OneChicago

Via Electronic Submission

November 19, 2018

Mr. Brent Fields
Secretary
Securities and Exchange Commission
100 F St. NE
Washington, D.C. 20549

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

Dear Mr. Fields:

OneChicago, LLC ("OneChicago") appreciates the opportunity to comment on the Securities and Exchange Commission's ("SEC's" or the "Commission's") proposed rules for Capital, Margin and Segregation Requirements for Security-Based Swap Dealers ("SBSDs") and Major Security-Based Swap Participants ("MSBSPs") and Capital Requirements for Broker-Dealers.

OneChicago is a Designated Contract Market ("DCM") under the Commodity Futures Trading Commission ("CFTC") and a notice registered national securities exchange under the SEC. The SEC and the CFTC jointly regulate security futures trading. OneChicago lists Single Stock Futures ("SSFs") which are security futures on single stocks and narrow based indexes. SSFs are a Delta One derivative, meaning that they have no optionality and their price moves step for step with the price of the underlying security. This makes them economically equivalent to Over the Counter ("OTC") equity swaps such as Total Return Swaps and Master Securities Lending Agreements which are also Delta One derivatives. Delta One derivatives are equity finance derivatives, used to obtain synthetic exposure to equities at lower overall finance costs.[1]

OneChicago believes that the Commission's proposal fails to adequately incentivize central clearing. In addition to the comments made in our February 19, 2013 letter, OneChicago would like to raise the following issues.

[1]For a detailed explanation of how SSFs are equivalent to OTC swaps, please see OneChicago's comment letter to the CFTC on position limits for security futures:
https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61824

Cleared swaps vs uncleared swaps

OneChicago believes that there is an important principle which the SEC has failed to take into account in its proposed rulemaking. Namely that margin and capital requirements for cleared swaps should be lower than margins for uncleared swaps. Cleared derivatives have lower levels of systemic risk than uncleared derivatives because central clearing eliminates counterparty risk and provide the surety of daily central counterparty valuations. As the Commission knows, Title VII of Dodd Frank required nonexempt swaps to be cleared and exchange-traded. This statutory requirement recognizes the diminished risk in a cleared environment; therefore, the Commission should give cleared derivatives more favorable capital and margin treatment than uncleared derivatives. The Financial Stability Board ("FSB") recognized this principle in their Fifth report on OTC Derivative Market Reform:

> Robust and globally adopted minimum capital and margin requirements for non-centrally cleared derivatives help increase the resilience of market participants and the broader financial system. Higher requirements for non-centrally cleared derivatives than those for centrally cleared derivatives reflect the additional protections to participants and markets afforded by CCPs.[2]

When there are higher margins for cleared derivatives, it impedes the movement of transactions from OTC markets to exchange traded and centrally cleared markets. This is especially true for financing transactions as any added cost makes equivalent derivatives that do not carry the cost burden more attractive. A 2018 study by FSB identified margin requirements for cleared derivatives as the largest disincentive to centrally clear.[3] When finalizing its capital and margin regulations for OTC swaps, the Commission should ensure its capital and margin levels reflect the reduced risk in cleared derivatives.

Capital Charge for Cleared Swaps

The Commission is proposing to assess a capital charge to firms in cases where cleared swap margins are lower than the uncleared swap margin. OneChicago does not understand this. The risk-based models used to calculate cleared swap margin will adequately assess risk and determine the appropriate margin. Requiring firms to further demonstrate their financial strength by holding an additional arbitrary percentage of capital does not reduce systemic risk but instead removes the incentive to centrally clear and reduces liquidity in financial markets. A lower margin level in cleared swaps should not be viewed as a deficiency of clearing models but as an advantage of central clearing. When the Commission claims that the purpose of this capital charge is to "account for the risk of the counterparty defaulting", they are ignoring the main tenant of central clearing. Central clearing inherently accounts for the risk of counterparty default through novation and by

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[2] Financial Stability Board. "OTC Derivatives Market Reforms: Fifth Progress Report on Implementation". April 15, 2013. Page 43 http://www.fsb.org/wp-content/uploads/r_130415.pdf?page_moved=1

[3] Financial Stability Board. "Incentives to centrally clear over-the counter (OTC) derivatives: A post-implementation evaluation of the effects of the G20 financial regulatory reforms". August 7, 2018. Page 25 http://www.fsb.org/wp-content/uploads/P070818.pdf

making both sides of the trade post initial margin and be subject to the discipline of marked to market pay/collects. The Commission should incentive cleared transactions.

Having a capital charge will only incentivize nonbank SBSD to continue trading in uncleared environments and not support cleared swaps for their clients. Providing a threshold below which the capital charge does not apply does not remedy this problem. The capital charge should be eliminated completely.

Minimum Margin Threshold for Uncleared Swaps

The Commission's request for comment indicates that they are considering establishing a minimum threshold below which margin need not be collected. While OneChicago applauds the Commission's recognition that fixed thresholds do not adequately assess risk, OneChicago opposes establishing a minimum threshold. There are two reasons for this. First, there is no minimum threshold in cleared marketplaces. Placing a threshold in uncleared markets provides incentives for market participants to remain in uncleared markets. This runs contrary to the Commission's Dodd-Frank mandates and FSB guidance. Second, this proposal would increase systemic risk. Unlike a centrally cleared environment, by spreading their exposure across multiple counterparties, a nonbank SBSD could hold a large position without being required to post margin, gaining an advantage. The Commission should incentivize central clearing, instead of encouraging firms to game the system.

Disparate Treatment for Equity Security-Based Swaps

The Commission's proposal continues to prohibit the application of risk-based margin to equity security based swaps while other security based swaps can enjoy risk-based margins. OneChicago further notes that the Commission allows equity Delta One agreements (using the name Master Securities Lending Agreements), clearing at the Options Clearing Corporation in the general risk pool, to be margined at risk-based levels, while other Delta One agreements remain at strategy based levels. This disparate treatment of equivalent Delta One derivatives appears arbitrary and capricious. The Commission appears to be deliberately picking winners and losers. The Commission should treat all Delta One derivatives equivalently, only treating cleared derivatives and uncleared derivatives differently.

Portfolio Margining for Swaps

The Commission requested comment on under what circumstances swaps should be permitted to be portfolio margined. OneChicago believes that the Commission should allow uncleared swaps to be portfolio margined only if segregated with other uncleared derivatives and allow cleared swaps to be portfolio margined with other cleared derivatives regardless of the registration of the carrying firm. No matter what type of account, and no matter what type of dealer is holding the swap, there is no need to collect margin above the aggregate risk level in uncleared and cleared derivatives in the customer's account. This is true not just for security based swaps, but for all types of derivatives.

Conclusion

As currently proposed, the Commission's proposal would not incentivize central clearing. The Commission treats Delta One swaps, Delta One agreements, and Delta One SSFs all in different and contradictory ways. To properly fulfill its Dodd Frank mandate and adhere to FSB guidance the Commission should align its regulations so that only one difference matters. Treat equivalent uncleared derivatives one way and treat cleared derivatives in a different way which recognizes the benefits of central clearing.

OneChicago thanks the SEC for the opportunity to comment on this subject. We would be happy to discuss any related issues with SEC staff. If you have any questions, please do not hesitate to contact me at ([redacted] or via email at [redacted]

Sincerely,

Thomas G. McCabe

Thomas G. McCabe
Chief Regulatory Officer