed to the CCP CA; and

(3) should review the CCP CA's showing and make an express determination that no other, less competitively restrictive measures are available to the CCP CA to manage the risk effectively.

We believe that the addition of these measures would ensure that any action taken by a CCP CA to increase the net capital requirement is necessary to safeguard the CCP CA against the risk posed by the relevant clearing member.

II. Proposed Rule 17Aj–1: Dissemination of Pricing and Valuation Information by CCP CAs

Proposed Rule 17Aj–1 would require CCP CAs to disseminate pricing and valuation information by incorporating the relevant requirements contained in the CDS Clearing Exemption Orders into the Commission's rules for clearing agencies.[14] The Commission has asked for comments as to whether the current requirement in the CDS Clearing Exemption Orders is helpful in promoting price transparency and efficiency in the credit default swap market and whether the Commission could improve the requirement to ensure better access by those persons that find the information difficult to obtain.[15]

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maximum capital requirement that a DCO can impose as part of the DCO's clearing membership requirements to $50 million.

[14] Proposing Release at 14492-93. Proposed Rule 17Aj–1 would require each clearing agency to "make available to the public, on terms that are fair, reasonable, and not unreasonably discriminatory, all end-of-day settlement prices and any other prices for SBSs that the clearing agency may establish to calculate its participants' mark-to-market margin requirements and any other price or valuation information with respect to SBSs as is published or distributed by the clearing agency to its participants."

[15] *Id.* at 14493.

MFA notes that one of the primary goals of the Dodd-Frank Act is to promote transparency in the financial system.[16] While we believe that proposed Rule 17Aj–1 would improve price transparency in the SBS market to some extent, we believe that the Proposed Rules should go further. Public dissemination by CCP CAs of end-of-day settlement prices would represent a first step toward providing improved transparency to the markets. Therefore, we do not believe that limiting the availability of such prices, whether through fees, subscription services or other barriers, is warranted.

MFA notes that the Commission's Proposed Rules differ from the CFTC's current rules, which require futures clearinghouses to publish daily settlement prices broadly, free of charge to the public.[17] Additionally, the CFTC's exemption orders for cleared over-the-counter derivatives also require daily publication of price information to the public at no charge.[18] We see no rationale for having the practices for the SBS market diverge from futures and other cleared markets, and we would urge the Commission to harmonize its practice with that of the CFTC and require clearing agencies to broadly publish end of day settlement prices at no charge.[19]

Requiring free publication of daily price settlement data by CCP CAs would serve the public interest and would have many beneficial results, including:[20]

(i) creating a baseline for clearing agencies to confirm prices;

(ii) allowing for a comparison between prices in the bilateral and cleared markets;

(iii) establishing a source of historical pricing data; and

(iv) greater liquidity in the market.

Currently, the need to pay a fee for daily settlement prices hampers entry into and participation in the market by smaller entities, such as certain buy-side participants, small hedge funds or other infrequent participants in the market. For such participants, purchase of an annual or other subscription would not be practical (*e.g.*, until recently, parties seeking settlement price data from IntercontinentalExchange, Inc. could only procure if from Markit Group Limited, a third

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16 Preamble to the Dodd-Frank Act; *Id.* at 14472.

17 17 C.F.R. Part 40.

18 Also, transactions by eligible contract participants in a certain narrow list of selected commodities may be conducted on an exempt board of trade ("**EBOT**") and be exempt from most CFTC regulation if the transactions meet the conditions for the exemption set forth in Section 5d of the Commodity Exchange Act, 7 USC 7a-3, one of which is that an EBOT that is determined to perform a significant price discovery function is required to disseminate publicly certain information on a daily basis.

19 We note that there will be a cost to providing such information to the public, but we believe that these costs should be borne across CCP CAs and their customers as a part of their user fees, clearing costs and other charges rather than borne by individuals seeking such information.

20 While it may not be unreasonable for the relevant clearing agency or any third party vendor it engages to charge for real-time or streaming data, such as a ticker service, which could involve greater start-up and administrative costs, individuals should not pay a fee or other charge to access daily price settlement data.

party vendor, for an annual fee). Free of charge availability of end of day settlement prices would allow for greater participation in the market by such market participants, which in the aggregate, would provide more liquidity to the market.

III. Further Recommendations for Rulemaking with respect to Clearing Agencies

While the Proposed Rules represent a vital step toward achieving open access at clearing agencies, protection of the integrity of cleared SBS markets and the elimination of anti-competitive barriers to customers' ability to access best execution, we believe that further structural features are necessary to meet these goals. As such, we urge the Commission to mandate in the final rules (or a separate Commission rulemaking) that CCP CAs provide the following structural features:

(i) Real-time submission of SBS transactions for clearing: The Commission should set forth uniform standards for submission of transactions to clearing agencies. These standards should include specific timeframes – which should be the shortest time period practicable for the given transaction – for submission by clearing agencies, SBS dealers, SBS major swap participants and SBS execution facilities;

(ii) Real-time acceptance for clearing: The Commission should require clearing agencies to be prepared at all times to provide real-time acceptance for clearing of eligible SBS transactions executed directly during normal market hours, without the need for the SBS transaction to first be executed bilaterally and then replaced following acceptance by the clearing agency. Real-time acceptance for clearing should apply regardless of the mode of execution of an SBS transaction or whether an SBS is subject to mandatory clearing. As part of the SBS real-time clearing process, the clearing agencies should require their clearing members to ensure real-time confirmation of acceptance of their client's transactions within their individual credit limits;

(iii) Coordination between market participants: The Commission should require that market participants, trading platforms and clearing agencies coordinate with one another to facilitate prompt and efficient transaction processing;

(iv) Prohibition of discriminatory treatment: The Commission should prohibit clearing agencies from adopting rules or engaging in conduct that is prejudicial to indirect clearing participants as compared to direct clearing participants with respect to eligibility or the timing of clearing or processing of trades generally (or that otherwise results in differential treatment by clearing agencies of indirect participants versus direct participants), including barriers to competitive price provision by a liquidity provider that is an indirect clearing participant versus a direct clearing participant. We believe that when an indirect clearing participant trades with another indirect clearing participant, the clearing process should be identical and as prompt as when one of the parties is a direct clearing participant,

so long as the transaction satisfies the relevant clearing agency's rules, requirements and standards otherwise applicable to such trades;

(v) Portability of Customer Positions: The Commission should eliminate barriers to full or partial portfolio portability by requiring that clearing agencies, upon customer request, must transfer promptly all or a portion of customer portfolios and related funds from one clearing participant to another, without requiring the closeout and re-booking of the portfolio prior to the requested transfer. Clearing agencies should be required to effect such a transfer in any situation, irrespective of a clearing participant default scenario, provided that the requesting customer's portfolio: (i) remains "appropriately margined", calculated using either the same margin methodology utilized previously or such other methodology as otherwise agreed between the customer and its clearing participant; and (ii) there is no ongoing event of default of the customer that would give the ceding clearing participant specific rights, in whole or in part, over portfolio and margin being transferred. In addition, we suggest that the Commission require clearing agency rules to specify that upon a requested transfer, the clearing agency will simultaneously transfer margin along with the related portfolio, and prohibit ceding clearing participants from imposing extraordinary charges on transfers that could act as deterrents or hidden consent rights;

(vi) Protection of anonymity and limitations on required documentation: The Commission should explicitly protect anonymity as between a customer's clearing participant and its execution counterparty. This protection should include prohibiting a market participant (such as an SBS dealer) from requiring, as a precondition to executing a cleared SBS, documentation (such as an ISDA agreement or other credit arrangement) or adherence to a credit limit or guarantee scheme that limits the number of eligible parties a market participant may transact with or otherwise impairs the market participant's access to competitive liquidity and best execution, other than the parties' direct and indirect clearing arrangements; and

(vii) Prohibition on anti-competitive restrictions in the SBS market: The Commission should include an express prohibition against the imposition of anti-competitive restrictions in the SBS market, including: (i) barring inclusion by clearing agencies of anti-competitive restrictions in their rules; and (ii) disallowing clearing participants from imposing execution limits or other forms of restrictions that are anti-competitive, compromise anonymity between a customer's trading counterparties and its clearing participant, limit the number of eligible parties a market participant may transact with or otherwise inhibit the customer's ability to achieve best execution in the relevant market.

We note that the CFTC proposed implementation of many of these structural features with respect to DCOs in its recent proposed rulemaking on "Requirements for Processing,

Clearing, and Transfer of Customer Positions."[21] We respectfully request that the Commission incorporate similar structural modifications in the final rules or in a separate Commission rulemaking.

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MFA thanks the Commission for the opportunity to provide comments regarding the Proposed Rules. Please do not hesitate to call Carlotta King or the undersigned at (202) 730-2600 with any questions the Commission or its staff might have regarding this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director, General Counsel

cc: The Hon. Mary Schapiro, Chairman
The Hon. Kathleen L. Casey, Commissioner
The Hon. Elisse B. Walter, Commissioner
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner

[21] CFTC Notice of Proposed Rulemaking on "Requirements for Processing, Clearing, and Transfer of Customer Positions", 76 Fed. Reg. 13101 (Mar. 10, 2011). MFA submitted a comment letter to the CFTC supporting these proposed rules and offering some constructive suggestions, which is available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=35520&SearchText= .