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By Electronic Mail – rule-comments@sec.gov

November 19, 2018

Mr. Brent J. Fields
Secretary of the Commission
Securities and Exchange Commission
100 F Street, NE
Washington DC 20549

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; RIN 3235-AL12

Dear Mr. Fields:

The Futures Industry Association ("**FIA**") welcomes the decision of the Securities and Exchange Commission ("**Commission**" or "**SEC**") to re-open the comment period for, and request additional comment on, the Commission's proposed amendments and rules that would, *inter alia*: (i) establish capital and margin requirements for security-based swap dealers ("**SBSDs**") and major security-based swap participants ("**MSBSPs**") that do not have a prudential regulator; (ii) establish segregation requirements for SBSDs; (iii) establish notification requirements relating to segregation for SBSDs and MSBSPs; and (iv) raise minimum net capital requirements and establish liquidity requirements for broker-dealers permitted to use internal models when computing net capital.[1]

FIA and its Members

FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington, DC. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry.

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[1] *Capital, Margin and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker Dealers*, 83 Fed. Reg. 53007 (Oct. 19, 2018) (the "**2018 Reproposal**"). The proposed amendments and rules were originally published for comment in November 2012. 77 Fed. Reg. 70214 (Nov. 23, 2012) (the "**2012 Proposal**").

FIA's core constituency consists of firms that operate as clearing members in global derivatives markets, including firms registered with the Commodity Futures Trading Commission ("**CFTC**") as futures commission merchants ("**FCMs**"). The majority of these FCMs, including the 25 largest FCMs measured by adjusted net capital, are also registered as broker-dealers with the SEC ("**BD/FCMs**").[2] Currently, all clearing of single-named credit default swaps, which are a type of security-based swap ("**SBS**"), for US customers is facilitated by our members who have built systems, account structures and risk management programs in order to provide clients with access to cleared markets, as described in more detail below.

We expect that these same entities will continue to play a central role in providing access to the cleared SBS markets, and, therefore, they have a keen interest in the results of this proposed rulemaking. We further welcome the Commission's recognition in the 2018 Reproposal that client clearing of SBS may be conducted by BDs rather than entities that register as SBSDs.

Portfolio Margining is Critical to FIA's Members and the Cleared CDS Markets

Our comments focus on issues arising from the Commission's consideration of portfolio margining programs and segregation for security-based swaps and swaps.[3] FIA applauds the Commission for coordinating with the CFTC to facilitate the growth of the cleared SBS market by authorizing portfolio margining of cleared SBS and swaps that are Credit Default Swaps under the terms and conditions of the Commission's *Order Granting Conditional Exemptions under the Securities Exchange Act of 1934 in Connection with Portfolio Margining of Swaps and Security-Based Swaps* ("**Order**")*.*[4] Pursuant to the Order, BD/FCMs that are clearing members of ICE Clear Credit, an SEC-registered clearing agency and CFTC-registered derivatives clearing organization ("**DCO**"), have been offering portfolio margining in a cleared swaps customer account to their customers since 2013. Such BD/FCMs and their customers, as appropriate, have expended significant resources, in both time and expense, to modify their systems, establish policies and procedures, and to put in place documentation required to meet the terms and conditions of the Order. It is essential, therefore, that, in the event the SEC elects to authorize additional portfolio margining programs, these additional

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[2] Source: Financial Data for FCMs (https://www.cftc.gov/MarketReports/financialfcmdata/index.htm). Only five firms that are dually-registered BD/FCMs are also registered with the CFTC as swap dealers.

[3] FIA understands that the Securities Industry and Financial Markets Association ("**SIFMA**") has submitted a detailed response to the instant *Federal Register* release on behalf of SBSDs and BDs.

[4] 77 Fed. Reg. 75211 (Dec. 19, 2012). FIA has consistently supported the adoption of procedures to permit, in appropriate circumstances, both non-futures positions and related property to be held in the customer segregated account and futures positions and related property deposited on behalf of qualified customers to be held in a securities account. Letter from John M. Damgard, President, FIA, to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC, dated September 14, 2009; letter from Barbara Wierzynski, Executive Vice President and General Counsel, FIA, to Jonathan G. Katz, Secretary to the SEC, dated March 2, 2005.

programs do not displace or disrupt the existing market infrastructure on which customers have come to rely.

As the SEC notes, "[p]ortfolio margining of security-based swaps, swaps and related positions can offer benefits to investors and the markets, including aligning margin requirements more closely with the overall risk of a customer's portfolio. Further, portfolio margining may help improve cash flows and liquidity, and reduce volatility."[5] In recognition of these benefits, the SEC, in December 2012, adopted the Order authorizing (i) a registered clearing agency that is also a CFTC-registered DCO and (ii) a BD/FCM that is a clearing member of such clearing agency/DCO to commingle and portfolio margin in a cleared swaps customer account under section 4d(f) of the Commodity Exchange Act ("**CEA**") cleared credit default swaps ("**CDS**") that are security-based swaps and CDS that are swaps, subject to the terms and conditions set out in the Order.[6]

Among other terms and conditions, the SEC required a BD/FCM offering its customers portfolio margining to obtain approval of its own proprietary margin methodology and internal risk model.

By order dated January 14, 2013, the CFTC took parallel action, authorizing ICE Clear Credit LLC and its clearing members that are also FCMs to commingle and portfolio margin in a cleared swaps customer account CDS that swaps and CDS that are security-based swaps. Later that year, the CFTC, pursuant to its authority under CEA section 20(c), adopted amendments to Part 190 of its rules governing commodity broker liquidations to clarify that securities, including security-based swaps, held in a cleared swaps customer account that is a portfolio margining account constitute "customer property", subject to the protections of the Bankruptcy Code and Part 190.[7]

The SEC Should Adopt a Harmonized Approach to Margin Methodologies that Defers to Standard Models by Clearing Agencies/DCOs

FIA believes that the terms and conditions of the Order are generally appropriate. However, FIA encourages the SEC to reconsider the requirement that a BD/FCM that wishes to offer portfolio margining obtain approval of its own proprietary margin methodology and internal risk model from the SEC or the staff and adopt, instead, a harmonized approach that defers more fully to the margin methodologies adopted by the relevant clearing agency/DCO. Clearing agency/DCO models, which are subject to review and approval by the SEC and the

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5 83 Fed. Reg. at 53014 (Oct. 19, 2018)

6 *Order Granting Conditional Exemptions under the Securities Exchange Act of 1934 in Connection with Portfolio Margining of Swaps and Security-Based Swaps*¸ 77 Fed. Reg. 75211 (Dec. 19, 2012).

7 *Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy*, 78 Fed. Reg. 66621 (Nov. 6, 2013).

CFTC, provide transparency, predictability and a sound baseline of models for all market participants.[8]

Requiring BD/FCMs to develop margin methodologies and to obtain regulatory approval for individually developed models has the effect of erecting barriers to entry for BD/FCMs that might otherwise offer to clear security-based swaps. BD/FCMs report that it is difficult not only to obtain approval for models but also to manage the models once approved. These challenges have discouraged some BD/FCMs from offering clearing services for security-based swaps, which both concentrates risk among fewer clearing members and limits liquidity and risk mitigation opportunities for customers.[9]

Individually developed and managed margin methodologies that are specific to each BD/FCM also pose operational challenges that would make it more difficult to port customer positions to another clearing member in the event of a BD/FCM insolvency. With custom margin models, clearing members may have to call for additional margin from a defaulting BD/FCM's customers to meet the requirements of their own models. An approved standardized model, by contrast, would tend to eliminate potential discrepancies and streamline customer porting. Bespoke margin methodologies also create significant tracking and risk management challenges for customers, especially those customers that, as a risk management best practice, elect to clear through multiple BD/FCMs. For these reasons, we urge the SEC to adopt a harmonized approach to margin methodologies that defers to standard models by Clearing Agencies/DCOs.

The SEC Should Amend Rule 15c3-3 to Parallel Proposed Rule 18a-4 in respect of Cleared SBS

The original 2012 Proposal would impose a new customer protection and segregation regime on SBSDs that facilitate client clearing in security-based swaps through Proposed Rule 18a-4, modelled on the Commission's existing Rule 15c3-3. FIA notes that customer positions in SBS may only be cleared by an entity that is registered as a BD, which entity may not also be registered as a SBSD. Accordingly, to the extent that the Commission imposes any customer protection obligations on a BD with respect security-based swaps, FIA agrees that such obligations should be integrated within Rule 15c3-3, rather than imposed through a parallel regime in Proposed Rule 18a-4. Consistent with that approach, FIA also supports an express recognition in 15c3-3 of margin posted by a BD to a clearing agency. FIA further urges the Commission to work with market participants on any technical issues that may arise from the application of Rule 15c3-3 and Proposed Rule 18a-4 segregation, possession and control, and

[8] We believe any concern that a clearing agency/DCO, for competitive reasons, might adopt a margin level that does not properly account for the risks of the positions being cleared is misplaced. In the unlikely event a clearing agency/DCO were inclined to do so, the clearing agency/DCO's clearing members would not permit it, since their default fund contributions would be at risk.

[9] A BD/FCM, of course, may require its customers to deposit additional margin above that required by a clearing agency/DCO, if the BD/FCM believes it appropriate for risk management purposes.

customer reserve account calculation requirements to the cleared derivatives markets to ensure that Rule 15c3-3, as revised, and Proposed Rule 18a-4 support the proper functioning of cleared markets and appropriately recognize the BD's role as market intermediary.

The SEC and CFTC Should Coordinate More Closely on Harmonized Capital Requirements with Respect to Security-Based Swaps and Swaps

FIA appreciates the efforts that the SEC and the CFTC have made over the years to coordinate and harmonize their respective capital requirements governing BDs[10] and FCMs.[11] It is disappointing, therefore, that the SEC's proposed capital charges with respect to security-based swaps do not appear to reflect the same level of coordination. In the limited comment period, we have not had an opportunity to identify and fully analyze the implications of the proposed amendments to SEC Rule 15c3-1 on BD/FCMs that provide, or may wish to provide, clearing services to customers trading security-based swaps and swaps. However, in the absence of a cost-benefit analysis, we are concerned that certain amendments may unnecessarily impair the ability of BD/FCMs to provide clearing services.

Examples of proposed amendments of particular concern include: (i) the proposal to incorporate a new "margin difference" deduction from net worth for clearing customer transactions involving both security-based swaps and swaps;[12] (ii) the proposal to modify the minimum net capital standard of two (2) percent of aggregate debits to include eight (8) percent of the "risk margin amount", as defined;[13] and (iii) the proposal to remove the ability of an Alternative Net Capital BD/FCM to calculate credit risk charges for all counterparties executing security-based swaps other than commercial end users.[14]

We look forward to the opportunity to address these and, perhaps, other capital rules with the SEC in greater detail. In any event, before taking any action on these proposed rules, we encourage the SEC to coordinate with the CFTC and, as appropriate, the prudential regulators to assure that their respective capital rules are harmonized to the extent practicable and do not have the unintentional effect of unnecessarily impairing the ability of BD/FCMs to provide clearing services for security-based swaps and swaps.

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10 17 CFR § 240.15c3-1.

11 17 CFR § 1.17.

12 Proposed Rule 15c3-1(c)(2)(xiv)(A).

13 Proposed Rules 15c3-1(a)(7)(i), 15c3-1(c)(17).

14 Proposed Rule 15c3-1e(a), (c).

FIA appreciates the opportunity to submit these comments for the Commission's consideration. If members of the Commission or its staff have any questions or need any additional information regarding the matters discussed herein, please contact Allison P. Lurton, FIA's Senior Vice President and General Counsel at [redacted]; [redacted].

Sincerely,

Walt L. Lukken
President and Chief Executive Office

cc: Honorable Jay Clayton, Chairman
Honorable Kara M. Stein, Commissioner
Honorable Robert J. Jackson Jr., Commissioner
Honorable Hester M. Peirce, Commissioner
Honorable Elad L. Roisman, Commissioner