

Via Email

November 8, 2018

Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

*Re: File Number S7-08-12*

Dear Mr. Secretary:

I am writing to respond to the Securities and Exchange Commission (SEC or Commission) reopening the comment period and requesting additional comment on Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers (Proposed Rules).<sup>1</sup>

The Council of Institutional Investors (CII), is a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management exceeding \$4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than \$25 trillion in assets under management.<sup>2</sup>

One lesson from the 2008 financial crisis is that overreliance on the “self-correcting nature of the markets” can have devastating effects on investors, workers, retirees, and the American and global economy.<sup>3</sup> More specifically, it is well accepted that the unregulated market for over-the-counter (OTC) derivatives contributed significantly to the crisis.<sup>4</sup>

---

<sup>1</sup> 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. 84,409, 83 Fed. Reg. 53,007 (Oct. 19, 2018), <https://www.gpo.gov/fdsys/pkg/FR-2018-10-19/pdf/2018-22531.pdf>.

<sup>2</sup> For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at <http://www.cii.org>.

<sup>3</sup> See Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report xviii (2011), [http://fcic-static.law.stanford.edu/cdn\\_media/fcic-reports/fcic\\_final\\_report\\_full.pdf](http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf); see also The Investors’ Working Group, U.S. Financial Regulatory Reform, The Investors’ Perspective 8 (July 2009) (“[v]igorous governmental oversight was abandoned as regulators placed their faith in the ability of markets to self-police and self-correct”), [https://www.cii.org/files/issues\\_and\\_advocacy/dodd-frank\\_act/07\\_01\\_09\\_iwg\\_report.pdf](https://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf).

<sup>4</sup> See Financial Crisis Inquiry Commission at xxiv (“[w]e conclude over-the-counter derivatives contributed significantly to this crisis”); see also Investors Working Group at 11 (“[a]lthough OTC derivatives have been

Beginning in 2009, CII became an active proponent of efforts by policy makers to establish a more robust federal regulatory regime for the OTC derivatives markets.<sup>5</sup> For example, in a November 2009 letter to Committee on Banking, Housing, and Urban Affairs Chairman Christopher J. Dodd, we explained:

Unregulated trading in OTC derivatives contracts, especially credit default swaps, was at the heart of the global financial crisis. The global OTC derivatives market is enormous, yet virtually exempt from all regulation under the Commodity Futures Modernization Act of 2000. Prices are hidden, speculation is rampant and leverage is high. Although derivative contracts can help manage risk, left unchecked, they can also multiply and spread risk throughout the financial system, increasing the possibility of enormous damage. *The Council supports your efforts in the discussion draft to bring meaningful regulation and transparency to this highly influential market.*<sup>6</sup>

Our views in support of meaningful oversight of the OTC derivatives market were derived from the findings and recommendations of the Investors' Working Group (IWG), an independent taskforce co-chaired by former SEC chairs William H. Donaldson and Arthur Levitt, Jr. and sponsored by CFA Institute Centre for Financial Markets Integrity and CII. In its seminal report on the 2008 financial crisis the IWG concluded:

The nation's regulatory umbrella should be comprehensive. Specifically, it should be broadened to cover important financial products, players and gatekeepers that lack meaningful oversight. Critical gaps that urgently need attention include OTC derivatives."<sup>7</sup>

As a result, we generally supported Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).<sup>8</sup> Title VII established a comprehensive framework for the oversight of OTC derivatives.<sup>9</sup>

We understand that the SEC currently has eight remaining outstanding proposed rules to implement provisions of Title VII.<sup>10</sup> We are pleased that SEC Chairman Jay Clayton is

---

justified as vehicles for managing risk, they have also spread and multiplied risk throughout the economy in the current crisis, causing great financial harm").

<sup>5</sup> See, e.g., Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to The Honorable Christopher J. Dodd, Senate Committee on Banking, Housing, and Urban Affairs 3 (Nov. 18, 2009) (emphasis added & on file with CII).

<sup>6</sup> *Id.*

<sup>7</sup> Investors' Working Group at 10.

<sup>8</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, §§ 701-774 (July 21, 2010), <https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf>.

<sup>9</sup> Press Release, Council of Institutional Investors, CII Welcomes Senate Passage of Financial Reform (July 15, 2010) ("These improvements will increase the transparency, lower the costs and reduce the risks of these complex but essential financial instruments that were at the heart of the financial crisis.") (on file with CII).

<sup>10</sup> U.S. Securities and Exchange Commission, Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act (last visited November 6, 2018), <https://www.sec.gov/spotlight/dodd-frank.shtml#>.

committed to completing the remaining Title VII rules and that the Commission has reopened the comment period to provide “the public with another opportunity to comment on several” of those proposals.<sup>11</sup>

### Margin Requirements

CII opposes the Proposed Rules “Alternative A” that provides a non-bank security based swap dealer (SBSD) an exception from collecting initial margin if the counterparty is another SBSB.<sup>12</sup> We prefer “Alternative B” in which “a nonbank SBSB would be required to collect initial margin from another SBSB and the initial margin would need to be segregated pursuant to Section 3E(f) of the . . . [Securities Exchange Act of 1934].”<sup>13</sup>

We note that the SEC has previously acknowledged that the likelihood a nonbank SBSB could fail or “that a default by a nonbank SBSB could translate to defaults of counterparty SBSBs . . . would be smaller under Alternative B than under Alternative A.”<sup>14</sup>

More broadly, we share the concerns of SEC Commissioner Kara M. Stein that the Proposed Rules include:

[S]ignificant policy shifts buried within this “reopening of the comment period” document. For example, the Commission’s proposed financial responsibility rules would be changed so that margin for security-based swaps would no longer need to be collected from dealers. There would also be significant changes to both the calculation of capital and the calculation of margin amounts for security-based swap transactions. This could mean that less money would be available if problems arise. And, more importantly, if the market believes that adequate financial resources are not available; this could spark a run in the market, creating asset calls that spiral out of control.<sup>15</sup>

It continues to be our view that making derivatives safer requires that all OTC derivative transactions should be subject to margin requirements.<sup>16</sup> We note that our view is consistent with the following recommendation of the IWG:

---

<sup>11</sup> Chairman Jay Clayton, Opening Statement at the SEC Open Meeting 1 (Oct. 11, 2018) (indicating that the Securities and Exchange Commission was “seek[ing] to complete the remaining Title VII rules”), <https://www.sec.gov/news/public-statement/statement-clayton-101118>.

<sup>12</sup> 83 Fed. Reg. at 53,013.

<sup>13</sup> *Id.* at 53,014.

<sup>14</sup> *Id.*

<sup>15</sup> Commissioner Kara M. Stein, Statement on Commission Action Regarding Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers 2 (Oct. 11, 2018), <https://www.sec.gov/news/public-statement/statement-stein-101118>.

<sup>16</sup> Letter from Justin Levis, Senior Research Associate, Council of Institutional Investors, to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System 1 (June 22, 2011) (“The Council believes that swaps and security based swaps involving a nonfinancial end user should not be exempt from margin requirements, as requiring margin reduces risk to taxpayers and to the financial system.”), <https://www.fdic.gov/regulations/laws/federal/2011/11c08ad79.pdf>.

A federal regulatory regime is needed for any continuing OTC market . . . . All OTC trades should be subject to federally imposed margin requirements, and all large market participants should be subject to capital requirements.<sup>17</sup>

The dangers of permitting entities to decide whether to collect adequate (or any) margin from counterparties was described in the following legislative history to Title VII of Dodd-Frank:

The main tool for regulating contagion and systemic risk is liquidity reserves (margin)[]. In the OTC market, margin requirements are set bilaterally and do not take account of the counterparty risk that each trade imposes on the rest of the system, thereby allowing systemically important exposures to build up without sufficient capital to mitigate associated risks. . . . [A]nd regulators should address this problem through the new margin requirements . . . .

While large losses are to be expected in derivatives trading, if those positions are fully margined there will be no loss to counterparties and the overall financial system and none of the uncertainty about potential exposures that contributed to the panic in 2008.<sup>18</sup>

Like SEC Commissioner Robert J. Jackson, Jr., we “worry that asking markets *at this moment whether they need less margin* will lead to answers that will make it difficult to protect investors from the next financial crisis.”<sup>19</sup>

We appreciate the opportunity to provide our views on the Proposed Rules. If we can be of any assistance to you on this or any other issue, please do not hesitate to contact me at [REDACTED] or [REDACTED].

Sincerely,



Jeffrey P. Mahoney  
General Counsel

---

<sup>17</sup> Investors Working Group at 11.

<sup>18</sup> S. Rep. No. 111—176, at 33 (Apr. 30, 2010), <https://www.congress.gov/111/crpt/srpt176/CRPT-111srpt176.pdf>.

<sup>19</sup> Commissioner Robert J. Jackson, Statement on Re-Opening Comment Period for Capital/Margin/Segregation for Security-Based Swap Dealers 1 (Oct. 11, 2018) (emphasis added), <https://www.sec.gov/news/public-statement/statement-jackson-101118>.