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November 15, 2018

Mr. Brent Fields
Director, Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, File Number S7-08-12.

Dear Mr. Fields:

We submit these comments on behalf of Federated Investors, Inc.¹ (“Federated”) regarding the Securities and Exchange Commission’s (“SEC”) request for additional comment² on establishing capital, margin and segregation requirements for the newly-regulated non-bank security based swap dealers (“SBSDs”) and non-bank major security based swap participants (“MSBSPs”).³

We support the SEC’s efforts to provide comprehensive oversight of security-based swap industry participants. Importantly, the proposed rules (proposed Rule 18a-3) will require SBSDs and MSBSPs to post, deliver and/or collect sufficient “eligible collateral” in connection with the exposure the parties may have in security-based swap transactions. The proposed rules (proposed Rule 18a-4) will also require SBSDs to segregate customer funds and deposit “qualified securities” on behalf of customers into a Special Reserve Account for the Exclusive Benefit of Customers.

¹ Federated is a Pittsburgh-based financial services holding company and a major sponsor of money market funds regulated under SEC Rule 2a-7 of the Investment Company Act of 1940. Federated money market funds have aggregate assets in excess of \$268 billion. Federated’s money market funds are designed for use by regulated entities where a statute, rule or instrument limits an investment to cash equivalents or high-quality, liquid short-term investments.

² See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, File Number S7-08-12, Proposed Rule, 83 Fed. Reg. 53007 (Oct. 19, 2018).

³ See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, File Number S7-08-12, Proposed Rule (“October 2012 Proposal”), 77 Fed. Reg. 70213 (Oct. 18, 2012).

As detailed below, we strongly recommend that the SEC (1) adopt final rules which permit SBSDs and MSBSPs to utilize U.S. Government Money Market Funds⁴ as “eligible collateral” for purposes of proposed Rule 18a-3, and (2) adopt final rules which permit all types of SBSDs to utilize U.S. Government Money Market Funds as a “qualified security” for purposes of proposed Rule 18a-4. In both instances, the use of U.S. Government Money Market Funds will provide a much needed additional option; provide regulated entities with operational flexibility in meeting their respective obligations under the new rules; avoid the burden of actively management a portfolio of U.S. Treasuries; and allow regulated entities to obtain a more competitive yield on such assets while, at the same time, not compromising the Congressional purpose of ensuring consistency and stability in the security-based swap markets.

The SEC should adopt a definition of “Eligible Collateral” under proposed Rule 18a-3 to include “U.S. Government Money Market Funds.”

Under proposed Rule 18a-3, the SEC proposes to require SBSDs and MSBSPs to collect (and deliver) collateral to cover both current exposure and potential future exposure to the counterparty of a security-based swap transaction. The proposed rule does not identify specific types of instruments that may be utilized for purposes of “eligible collateral.”⁵ However, the October 2012 Proposal presents two alternatives: (1) adopt a definition of eligible collateral similar to those identified, and adopted by, Prudential Regulators⁶ and the U.S. Commodity Futures Trading Commission (“CFTC”); or (2) adopt a definition of eligible collateral to only include cash and U.S. Treasuries.

⁴ The SEC has previously proposed to define a “U.S. Government Money Market Fund” as an unaffiliated money market fund that: (1) is described in Rule 2a-7 of the Investment Company Act of 1940; (2) invests solely in securities issued by the United States or guaranteed by the United States as to interest and principal; (3) agrees to redeem fund shares in cash no later than the business day following a redemption request by a shareholder; and (4) has net assets equal to at least 10 times the value of the shares deposited by the broker-dealer in its customer reserve account. See Amendments to Financial Responsibility Rules for Broker-Dealers, Proposed Rule, (“Financial Stability Proposed Rule”) 72 Fed. Reg. 12861, 12865 (Mar. 19, 2007). U.S. government money market funds are generally made up of cash, U.S. Treasury securities and repurchase agreements collateralized fully by U.S. Treasury securities. As such, U.S. Government Money Market Funds should also hold repurchase transactions of qualified securities, consistent with current practice.

⁵ The reason for not proposing a definition to “eligible collateral”, according to the October 2012 Proposal, is that counterparties are expected to engage in a wide range of trading strategies and permitting various types of securities to count as collateral may be more practical for margin arrangements involving security-based swaps. See October 2012 Proposal, 77 Fed. Reg. at 70264. If the SEC determines to not define “eligible collateral” for purposes of Rule 18a-3, we understand that U.S. Government Money Market Funds, as well as any mutual funds, would be permitted.

⁶ Prudential Regulators include the Board of Governors of the Federal Reserve System (“FB”), the Office of the Comptroller of the Currency (“OCC”), the Federal Deposit Insurance Corporation (“FDIC”), the Farm Credit Administration (“FCA”), and the Federal Housing Finance Agency (“FHFA”). See Section 1(a)(3) of the Commodity Exchange Act (7 U.S.C. 1(a)(39)), and Section 3(a)(74) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(74)).

- **Adopting rules similar to Prudential Regulators and CFTC’s final rules will allow SBSDs and MSBSPs to utilize U.S. Government Money Market Funds.**

The Prudential Regulators and CFTC adopted final rules in November 2015 and January 2016, respectively, to define “eligible collateral,” in relevant part, to include U.S. government money market funds, if the fund’s investment are limited to, among other things, securities that are issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury and immediately-available cash funds denominated in U.S. dollars.⁷

Uniformity and consistency of regulations across a specific industry is important to not only provide proper regulatory oversight, but also to the entities being regulated. Compliance is always burdensome, and having to comply with variant regulation is even more difficult and more costly.⁸ Regulated entities engaged in swaps, who may also engage in security-based swaps, have for the past 3 years developed systems and compliance programs under the Prudential Regulators and the CFTC’s “eligible collateral” rules. To bring uniformity of regulation to the swap and security-based swap markets, we recommend the SEC adopt similar final rules to permit the use of U.S. government money market funds as “eligible collateral.”⁹

⁷ See FRB, OCC, FDIC, FCA, FHFA, Margin and Capital Requirements for Covered Swap Entities, 80 Fed. Reg. 74840 (Nov. 30, 2015) (adopting capital and margin requirements for bank swap dealers, bank SBSDs, bank swap participants, and bank MSBSPs); CFTC, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016) (adopting margin requirements for nonbank swap dealers and nonbank major swap participants). See also 12 CFR 45.6 “Eligible Collateral” (Prudential Regulators) and 17 CFR 23.156 “Forms of Margin” (CFTC).

⁸ As stated by Commissioner Elad L. Roisman, “Other regulators have established comprehensive regulations to govern swaps. The prudential regulators have implemented capital and margin requirements for bank swap dealers, bank security-based swap dealers, bank swap participants, and bank major security-based swap participants. The CFTC has established margin requirements for nonbank swap dealers and nonbank major swap participants, as well as proposed and re-proposed capital requirements for these entities. And, of course, market participants have spent millions of dollars and thousands of hours developing systems and processes to comply with these rules.” <https://www.sec.gov/news/public-statement/statement-roisman-101118> (Statement on Re-Opening the Comment Period).

⁹ The Prudential Regulators and CFTC’s final rules place a restriction on the investment activities of such U.S. government money market funds. Specifically, assets of such funds may not be transferred through securities lending, securities borrowing, repurchase agreements, reverse repurchase agreements, or other means that involve the fund having rights to acquire the same or similar assets from the transferee. If the SEC determines to adopt similar “eligible collateral” rules as that of the Prudential Regulators and the CFTC, we do not recommend including such limitation. Rather, as U.S. government money market funds are generally made up of cash, U.S. Treasury securities and repurchase agreements collateralized fully by such, U.S. Government Money Market Funds under proposed Rule 18a-3 should be permitted to utilize repurchase transactions and other similar type transactions of qualified securities, consistent with current practice.

- **Cash and U.S. Treasuries, as an alternative proposed by the SEC, may not be adequate for addressing the collateral needs of SBSBs and MSBSPs.**

Cash is held on the balance sheet of the bank where the cash deposit exceeds the FDIC level of insurability. Banks are not required to hold the cash separately from the bank's other assets. Therefore, funds become subject to the same risks as any other bank deposit. This is particularly true in the instance of large cash deposits being made that are held at a limited number of major banks. A substantial portion of the cash deposits may only be backed by the balance sheets of these banks rather than FDIC insured. Further banks are either, rejecting, or charging a fee for, large cash deposits. The July 2018 ISDA and SIFMA report on "Initial Margin for Non-Centrally Cleared Derivatives: Issues for 2019 and 2020," referenced this growing problem:

Custodians in the US are reluctant to accept cash for IM (Initial Margin) because they are subject to leverage capital standards that impose restrictions on their ability to accept cash and other low-risk assets that qualify as IM. Since custodial services are generally low-return, fee-based business lines, bank custodians are often unwilling to provide unlimited balance sheet space to accept IM.¹⁰

U.S. Treasuries, by themselves, are also problematic. In the past few years, there has been a continued scarcity of available U.S. Treasuries for financial firms to meet their collateral requirements.¹¹ A leading firm in the areas of treasury management and liquidity, Treasury Strategies, Inc., released a study, "Collateral Scarcity: An Approach to Preventing Market Stress From Becoming Contagion" (the "Study") which examines the actual and potential causes of collateral scarcity and concludes that systemic risks associated with heightened global demand for high-quality collateral can be reduced by permitting financial firms in need of high-quality collateral to access U.S. Government Money Market Funds, a security which is functionally equivalent to U.S. Treasuries.

¹⁰ ISDA and SIFMA, Initial Margin for Non-Centrally Cleared Derivatives: Issues for 2019 and 2020, p. 27, July 2018.

¹¹ See, e.g., "Pressure in Repo Market Spreads," WSJ, Apr. 2, 2015 (discussing the shortage of high-quality bonds and factors contributing towards "the dearth of sought-after securities"); "Banks Retreat From Market That Keeps Cash Flowing," WSJ, Aug. 13, 2014 (same); "Treasury Plans More Short-Term Debt," WSJ, May 6, 2015 ("[The U.S.] Treasury's plans to issue more bills comes as there is a growing scarcity of high-quality, short-term debt instruments"); "Concern About Trading of U.S. Treasuries Prompts Review by Regulators," WSJ, July 12, 2015 (Wall Street firms argue that capital and leverage rules making it more expensive for banks to facilitate bond trades contributed to the Oct. 15 flash crash); "Negative T-Bill Rates Persist as Supply Shortage Seen Worsening," Bloomberg, June 22, 2015 (discussing the mismatch between supply and demand of U.S. Treasury bills); "The \$900 Billion Influx That's Wreaking Havoc in U.S. Bills," Bloomberg, May 10, 2015 (same); "'Once-in-3-Billion-Year' Jump in Bonds Was a Warning Shot, Dimon Says," Bloomberg, Apr. 8, 2015 (JPMorgan Chase & Co. head Jamie Dimon believes last year's volatility in U.S. Treasuries was a "warning sign" and that a future crisis could be worsened because there "is a greatly reduced supply of Treasuries to go around.").

In the October 2012 Proposal, the SEC endorsed the use of U.S. government securities asserting that they were instruments that SBSBs and MSBSPs would be able to liquidate promptly and at current market prices if necessary to cover the obligations of a defaulting counterparty, as U.S. government securities are substantially less susceptible to market stress or rapid market declines than other types of securities and, in fact, may become the investment of choice during a period of market stress as investors seek the relative safety of these securities.¹²

The same is true of U.S. Government Money Market Funds. U.S. Government Money Market Funds are also substantially less susceptible to market stress risk than other types of securities and, in fact, may become the investment of choice during a period of market stress. In August 2014, the SEC concluded its study of money markets and confirmed the stability and soundness of U.S. Government Money Market Funds.¹³ The SEC analyzed the 2008 and 2013 financial crises and concluded that U.S. government money market funds are resilient and function well during financial crises, have virtually no default risk and are highly liquid even during market stress, noting that during times of market stress, e.g., September 2008 financial crisis, U.S. Government Money Market Funds experienced heavy inflows.

The SEC should adopt a definition of “Qualified Security” under proposed Rule 18a-4 to include “U.S. Government Money Market Funds.”

Under proposed Rule 18a-4, the SEC proposes to require all types of SBSBs to segregate security-based swap customer funds and deposit “qualified securities” on behalf of such customers into a Special Reserve Account for the Exclusive Benefit of Customers that reflects the net cash owed to such customers. The segregation and reserve account requirements are modeled after the broker-dealer financial responsibility rules, Rule 15c3-3 under the Securities Exchange Act.

The SEC proposes to define “qualified securities” for purposes of proposed Rule 18a-4 as (1) obligations of the United States; (2) obligations fully guaranteed as to principal and interest by the United States; and (3) general obligations of any State or subdivision of a State that are not traded flat or are not in default, were part of an initial offering of \$500 million or greater, and were issued by an issuer that has published audited financial statements within 120 days of its most recent fiscal year-end.¹⁴

Although we applaud Congress, and the SEC, for recognizing the need to expand the available instruments under “qualified security” for purposes of SBSBs to include

¹² See October 2012 Proposal, 77 Fed. Reg. at 70273.

¹³ See Money Market Fund Reform, Final Rules, (“Money Market Reform”) 79 Fed. Reg. 47736 (Aug. 14, 2014).

¹⁴ See October 2012 Proposal, 77 Fed. Reg. at 70283 (“Rule 15c3-3 currently contains a similar definition of “qualified security,” except the definition does not include municipal securities.”)

municipal securities, other additional forms of collateral are necessary.¹⁵ Needlessly limiting instruments to be utilized by SBSBs under financial responsibility requirements will create pressure on regulated entities in search of those limit instruments to buy and sell on a continuous basis in their Reserve Accounts.

We recommend the SEC adopt a definition of “qualified securities” for purposes of proposed Rule 18a-4 to include U.S. Government Money Market Funds.¹⁶ As discussed above, the SEC has conducted extensive study of such funds and has concluded that they are resilient and function well during financial crises¹⁷ and also provide less-burdensome, operational flexibility.¹⁸ Indeed, in 2007 (and re-opened for comment in 2012), the SEC proposed to adopt rules to expand the definition of “qualified securities” under Rule 15c3-3, proclaiming, “We [the SEC] believe expanding the definition to include money market funds that only invest in securities meeting the definition of “qualified securities” in Rule 15c3-3 would be appropriate.”¹⁹

The SEC’s counterpart, the CFTC, has for many years permitted the use of U.S. Government Money Market Funds under the CFTC’s customer segregation rules for Futures Commission Merchants (“FCMs”).²⁰ The CFTC has also analyzed U.S. Government Money Market Funds, in its final rule release, Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions, 76 Fed. Reg. 78776 (Dec. 19, 2011) and concluded that U.S. government money market mutual funds are an important and appropriate investment vehicle for customer segregated funds. The important factors relied upon by the CFTC in its review of the role of U.S. government money market mutual funds in the customer fund

¹⁵ Pursuant to 15 U.S.C. Sec. 78c-5(d), the Congress included municipal securities as a permitted investment, as well as authorized the SEC to include “any other investment that the Commission may by rule or regulation prescribe.”

¹⁶ As referenced in Footnotes 4 and 9, U.S. government money market funds are generally made up of cash, U.S. Treasury securities and repurchase agreements collateralized fully by U.S. Treasury securities. U.S. Government Money Market Funds under proposed Rule 18a-4 should be permitted to utilize repurchase transactions of qualified securities, consistent with current practice.

¹⁷ See Money Market Reform, 79 Fed. Reg. 47736 (Aug. 14, 2014).

¹⁸ See Financial Stability Proposed Rule, 72 Fed. Reg. at 12865.

¹⁹ Financial Stability Proposed Rule, 72 Fed. Reg. at 12865. The SEC further stated, “The assets held by such a money market fund would be same as those a broker-dealer can hold directly in its customer reserve account. Consequently, a broker-dealer might choose to deposit qualifying money market fund shares into the customer reserve account based on operational considerations such as avoiding the need to actively manage a portfolio of U.S. Treasury securities. This operational benefit also could decrease burdens on ... broker-dealers.... A broker-dealer that deposits cash into the customer reserve account to avoid the operational aspects of holding and managing U.S. Treasury securities would have the option of depositing a qualifying money market fund to replace the cash deposit.”

²⁰ See “Permitted Investments,” 17 CFR 1.25, which is analogous to proposed Rule 18a-4 (for SBSBs) and Rule 15c3-3 (for BDs).

segregation process included the safety provided by enhanced SEC Rule 2a-7, the operational and administrative efficiency of U.S. government money market funds, as well as their market equivalency to U.S. Treasury portfolios.²¹ In fact, the CFTC found that the indirect investment in Treasuries via a Treasury-only money market mutual fund “is essentially the risk equivalent of a direct investment” in Treasuries.²²

Furthermore, the financial industry as well as state and federal governmental authorities universally accept U.S. Government Money Market Funds as the functional equivalent to cash and have promulgated guidance, rules and regulations to explicitly treat U.S. Government Money Market Funds the same as U.S. Treasuries and cash.²³

The SEC should adopt the currently pending financial responsibility rule amendment to include U.S. Government Money Market Funds as a “qualified security” for purposes of Rule 15c3-3’s reserve requirements.

As various sections of Rule 15c3-3 will be amended in connection with the inclusion of the SBSB regulatory framework, the SEC should also adopt the currently pending rule proposal to amend Rule 15c3-3 to include U.S. Government Money Market Funds as a “qualified security” for purposes of Rule 15c3-3’s reserve requirements.

The Commission issued this proposed amendment for inclusion of U.S. Government Money Market Funds as “qualified securities” for public comment twice (in March 2007 and again in July 2012), and received comments of unanimous support from the industry which were summarized and presented to the Commission in an August 2013 open meeting. In the interim time period, broker-dealers have also, through calls to the SEC Division of Trading and Markets, individually expressed their need for the use of U.S. Government Money Market Funds. Moreover, in numerous conversations on the proposed amendment, the SEC Division of Trading and Markets has not raised any substantive concerns with regard to the purpose, structure or language of this pending Rule 15c3-3 amendment.²⁴

²¹ See Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions (“Investment of Customer Funds”), 76 Fed. Reg. 78776 (Dec. 19, 2011).

²² See Investment of Customer Funds, 76 Fed. Reg. at 78796.

²³ See, e.g., Willkie Farr & Gallagher, 2000 SEC No-Act. LEXIS 916 (Oct. 23, 2000) (stating that “money market fund shares generally are equivalent to cash items”); Federal Reserve System - Title 12: Banks and Banking, Part 220, Credit by Brokers and Dealers (Regulation T), 12 C.F.R. § 220.2. (“Cash equivalent means securities issued or guaranteed by the United States or its agencies, ..., or money market mutual funds.”); FASB Accounting Standards Codification, Cash Equivalents, 305-10-20 (“Cash equivalents are short-term, highly liquid investments that have both of the following characteristics: (a) readily convertible to known amounts of cash; (b) So near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Examples of items commonly considered to be cash equivalents are Treasury bills, commercial paper, money market funds,...”).

²⁴ In fact, the SEC, by order, currently permits the NCSS to invest undeployed customer funds held in a segregated account into money market mutual funds. The NCSS segregated account is the functional equivalent of a Rule 15c3-3 Reserve Account. See Self-Regulatory Organizations; The Depository Trust

Nevertheless, the Commission “deferred” the adoption of the proposed amendment until after the then-pending amendments to money market funds were adopted by the Commission.²⁵ In August 2014, the Commission concluded its review of money market funds with the adoption of money market fund reform amendments. In the adopting release, the Commission provided careful analysis of U.S. government money market funds and confirmed their stability and strength.²⁶ The pending public proposal to amend Rule 15c3-3 to include U.S. Government Money Market Funds should be adopted as part of the Rule 15c3-3 amendments being finalized with regard to SBSBs.

Conclusion

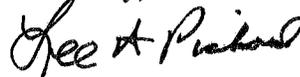
For the reasons noted above, we respectfully submit that the SEC should

- (1) adopt a definition of “Eligible Collateral” under proposed Rule 18a-3 which includes “U.S. Government Money Market Funds”;
- (2) adopt a definition of “Qualified Security” under proposed Rule 18a-4 which includes “U.S. Government Money Market Funds”; and
- (3) adopt the currently pending proposed amended definition of “Qualified Security” under Rule 15c3-3 to include “U.S. Government Money Market Funds.”

* * * * *

If you have any questions, please call Lee A. Pickard or Peter E. McLeod at [REDACTED]. On behalf of Federated Investors, Inc., we appreciate your consideration of our comments.

Sincerely,



Lee A. Pickard

cc: Mr. Eugene F. Maloney, Executive Vice President, Federated Investors, Inc.

Company; Fixed Income Clearing Corporation; National Securities Clearing Corporation; Notice of Filing of Amendments No. 1 and Order Granting Accelerated Approval of Proposed Rule Changes, as Modified by Amendments No. 1, Relating to Clearing Agency Investment Policy, Release No. 34-79528; File Nos. SR-DTC-2016-007; SR-FICC-2016-005; SR-NSCC-2016-003, December 12, 2016.

²⁵ See Financial Responsibility Rules for Broker-Dealers, Final Rule, 78 Fed. Reg. 51824, 51843-44 (Aug. 21, 2013).

²⁶ See Money Market Fund Reform, Final Rules, 79 Fed. Reg. 47736 (Aug. 14, 2014).