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Financial Security...for Life.

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November 19, 2018

Brent Fields, Secretary
Securities and Exchange Commission
100 F Street
Washington, DC 20549

Re: Proposed Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers Proposed Rule (Release No. 34- 84409; File No. S7–08–12)

Dear Mr. Fields:

The SEC recently invited continuing comment on proposed capital, margin and segregation requirements for security-based swap dealers and major swap participants.[1] The initiative appeared in the Federal Register on October 19, 2018 and established a comment deadline expiring on November 19, 2018. The proposals will directly impact life insurers' management of asset and liability risks that are hedged with derivatives.

These detailed and significant initiatives merit careful analysis that has been challenging to fully execute within the short 30-day comment period. A full reproposal of the rule or an extended comment period would be significantly more appropriate and will generate more valuable and informed input, as the Administrative Procedure Act intends. Nonetheless, we offer preliminary input below reflecting the constrains of an abbreviated comment period.

I. Background

Life insurers actively participated in the legislative dialogue concerning regulation of derivatives markets and have provided constructive input on numerous proposed rulemakings implementing Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). ACLI has addressed parallel regulatory initiatives by US prudential regulators, the CFTC, and international regulatory bodies on margin, collateral and segregation. ACLI offered substantive input on the SEC's original 2012 proposal.[2] We are, therefore, very interested in fully commenting on the SEC's treatment of directly analogous issues by market participants.[3]

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[1] https://www.gpo.gov/fdsys/pkg/FR-2018-10-19/pdf/2018-22531.pdf (Oct. 19, 2018).
[2] *See* ACLI submission at https://www.sec.gov/comments/s7-08-12/s70812-10.pdf (Jan 11, 2013).
[3] *See, e.g.* ACLI submissions on:

- Supplemental Request for Comments on Proposed Margin and Capital Requirements for Covered Swap Entities ; [http://www.fhfa.gov/webfiles/24691/95_American%20Council%20of%20Life%20Insurers%20ACLI.pdf] [five prudential regulators];

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ACLI promptly circulated the SEC's initiative to its membership and convened three meetings of our Derivatives Policy Working Group. This process ensures broad, consensus-based policy development and provides valuable substantive feedback. It is, however, meticulous and time consuming.

The important task of identifying and thoroughly analyzing the full implications of the initiative requires concentrated analytical resources. We will continue to evaluate the regulatory, structural and financial implications of the proposals for life insurers. Moreover, each of these considerations must be analyzed against unique fact patterns, business models, and organizational structures.

Industry groups like our trade association circulate regulatory proposals, elicit membership input, develop a consensus, and circulate draft letters of comment before submission. This worthwhile, but time intensive, process is difficult to execute in a 30-day comment period, particularly given the proposals' significance and complexity.

The special time burdens confronting regulated industries and large organizations in digesting regulatory proposals were explicitly recognized by the Administrative Conference of the United States in its publication entitled *A Guide to Federal Agency Rulemaking*[4] ("*Guide*"), which notes that:

> [i]nterested persons often are large organizations, which may need time to coordinate an organizational response, or to authorize expenditure of funds to do the research needed to produce informed comments.[5]

The *Guide* reviews the legislative history of the Administrative Procedure Act and emphasizes that the notice of proposed rulemaking "must be sufficient to fairly apprise interested parties of the issues involved, so that they may present responsive data or argument." [6] The *Guide* further explains that rules developed through notice and comment procedures must be rational, and that notice and opportunity for comment under §553 of the APA should properly "give interested persons a chance to submit available information to an agency to enhance the agency's knowledge of the subject matter of the rulemaking."[7]

The *Guide* also points out that "informal rulemaking procedures should provide interested persons an opportunity to challenge the factual assumptions on which the agency is proceeding and to show in

- Supplemental Request for Comments on Proposed Margin Requirements Governing Uncleared swap Transactions for Swap Dealers and Major Swap Participants [http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58806&SearchText=wilkerson] [CFTC];
- CFTC Proposal on Protection of Cleared Swaps Customer Contracts and Collateral [http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48045&SearchText=wilkerson] [CFTC]

[4] *See, A Guide to Federal Agency Rulemaking* (1983) at 124. The American Bar Association updated and republished this *Guide* in 1998. *See* Lubbers, *A Guide to Federal Agency Rulemaking*, Third Edition (1998), American Bar Association, Government and Public Lawyers Division and Section of Administrative Law and Regulatory Practice. Subsequent citations to the Guide are to the updated and revised ABA publication.

[5] *See* Guide at 196.

[6] Administrative Procedure Act: Legislative History, S. Doc. No.24879-258 (1946) [hereinafter legislative history of the APA].

[7] *See* Guide at 197.

what respect such assumptions are erroneous."[8] Our request for a new reproposal or at least an extended comment period comports with these goals.

II. Need for a Reproposed Rule or an Extended Comment Period

Unlike some other commentators, ACLI's submission will reflect the views of over 290 life insurance companies representing 95% of the life insurance and annuities business. Our consensus-based position, therefore, will provide substantial, broad input for the SEC on this initiative. By the same token, however, the process of achieving consensus is more time consuming for a large organization representing diverse interests.[9]

The proposal's 30-day comment period occurs as businesses face peak of year-end business responsibilities and over a Federal holiday. The complex 2018 release raises 74 specific questions and contains 69 substantive footnotes. The initiative is profound, and merits thorough analysis and constructive input.

In responsibly formulating comment, our members have held three meetings to digest the initiative. This high-level conceptual review of all the proposal's features is essential, time consuming, and fundamental to any rulemaking review. Many of the specific requests for comment present valuable queries requiring substantial analytical or conceptual effort.

We would appreciate the reasonable opportunity to review and respond to the important, requirements and practical realities of the initiative. A reproposed rule or an extended comment period would enable scrutiny and input in response to these matters.

A reproposed rule or an extended comment period is also justified because the SEC's proposal follows numerous other similar regulatory actions taken by US prudential regulators, the CFTC, and international derivatives regulators. The outcomes of these parallel regulatory initiatives have changed significantly since the original 2012 SEC proposal.

Detailed analysis of the other regulatory proposals within the context of the SEC's supplemental request for comment will demand careful and time-consuming scrutiny that is difficult to responsibly execute in 30 days. Informed regulatory treatment of similar issues among all regulators will ensure harmonized regulatory standards and prevent regulatory arbitrage. It makes sense, therefore, to publish a reproposed rule or elongate the SEC's comment period for these reasons.

In addition to evaluating the initiative's substance, several other significant statutory, procedural and cost considerations merit careful analysis, such as:

- The proposal's cost-benefit analysis;
- Effects of the proposal on competition, efficiency and capital formation.
- Paperwork Reduction Act considerations; and,
- Regulatory Flexibility Act analysis.

[8] *Id* at 182 and 196.
[9] This sentiment is drawn directly from the Guide text cited in footnote 3 *supra*.

Observations on Reproposing the Initiative or Extending the Comment Period

Neither the APA[10] nor the SEC's rules of conduct establish a "standard" period of comment on rulemakings. Rather, the goal of robust public comment on administrative rulemakings is best served by selecting a time period based on the unique factors and complexity of the individual initiative, and not "routine" practices. Some proposals should properly have longer comment periods than others.

In this instance, an extended comment period of 60-90 days will promote the most informed feedback given the size and diversity of ACLI's membership, as well as the profound complexity and importance of the issues under examination. The depth and quality of comment are higher priorities than the speed of completing the project. There are no apparent emergencies warranting a profoundly short comment period, particularly with a complex rulemaking.

ACLI has actively and constructively participated in numerous SEC rulemaking initiatives over many years. We will likewise devote substantial resources and time in developing policy positions and providing useful feedback. Our consensus-based process is neither dilatory nor obstructionist. Our request for a reproposed rule or a comment extension will allow the most useful feedback on this significant initiative.

We fully understand the SEC's obligation to implement rules fulfilling the Dodd-Frank Act. While it is important to implement Dodd-Frank Act rules, it is equally important to execute rulemaking within a deliberative process allowing proper identification of issues and development of recommended solutions.

III. The Regulation and Use of Derivatives by Life Insurers

A brief explanation on the regulation and use of derivatives by life insurers provides useful context for our comments below. Life insurers' financial products protect millions of individuals, families and businesses through guaranteed lifetime income, life insurance, long-term care insurance and disability income insurance, among other products. These products provide consumers with financial security through various stages of life and enable them to plan for their financial future, including retirement. Accordingly, many life insurer obligations to policyholders, as well as the assets that are purchased to support those liabilities, have durations that extend for one or more decades. Life insurers prudently manage asset and liability risks associated with their financial products with derivatives.

Life insurers' use of derivatives is strictly limited and subject to comprehensive state insurance regulation.[11] Consistent with such regulations and the needs of their business and contract holders,

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[10] *See* Guide at 196.

[11] For example, state insurance regulation precludes life insurers from taking the speculative side of a derivatives transaction, and limits life insurers to hedging and replication transactions. Unlike other financial service institutions, life insurers typically are fully collateralized. To provide further context on the state regulation of insurers' derivatives activities, we attach as Appendix A an outline of the National Association of Insurance Commissioners' ("NAIC") Investments of Insurers Model Act which shows the breadth and depth of regulatory oversight of derivatives transactions. The NAIC's Financial Regulation Standards and Accreditation Program requires adoption of legislation that is substantially similar to the Investments of Insurers Model Act. *See* NAIC 2012 Statement on Existing U.S. Corporate Governance Requirements at 8, Section C [http://www.naic.org/documents/committees_ex_isftf_ccrp_governance_111222_existing_us_ccrp_gov_reqs.pdf]. The outline in Appendix A also

life insurers predominantly use derivatives for hedging transactions to reduce risks associated with existing or anticipated assets or liabilities. Such risks include the risk of changes in value, yield, price, cash flow or quantity of assets or liabilities as well as foreign currency exchange risk. In order to mitigate such risks, life insurers participate in both the exchange-traded futures and options markets and over-the-counter ("OTC"), bilaterally negotiated markets.

Life insurers are among the financial end users that will be subject to mandatory clearing requirements and margin requirements for non-cleared swaps under the Dodd-Frank Act. For most of insurers' existing OTC transactions, no initial margin or independent amount is required and variation margin is exchanged on a daily basis.[12] Furthermore, in response to the financial crisis, many life insurers renegotiated their OTC agreements to reduce or eliminate thresholds for posting collateral. As a result, their derivatives exposures are generally fully collateralized with the exception of one day market value movements. Very simply, life insurers are financial end users of derivatives that pose minimal risk to the financial markets – their trades are risk reducing in nature and almost fully collateralized.

Life insurers appreciate that the Dodd-Frank Act requires adoption of margin requirements for Covered Swap Entities ("CSEs"), such as security-based swap dealers, in order to offset perceived greater risk associated with non-cleared swaps. Nevertheless, ACLI and its members believe it is important for the SEC to recognize that the proposed rules could impose significantly greater costs on life insurers due to both substantial initial margin requirements and potential narrowing of the security categories eligible to be used as margin. As more particularly described in this letter, rules limiting the asset types that may be pledged by financial end users as margin, and failing to require bilateral pledging of margin by CSEs and financial end users, threaten to undermine numerous conservative, risk-mitigating OTC arrangements that have been carefully negotiated between life insurers and their counterparties, potentially exacerbating systemic risk rather than reducing it.

Although the proposed rules govern SBSDs and MSBSPs, they will unequivocally have a direct and significant impact on counterparties to SBSDs and MSBSPs in non-cleared derivatives transactions. In evaluating the economic and competitive impact of the proposed rules, it will be important to recognize distinctions among counterparties to SBSDs and MSBSPs involving their unique regulatory framework, business models, and role in the derivatives markets. In this way, the proposed rules will fulfill the mandate of the Dodd-Frank Act in a fair and cost-effective manner.

For example, life insurers are limited to hedging and replication transactions, and are precluded from speculative positions under state insurance laws. Life insurers tend to be fully collateralized in their non-cleared derivatives transactions. Life insurers have long been fully transparent in their derivatives obligations through schedule DB of the life insurers' state insurance reporting obligations, and are fully

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summarizes the NAIC Derivatives Instruments Model Regulation, which further implements the Investments of Insurers Model Act. In addition, as Appendix B we provide portions of the NAIC's Financial Condition Examiner's Handbook that provides guidance to examiners in reviewing an insurer's derivatives activities. Finally, in Appendix C we show sample pages from an insurer's annual statutory financial statements where all derivatives transactions must be reported. These documents demonstrate that insurers' use of derivatives is already carefully regulated and routinely examined by, as well as transparently reported to, state insurance regulators.

[12] We appreciate that the release recognizes ACLI's position in a submission to prudential regulators which emphasized that we "pointed out that life insurers also typically do not post initial margin and recommended that initial margin requirements be appropriately sized to reflect the potential exposure during the close out of a defaulting party." 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70266, footnote 575.

examined on these specific transactions pursuant to meticulous standards in the NAIC Financial Examiners Handbook.

In sum, life insurers present a different profile from most other financial service institutions. A "one-size-fits-all" design in the proposed rules would ignore these important substantive distinctions. As discussed further below, several directly parallel issues currently under consideration by domestic and international derivatives regulators address regulatory solutions that flexibly recognize differences among counterparties to SDs and MSPs. The SEC's proposed rules governing SBSDs and MSBSPs would be even more effective if they followed similar conceptual paths.[13]

V. Preliminary Comments Under the Constraints of an Abbreviated 30-Day Comment Period

We offer a few summary observations below in view of the short comment period, and the absence of any explanatory alignment between the SEC's proposal and actions taken by other domestic and global regulators. It would better fulfill the requirements of the APA if the SEC reproposes the rule or provides a substantial extended comment period to do justice to the complexity of the initiative

[13] In the release, the SEC itself recognizes that different counterparties to SBSDs and MSBSDs present different risk profiles. For example, proposed Rule 18a-3 provides an exception from margin requirements for "commercial end users" which is "intended to account for the different risk profiles of commercial end users from financial end users." 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70265. In explaining this exception, the release references the margin proposal of the prudential regulators, noting "financial end users are considered more risky than nonfinancial end users because the profitability and viability of financial end users is more tightly linked to the health of the financial system than nonfinancial end users. Because financial counterparties are more likely to default during a period of financial stress, they pose greater systemic risk and risk to the safety and soundness of the covered swap entity." Id. at footnote 554 on page 70265. The release explains that when

> "trigger events" occurred during the financial crisis, counterparties faced significant liquidity strains in seeking to meet the requirements to deliver collateral. As a result, some dealers experienced large uncollateralized exposures to counterparties experiencing financial difficulty, which, in turn, risked exacerbating the already severe market dislocation. The Dodd-Frank Act seeks to address the risk of uncollateralized credit risk exposure arising from OTC derivatives by, among other things, mandating margin requirements for non-cleared security-based swaps and swaps. In particular, section 764 of the Dodd- Frank Act added new section 15F to the Exchange Act.480 Section 15F(e)(2)(B) of the Exchange Act provides that the Commission shall adopt rules for nonbank SBSDs and nonbank MSBSPs imposing "both initial and variation margin requirements on all security based swaps that are not cleared by a registered clearing agency." Section15F(e)(2)(A) of the Exchange Act provides that the prudential regulators shall prescribe initial and variation margin requirements for non-cleared security-based swap transactions applicable to bank SBSDs and bank MSBSPs. Section 15F(e)(3)(A) also provides that "[t]o offset the greater risk to the security-based swap dealer or major security-based swap participant and the financial system arising from the use of security-based swaps that are not cleared," the margin requirements proposed by the Commission and prudential regulators shall "help ensure the safety and soundness" of the SBSDs and the MSBSPs, and "be appropriate for the risk associated with non-cleared security-based swaps held" by an SBSD or MSBSP. 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70258 [footnotes omitted].

In significant contrast, although life insurers invoke the definition of financial end user under the Dodd-Frank Act, they do not share the risk profile described in the above quoted language in the SEC release. As previously explained, life insurers are hedgers, fully collateralized and fully transparent. As such, they present significantly lower risk profiles than other financial end users. Indeed, life insurers generally did not suffer the negative consequence of the 2008 market stresses in their derivatives transactions like other financial end users because life insurers were fully collateralized with their counterparties and engaged only in hedging asset and liability risks. They were not engaged in speculative positions, as mandated by state insurance laws. Accordingly, it is sound to recognize the substantive, regulatory and business model differences among counterparties to SBSDs and MSBSPs in promulgating the margin and collateral standards in the proposed rules.

and the many numerous questions in the release warranting careful study and analysis. Given the extremely short 30-day comment period, we lack a reasonable opportunity to respond to the 74 new questions posed in the SEC's October 19, 2018 reopened request for comment.

A. Incongruity with Global and Domestic Regulation

On a quick examination, significant aspects of the SEC initiative continue to conflict with international standards. The SEC's collateralization requirements in the proposal contradict those adopted by the CFTC, Prudential Regulators and global standard setters. This incongruity could have profound and expensive negative impacts on market participants. Absent a reproposal that constructively aligns the initial proposal with the sensible standards that have evolved across all other regulatory platforms, observers are unable to properly offer meaningful comment on how the SEC action meshes with global and domestic regulatory constructs. There is an unnecessary imbalance between the 30-day comment period and the nearly four year hiatus between the initial SEC proposal and the present.

B. Bilateral Margin Requirements

Proposed Rule 18a-3(c)(2) would require SBSDs to collect collateral from their counterparties in non-cleared security-based swap transactions to buffer current and potential future exposure from the counterparty. The rule, however, would *not* require bilateral exchange of collateral to cover potential future exposure from the SBSD.

In opposition to this proposed standard, we strongly recommend that SBSDs post margin to non-SBSD counterparties in the same way as required for counterparties to the SBSD. The BCBS-IOSCO Consultative Paper advises that entities engaged in non-centrally cleared derivatives should exchange margin on a bilateral basis, observing a "broad consensus within the BCBS and IOSCO that all covered entities engaging in non-centrally cleared derivatives must exchange" margin.[14] Bilateral margin standards promote economic stability in the financial markets and prevent the accumulation of systemic risk at financial institutions engaged in significant derivatives transactions. Quite simply, bilateral margining protects both sides of a swap transaction against future credit risk and default by either counterparty.

The proposed initiative, therefore, should be revised to impose bilateral margin requirements. These modifications reflect the intent and purposes of the Dodd-Frank Act to ameliorate systemic risk to the financial system in non-cleared swap transactions. Further, paralleling the approach suggested in the BCBS-IOSCO Consultative Paper would achieve global harmonization in derivatives regulation, as explained immediately below, and would promote enterprise-wide compliance and concomitant cost-effectiveness.

The Consultative Paper indicates that a majority of the BCBS and IOSCO members supported margin requirements that, in principle, would involve the mandatory exchange of both initial and variation margins among parties to non-centrally cleared derivatives, which was labeled as "Universal Two-way Margin." BCBS and IOSCO recognized that two-way margining would impose substantial liquidity costs, and that the use of thresholds could potentially balance the policy goals of reducing systemic risk and promoting central clearing with mitigating the costs of bilateral margin exchange. BCBS and

[14] *See* BCBS-IOSCO Consultative Paper at 14.

IOSCO considered a variety of options for implementing universal two-way margin. The Consultative Paper, however, revealed that no unanimous view developed on the design and calibration of thresholds to achieve an optimal compromise between liquidity burdens and reduced systemic risk.[15]

In our July 11, 2011 comment letter to the CFTC, ACLI emphasized that two-way posting between CSEs and financial end users is of particular significance to the life insurance industry. It is customary practice for life insurers to require two-way posting of variation margin in the OTC market, which enhances the safety and soundness of life insurance companies in a manner consistent with the regulatory scheme to which they are subject, thereby enhancing the stability of the financial system as a whole. In our comment letter, ACLI strongly supported the CFTC's approach to two-way variation margin over the prudential regulator's disinclination for two-way margining.

ACLI emphasized the CFTC's observation that the imposition of a two-way margin requirement will *enhance* the stability of CSEs and the financial system for a number of reasons, including:

- Two-way margin removes each day's exposure from the marketplace for all products and all participants and prevents CSEs from accumulating obligations they cannot fulfill; and,

- Unchecked accumulation of exposures was a contributing factor to the financial crisis that led to the enactment of the Dodd-Frank Act.

As a result of further discussions with market participants, ACLI believed that swap dealers and financial firms should have the flexibility to determine whether swap dealers will be required to post initial margin on a case-by-case basis depending on the nature of the trade, product type or creditworthiness of the Swap Dealer or Major Swap Participant, in order to mitigate the impacts of Initial Margin Requirements on liquidity.[16] Moreover, financial firms should have the ability to choose the level of protection for initial or variation margin pledged to Swap Dealers and Major Swap Participants, which could include Tri-party or Custodial Arrangements as well as granting re-hypothecation rights over Initial or Variation Margin

In sum, therefore, ACLI broadly supports two-way margin requirements between swap dealers and financial firms in variation margin, while providing flexibility for the parties to determine whether and to

[15] In its second Consultative Paper, BCBS-IOSCO published and reiterated Element 2 in its Key Principles, which states:

> 2(e) In the case of variation margin, the BCBS and IOSCO recognise that regular and timely exchange of variation margin represents the settlement of the running profit/loss of a derivative and has no net liquidity costs as variation margin represents a transfer of resources from one party to another. The BCBS and IOSCO also recognise that the regular and timely exchange of variation margin is a *widely adopted best practice that promotes effective and sound risk management*. See second Consultative Paper (Feb. 15, 2013) http://www.bis.org/publ/bcbs 242.pdf at 7 [emphasis added].

Thus, even though the proposed SEC standard is based on currently existing broker-dealer margining standards, global regulators, which included SEC participation, recognized that bilateral margining is a widely adopted best practices. Currently, most non-cleared swap transactions have Credit Support Annexes (CSAs) stipulating bilateral margin, especially with variation margin. A CSA is a legal document which regulates credit support (collateral) for derivative transactions.

[16] Additionally, the On February 15, 2012, BCBS-IOSCO published a second Consultative Paper "which represents a near-final proposal on margin requirements for non-centrally-cleared derivatives." *See* http://www.bis.org/publ/bcbs242.htm . Under the second Consultative Paper's near final initiative, BCBS-IOSCO recommended reciprocal, bilateral margining. The SEC, therefore, has additional reason to adopt bilateral margining requirements in the interest of harmonized domestic and global derivatives regulation.

what extent Swap Dealers and Major Swap Participants should be required to pledge Initial margin to financial firms. We also recommend that the parties have the right to determine the protections afforded to initial margin pledged by financial firms to Swap dealers and Major Swap Participants, which could include placement in third-party custodial or Tri-party Accounts, and note that liquidity concerns can be addressed in part by establishing appropriate initial margin requirements and broadening eligible collateral types.

C. Margin Standards Across Jurisdictions

The initial SEC release perceptively observes that capital, margin, and segregation requirements could have a substantial impact on international commerce and the relative competitive position of intermediaries operating in various, or multiple, jurisdictions.[17] In particular, the release notes that intermediaries operating in the U.S. and in other jurisdictions could be advantaged or disadvantaged if corresponding requirements are not established in other jurisdictions or if the Commission's rules are substantially more or less stringent than corresponding requirements in other jurisdictions. According to the release, this could affect the ability of intermediaries and other market participants based in the U.S. to participate in non-U.S. markets, the ability of non-U.S.-based intermediaries and other market participants to participate in U.S. markets, and whether and how international firms make use of global "booking entities" to centralize risks related to security-based swaps.[18]

The release commendably observes that the potential international implications of the proposed capital, margin, and segregation requirements warrant further consideration. It notes, however, that "consistent with the SEC's general approach with respect to its other proposals under Title VII, these implications are recognized here but not fully addressed."[19] Instead, the release explains that the SEC intends to publish a comprehensive release seeking public comment on the full spectrum of issues relating to the application of Title VII to cross-border security-based swap transactions and non-U.S. persons that act in capacities regulated under the Dodd-Frank Act. According to the release, "this approach will provide market participants, foreign regulators, and other interested parties with an opportunity to consider, as an integrated whole, the proposed approach to the cross-border application of Title VII, including capital, margin, and segregation requirements."

These statements in the SEC's release prudently acknowledge the significance of harmonized global derivatives regulation. In this regard, we strongly support the sentiment reflected in the BCBS-IOSCO Consultative Paper that:

> Market conditions and asset availability differ across jurisdictions. National supervisors should develop their own list of eligible collateral assets based on the key principle, taking into account the conditions of their own markets and making reference to the list of examples of eligible collateral under the proposed requirement section. Allowing jurisdictions to develop their own list of eligible collateral assets is expected to reduce margining requirements' impact on the liquidity and prices of eligible assets, reduce concentration risk, and provide sufficient flexibility to permit new assets to serve as collateral in the future as markets evolve.

[17] 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70305 .
[18] *Id.*
[19] 77 Fed. Reg. 226 (Nov. 23, 2012) 70214 at 70217.

> Subject to meeting the key principle, the scope of eligible collateral assets should be kept broad, with appropriate haircuts. It is expected that demand for high quality liquid assets may increase with the implementation of various regulatory reforms, including central-clearing, margin requirements for non-centrally-cleared derivatives and Basel liquidity requirements. Keeping the scope of eligible assets broad may help relieve pressure on the supply of eligible collateral assets. It may also help avoid concentration risks.
>
> Haircut requirements should be transparent and easy to calculate, so as to facilitate payments between counterparties, avoid disputes and reduce overall operational risk. Haircut levels should be risk-based and should be calibrated appropriately to reflect the underlying risks that affect the value of eligible collateral, such as market price volatility, liquidity, credit risk and FX volatility, during both normal and stressed market conditions.
>
> Given the diversity of eligible collateral assets, there may be practical difficulties for supervisors to stipulate in advance the haircut level for each type of collateral. The pre-determined haircut levels may also become outdated as market conditions change. Adopting internal or third-party models that have been approved by supervisors to calculate haircut level may therefore be desirable. However, some firms may be unable or unwilling to develop internal haircut calculation models that meet regulators' requirements. To provide a conservative alternative in those cases, the Consultative Paper proposes a set of standardized haircuts that can be used in lieu of model-based haircuts.

ACLI strongly supports the recommendations in the BCBS-IOSCO Consultative Paper that the scope of eligible collateral should be kept broad, with appropriate haircuts. Alternatives reflecting internal or third-party haircut models coextensively with a set of standardized haircuts that can be used in lieu of model-based haircuts provide a sound and responsible flexibility.

We encourage The SEC to carefully consider the recommendations in the BCBS-IOSCO Consultative Paper concerning harmonized international derivatives regulation, and to coordinate with U. S. prudential regulators that have adopted margin and collateral rule proposals under the Dodd-Frank Act in light of the Consultative Paper. In the interest of harmonized international derivatives standards and to avoid the potential regulatory arbitrage recognized in the SEC's release, we recommend revisions to the SEC proposal incorporating the prudent flexibility reflected in the above quoted language on margin, collateral, and haircuts.

IV. Other Issues

Under the extreme time constraints of a 30-day comment period we have not been afforded the opportunity to reevaluate a number of issues we addressed in our 2013 comment letter (or the impact of specific questions in the 30-day re, including:

- Segregation Standards. ACLI supports the proposal's framework that allows counterparties to SBSDs to elect having collateral maintained by an independent custodian. This option fulfills the goals of the Dodd-Frank Act by allowing SBSD counterparties to insulate themselves from retrieving assets of an insolvent SBSD through bankruptcy proceedings. We are concerned, however, that the imposition of a capital charge on SBSDs when their counterparties elect to obtain the insulation provided by segregation may force SBSDs to pass these added capital charge on to the counterparties.

- Eligible Collateral. As we understand the SEC's reopened request for comment, it is unclear whether the initiative would deviate from sensible, well-examined standards for eligible collateral adopted by the CFTC, U.S. Prudential Regulators, and Global Standard setters as evidenced in the BCBS-IOSCO Final Consultative Paper on eligible collateral in derivatives transactions. We recommend that the SEC initiative not limit categories of eligible collateral in proposed Rule 18a-3, not incorporate requirements for collateral drawn from broker-dealer collateral standards for securities customers in current Rule 15c3-1 under the Securities Exchange Act, and carefully parallel the approach recommended by the CFTC, U.S. Prudential Regulators, and Global Standard setters. Narrow limits on the types of permitted collateral could greatly impair liquidity in the derivatives marketplace and thwart constructive risk management.

V. Conclusion

Given the many complex domestic and global rule implementations concerning derivatives' capital, margin and segregation, it is critical that the SEC proceed deliberatively in refocusing its attention on these original SEC proposals and allow a meaningful opportunity for the public to reasonably address the recent 30-day request for comment. It would be most responsible for the SEC to fully repropose the rule with a 60-90 day comment period or to extend the comment period expiring on November 19, 2018 for a similar time frame. The Administrative Procedure Act demands no less and avoids the potential for post-adoption litigation. In the event the SEC declines to extend the comment period or repropose the initiative, we have offered preliminary, rushed feedback on the initiative above and below.

In sum, ACLI supports harmonized domestic and international standards for margin in uncleared swaps transactions. The BCBS and IOSCO Consultative Paper contained several important elements very relevant to the SEC's proposed rule that would establish margin and collateral requirements on uncleared swaps for SBSDs and MSBSPs. Most of the concepts in the Consultative Paper dovetail with the SEC's rule proposals on margin and collateral requirements for uncleared swaps. SEC representatives participated in the Working Group on Margining Requirements of the Basel Committee on Banking Supervision and the International Organization of Securities Commissions.[20]

We strongly encourage coordinated domestic and international approaches to derivatives regulation that will ensure cost-effective, harmonized regulation and prevent regulatory arbitrage. Regulations governing SBSDs and MSBSDs should be conceptually uniform with regulations governing swap dealers and major swap participants to minimize or eliminate unnecessary and costly differences that could thwart enterprise-wide compliance procedures and greatly increase systems costs.

It is appropriate that the SEC intends to publish a comprehensive release seeking public comment on the full spectrum of issues relating to the application of Title VII to cross-border security-based swap transactions and non-U.S. persons that act in capacities regulated under the Dodd-Frank Act. The

[20] See second Consultative Paper (Feb. 15, 2013) http://www.bis.org/publ/bcbs 242.pdf on the second unnumbered page following the table of contents.

release correctly recognizes that intermediaries operating in the U.S. and in other jurisdictions could be advantaged or disadvantaged if corresponding requirements are not established in other jurisdictions or if the SEC's rules are substantially more or less stringent than corresponding requirements in other jurisdictions. We strongly recommend that the SEC's approach to collateral and margin requirements parallel the recommendations in the BCBS-IOSCO Consultative Paper and the approaches implemented by the CFTC and prudential regulators in light of the Consultative Paper.

ACLI supports the incorporation of concepts about initial and variation margin from the Consultative Paper into the SEC's proposed rule, including enlarging the scope of eligible collateral and focusing on the impact of margin requirements on liquidity. ACLI concurs with the Consultative Paper's strong support for universal two-way variation margining and urges the SEC to adopt a flexible approach with respect to initial margin requirements for SBSDs and MSBSPs to mitigate the impact on liquidity. We support alignment of margin requirements for uncleared swaps globally, especially between major market jurisdictions. All these matters will lower the risk of financial entities and prevent regulatory arbitrage.

ACLI supports the option for counterparties of SBSDs to elect segregated treatment of collateral to avoid commingled or omnibus treatment by default. The option to elect segregation of collateral fulfills the intent of the Dodd-Frank Act to allow counterparties to insulate their assets from general bankruptcy treatment of defaulted or insolvent SBSDs. We recommend that the SEC eliminate the credit charge to SBSDs whose counterparties elect segregated treatment to eliminate disincentives for taking this prudent action due to the passing on of costs to counterparties that exceed the cost of third-party custody of the collateral.

We greatly appreciate your attention to our views. If any questions develop, please let me know.

Sincerely,

Carl B. Wilkerson

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