CITADEL

December 7, 2020

Mr. Christopher J. Kirkpatrick
Secretary
Commodity Futures Trading Commission
[redacted]
Washington, DC 20581

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090

Re: Portfolio Margining of Uncleared Swaps and Non-Cleared Security-Based Swaps (File Number S7-15-20 / RIN 3038-AF07)

Citadel appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC") on potential ways to implement portfolio margining of uncleared swaps and non-cleared security-based swaps.[1]

We support the efforts of the CFTC and SEC to harmonize regulatory requirements and to permit portfolio margining where appropriate in order to facilitate the netting and cross-margining of related positions in a single account. However, care must be taken to ensure that portfolio margining does not provide a mechanism for market participants to engage in regulatory arbitrage in light of the significant differences between the current margin rules for CFTC-regulated uncleared swaps and SEC-regulated non-cleared security-based swaps. We, therefore, encourage the CFTC and SEC to either further harmonize these underlying requirements or ensure that key aspects of both regulatory regimes are maintained to the extent portfolio margining is permitted.

One important difference between CFTC and SEC margin rules is that, under SEC rules, security-based swap dealers generally are not required to post initial margin for non-cleared security-based swaps.[2] This means, in practice, that (1) inter-dealer non-cleared security-based swaps are entirely exempted from initial margin requirements, and (2) customers are less protected with respect to non-cleared security-based swaps in the event of a failure of a dealer counterparty.

Importantly, both of these outcomes under SEC rules directly conflict with final CFTC policy positions.[3] In particular, the CFTC concluded that it was critical for uncleared inter-dealer

[1] 85 FR 70536 (Nov. 5, 2020), available at: https://www.cftc.gov/sites/default/files/2020/11/2020-23928a.pdf.

[2] *Id.* at 70542.

[3] We note the SEC rules also conflict with the uncleared margin rules adopted by the US prudential regulators (*see* https://www.govinfo.gov/content/pkg/FR-2015-11-30/pdf/2015-28671.pdf) and the minimum standards for margin requirements for non-centrally cleared derivatives as agreed by the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) (*see* https://www.bis.org/bcbs/publ/d317.pdf at page 5).

positions to be subject to initial margin requirements in order to mitigate systemic risk, given the size and interconnected nature of these positions and experience from the financial crisis, where under-collateralized bilateral OTC derivatives served as a source of contagion and transmitted risk throughout the financial system.[4] In addition, the CFTC concluded that requiring dealers to post initial margin on customer positions would better protect end users in the event of a failure of a dealer counterparty and would impose an appropriate level of discipline on swap dealers.[5]

Permitting swap dealers to be exempted from posting initial margin with respect to CFTC-regulated uncleared swaps to the extent they are held in an SEC-regulated portfolio margining account would undermine the CFTC policy positions described above and would create significant regulatory arbitrage, incentivizing swap dealers to transfer uncleared positions to SEC-regulated accounts. In addition, the role of uncleared margin requirements in promoting central clearing would be reduced, as data shows that (a) voluntary clearing rates increase following the implementation of initial margin posting requirements for inter-dealer transactions[6] and (b) in contrast, bilateral trading is less costly than central clearing if there is an available exemption from posting initial margin.[7] To the extent portfolio margining provides a framework where only cleared inter-dealer transactions are subject to initial margin requirements (and not uncleared inter-dealer OTC derivatives), the incentives to voluntarily clear will be undermined to a significant extent.

Given the above, we encourage the CFTC and SEC to ensure that initial margin posting requirements for swap dealers with respect to CFTC-regulated uncleared swaps are maintained to the extent portfolio margining is permitted.

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We appreciate the opportunity to provide comments on potential ways to implement portfolio margining of uncleared swaps and non-cleared security-based swaps. Please feel free to call the undersigned at (646) 403-8200 with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger

Managing Director

Global Head of Government & Regulatory Policy

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[4] *See* 79 FR 59898 (Oct. 3, 2014) at 59907.

[5] *See* CFTC Final Margin Release, 81 FR at 649.

[6] Incentives to centrally clear over-the-counter (OTC) derivatives: A post-implementation evaluation of the effects of the G20 financial regulatory reforms (Nov. 19, 2018) at Figure C.7 (page 21), available at: http://www fsb.org/wp-content/uploads/R191118-1-1.pdf (the "DAT Report").

[7] DAT Report at pages 36-37.