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Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

April 4, 2013

Re: FINRA Rule 4240 (Margin Requirements for Credit Default Swaps); Release No. 34-69089; File No. SR-FINRA-2013-017

Dear Ms. Murphy:

The American Council of Life Insurers ("ACLI") is a national trade association with 300 members that represent more than 90 percent of the assets and premiums of the life insurance and annuity industry. Life insurers actively participated in the legislative dialogue concerning regulation of derivatives markets and have provided constructive input on proposed rulemaking implementing Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

ACLI respectfully submits the following response to the SEC's request for comment on FINRA Rule 4240. Life insurers manage asset and liability risks by hedging with derivatives instruments, and are among the financial end-users affected by FINRA Rule 4240 and several related SEC administrative developments. Life insurers support the legislative objectives of the Dodd-Frank Act in Title VII designed to ensure stability of the financial markets.

ACLI has actively participated in a numerous FINRA rulemaking initiatives. SEC oversight of SRO rule proposals ensures balanced regulations in the public interest, and provides an important protection against SRO rules that may burden competition. The full execution of SEC oversight and public comment is fundamental to sound rulemaking.

On March 8, 2013, the SEC approved a FINRA proposal to amend FINRA Rule 4240, which implements an interim pilot program governing margin requirements for credit default swaps (CDS).[1] The SEC approved the rule immediately on an accelerated basis at the request of FINRA and provided an opportunity for after-the-fact comment within a 21-day period. We offer preliminary comment on the SEC's rule approval under this tight post-adoption time frame to express significant concerns about the competitive impact of the rule and the protection of investors, particularly in light of a separate, but interrelated, action the SEC took in a letter to futures commissions merchants (FCMs) dated March 8, 2013.

[1] Release No. 34-69089; File No. SR-FINRA-2013-01778; Fed. Reg. 50 (Mar. 14, 2013) at 16341 [http://www.gpo.gov/fdsys/pkg/FR-2013-03-14/pdf/2013-05894.pdf]

Administrative Background

FINRA Rule 4240. The SEC approved rule change provides that, in lieu of the margin methodology requirements set forth in the rule, a FINRA broker-dealer may margin CDS on a portfolio margin basis. However, the member firm must notify FINRA in advance in writing of its intent to operate under the portfolio margin program. The revised rule also clarifies that, in addition to requiring initial margin, FINRA broker-dealers must collect daily variation margin from each customer or broker-dealer counterparty. In addition, the revised rule amends the reference to "largest maximum possible loss" by providing a reference point for the computation of such loss.

The release approving Rule 4240 explains that Section 713(a) of the Dodd-Frank Act amended the Exchange Act to generally permit a broker-dealer that is also registered as a futures commission merchant ("FCM") under the Commodity Exchange Act (CEA) to hold cash and securities in a portfolio margining account that is carried as a futures account, pursuant to a portfolio margining program that is approved by the CFTC. Reciprocally, Section 713(b) of the Dodd-Frank Act amended the CEA to generally permit an FCM that is also registered as a broker-dealer to hold futures contracts and options on futures contracts (as well as money, securities or other property received from a customer to margin, guarantee or secure such contracts, or accruing to a customer as a result of such contracts) in a portfolio margining account that is carried as a securities account pursuant to a portfolio margining program that is approved by the SEC. The SEC and the CFTC have recently acted to grant specific exemptions to facilitate portfolio margining of swaps and security-based swaps.[2]

To help facilitate portfolio margining pursuant to this regulatory relief, FINRA proposed to amend FINRA Rule 4240, which implements an interim pilot program (the "Interim Pilot Program") regarding margin requirements for certain transactions in CDS.[3] Specifically, proposed new FINRA Rule 4240(c)(3) provides that, in lieu of the requirements set forth in paragraphs (c)(1) and (c)(2) of the rule,[4] a FINRA member may require, with respect to CDS held in an account subject to an approved portfolio margining program, the amount of margin determined by the member's portfolio margin methodology, provided that, prior to margining CDS on a portfolio margin basis, the member shall notify FINRA in advance in writing of its intent to operate under the portfolio margin program.[5]

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[2] *See* Exchange Act Release No. 68433 (Order Granting Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection With Portfolio Margining of Swaps and Security-Based Swaps) (December 14, 2012), 77 FR 75211 (Dec. 19, 2012); see also CFTC Order, Treatment of Funds Held in Connection with Clearing by ICE Clear Credit of Credit Default Swaps (January 14, 2013) available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/icecreditclearorder011413.pdf.

[3] On July 13, 2012, FINRA extended the implementation of the Interim Pilot Program to July 17, 2013. *See* Exchange Act Release No. 67449 (July 17, 2012), 77 FR 43128 (July 23, 2012) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change; File No. SR-FINRA-2012-035).

[4] FINRA Rule 4240(c)(1) addresses transactions in CDS that make use of the central counterparty clearing facilities of a clearing agency using a margin methodology the use of which has been approved by FINRA as announced in a Regulatory Notice. FINRA Rule 4240(c)(2) addresses transactions making use of facilities that do not use such a methodology, or that settle over-the-counter.

[5] In its request for SEC approval, FINRA proposed to amend the margin requirements set forth in paragraph (c)(2) and Supplementary Material .0110 of FINRA Rule 4240 to clarify that, in addition to requiring the applicable minimum margin ("initial margin"), a member must collect daily from each customer or broker-dealer counterparty an amount at least equal to the member's current exposure, as defined in Exchange Act Rule 15c3-1e(c)(4) (provided, however, that members not otherwise subject to Exchange Act Rule 15c3-1e are not required

SEC Letter to Futures Commission Merchants. On March 8, 2013, the SEC issued a letter to FCMs ("SEC FCM Letter") stating that under certain circumstances related to credit derivative trades, buy-side participants would post higher margin than what either the sell-side would post, or the clearinghouse requires for margin. A generic copy of the letter is attached as Appendix A.

ICE Clear Credit has been attempting to roll out a portfolio margin model that looks across Index and Single Name Credit Derivative positions. This has required the approval of both the CFTC and the SEC because the jurisdiction for the regulation of credit derivatives is split between the two regulators. This model was previously approved for use by Clearing Members, but the SEC, at least temporarily, wants buy-side firms to post a multiple (1.5 times to 2 times) of the calculated portfolio margin requirement.

Based on informal conversations with FINRA staff, we understand that FINRA would implement the SEC FCM Letter in administering recently amended and approved Rule 4240, and would require the posting of the additional multiples of the calculated portfolio margin requirements in situations such as the ICE Clear Credit approach. The integration of these two separate administrative actions would impose unacceptable competitive burdens, conflict with the Dodd-Frank clearing mandate, and contradict investor protection. Our members are troubled that they only learned about the SEC FCM Letter indirectly, which is not currently available to the public. The SEC FCM Letter will have a direct and significant impact on life insurers, who had no opportunity to convey input on this important development.

Statement of Position

Life insurers oppose the use of stipulated buy-side multiples of clearinghouse margin for cleared trades. While the FCM's may require additional margin for individual counterparty credit purposes, this should not be systematic across all buy-side firms. Posting excess margin at FCMs creates increased counterparty risk for ACLI members, skews margin protections to the sell-side, increases costs, and creates a disincentive to clearing.

We are aware that at least one Clearinghouse has determined that the additional 50-100% of margin would be treated as excess margin and would not be held by the Clearinghouse, but would be held at the broker-dealer and does not, therefore, benefit from the customer protections related to initial margin. As a result, customers will be subject to FCM counterparty risk to the extent of such additional margin requirement. Any excess margin required by the SEC would not be held by the Clearinghouse, but would be held by the broker-dealer. As a result of this, buy-side firms would not benefit from the customer segregation protections at the derivatives clearing organization (DCO), and would be subject to counterparty credit risk on the amount of any excess.

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to take into account paragraph (c)(4)(v)(G) of such Rule), arising from the daily mark to market of the CDS ("variation margin"). FINRA notes that collection of variation margin has been implicitly required by the administration of Rule 4240. According to the SEC's release, the FINRA amendments were designed to make this variation margin requirement clear.

FINRA proposed to amend the reference to "largest maximum possible loss" in paragraph (d)(8) of the rule by adding the phrase "(that is, the notional amount of the CDS less the estimated recovery given default)." FINRA believes that the proposed language, by providing members a reference point for computing the largest maximum possible loss pursuant to the rule, lessens the potential burdens from higher capital charges that could result absent the proposed language.

This consequence is untenable and contradicts the purposes of the clearing mandate in the Dodd-Frank Act.[6] Furthermore, the coupling of the SEC's March 8, 2013 FCM letter with FINRA implementation of Rule 4240 effectively fails statutory mandates for SRO rules because it disadvantages buy-side participants in the marketplace and advantages sell-side participants without rational basis. In practice, therefore, Rule 4240's implementation of the SEC position creates unwarranted anticompetitive burdens and does not protect investors as required under the Exchange Act.

While we understand that FINRA's amended rule proposal requested accelerated approval upon filing due to the approaching deadlines for the clearing mandate, the nominal 21-day after-the-fact comment period provides neither adequate opportunity for meaningful analysis of the rule modification, nor a meaningful time within which to formulate comments for submission.

The proposal merits thorough discussion and analysis, including an objective review of its economic and competitive impact.[7] Nothing in the FINRA application for rule approval reveals whether FINRA thoroughly considered the detailed implications of the SEC's FCM letter. The FINRA request for approval of Rule 4240 simply states that "FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act." The 1934 Act demands more in this instance. Without full analysis of this rather complex set of interrelated administrative developments, FINRA's rule request was not ripe for approval because it did not contemplate the rule's disparate impact on certain investor-participants in the derivatives market.

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[6] Several news sources have begun to comment on this responsive development in the marketplace. *See, e.g., SEC Forces ICE into Single-Name CDS Clearing U-Turn*, RiskNet (Apr. 3, 2013); *ICE Blames SEC as It Drops Single-Name CDS Clearing Plans*; Risk Magazine (Mar. 19, 2013) [Firms that trade index and single-name CDSs will see margin requirements increase].

[7] A 21-day comment period is insufficient to address the issues raised in the release. As a practical matter, most observers had fewer than 21 days to digest the proposal following its Federal Register printing date due to time consumed in delivery and dissemination of the Federal Register. Industry groups like our trade association circulate regulatory proposals, elicit membership input, develop a consensus, and circulate a draft letter of comment before submission. This is a worthwhile, but time intensive, process that is difficult to execute in 21 days.

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*, which observes

> The 60-day period established by Executive Order 12044 for significant regulations (and no longer in effect unless adopted by agency rule) is a more reasonable *minimum* time for comment. However a longer time may be required if the agency is seeking information on particular subjects or counter-proposals from regulated industry. *"Interested persons" often are large organizations and they need time to coordinate and approve an organizational response or to authorize expenditure of funds to do the research needed to produce informed comments.*

See Lubbers, *A Guide to Federal Agency Rulemaking,* Administrative Conference of the United States (1983) at 124. *See also* Lubbers, *A Guide to Federal Agency Rulemaking,* 3d Edition, American Bar Association (1998) at 196, which is an updated and expanded version of the original documentation on this issue.

Statutory and Regulatory Considerations

When it amended the Exchange Act in 1975, Congress specifically charged the SEC with the responsibility to evaluate competitive burdens of SRO rules and rule changes. The Senate report on the legislation stated that:

> Sections 6(b)(8), 19(b) and 19(c) of the Exchange Act would obligate the Commission to review existing and proposed rules of the self-regulatory organizations and to abrogate any present rule, or to disapprove any proposed rule, having the effect of a competitive restraint it finds to be neither necessary nor appropriate in furtherance of a legitimate regulatory objective.[8]

Section 23(a) of the Exchange Act was also added in 1975, and requires the SEC to consider the anti-competitive effects of rule changes, and to balance any impact against the regulatory benefit to be obtained.[9] Similarly, Sections 15A(b)(6) and (9) of the 1934 Act require the SEC to evaluate carefully the competitive impact of proposed SRO rules and amendments.

The Securities Act Amendments of 1975 significantly expanded the SEC's oversight and regulatory powers concerning SRO rules, and specifically directed the SEC to carefully evaluate competitive factors in exercising its SRO oversight. Importantly, Congress did not intend to confer general antitrust immunity on SRO rulemaking that was subject to the SEC's oversight review.[10]

The antitrust immunity created by Congress contemplates active oversight by the SEC in executing its responsibilities to ensure consistency with the securities laws, and to blunt the anticompetitive behavior inherent in self-regulatory conduct. Otherwise, a Congressional grant of substantial regulatory authority to private organizations without federal regulatory oversight would violate the constitutional prohibition against the delegation of legislative powers.

In order for SEC review to provide immunity for self-regulatory conduct, the review must be active, and must result in a ruling by the SEC that is judicially reviewable.[11] Section 25 of the 1934 Act states that the SEC's actual findings are conclusive if supported by substantial *evidence*, and that its decisions should be overturned only if "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law, the excess of statutory jurisdiction, authority, or limitations, or short of statutory right, or without observance of procedures required by law." Recently approved FINRA Rule 4240 fails the statutory safeguards to competition set forth above.[12]

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[8]S. Rep. 94, 94th Cong., 1st Sess. (April 14, 1975) at 12.

[9]*Id*. at 12.

[10]*See*, Smythe, *Government Supervised Self-Regulation in the Securities Industry and the Antitrust Laws: Suggestions for an Accommodation*, 62 N.C. L. Rev. 475 (1984) at 504 [the SEC has an obligation in reviewing SRO conduct to "weigh the competitive impact in reaching regulatory conclusions"].

[11]*Id.*

[12] Additionally, Section 964 of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) requires the Government Accountability Office (GAO) to review every two years the SEC's oversight of national securities associations registered under section 15A of the Securities Exchange Act of 1934 (Exchange Act), a provision that solely applies to FINRA. Specifically, Section 964 identifies several aspects of SEC's oversight of FINRA for GAO review, including the *effectiveness of FINRA's rules*.

In a different context, former SEC Chairman Levitt emphasized the importance of reviewing the impact of rulemaking on competition when he stated:

> In response to the National Securities Markets Improvement Act of 1996 (NSMIA), the Commission has rededicated itself to considering how rules affect competition, efficiency, and capital formation as part of its public interest determination. Accordingly, the Commission intends to focus increased attention on these issues when it considers rulemaking initiatives. In addition, the Commission measures the benefits of proposed rules against possible anti-competitive effects, as required by the Exchange Act.[13]

In light of the complex interrelationship of the SEC's letter to FCMs with Rule 4240, the SEC's accelerated approval without advance opportunity for analysis and comment underserves the important SEC and statutory goals to protect both competition and investors. The SEC should not have approved the FINRA initiative on an accelerated basis without the opportunity for advance notice and comment in view of the rule's anticompetitive impact under the complex circumstances of the SEC's FCM Letter.

Conclusion

We respectfully suggest that the SEC should immediately retract its FCM Letter because it thwarts the Dodd-Frank Act clearing mandate, and because posting excess margin at FCMs creates increased counterparty risk for life insurers, skews margin protections to the sell-side, increases costs, and creates a disincentive to clearing. The integration of the SEC FCM Letter in Rule 4240 implementation fails the required statutory requirement that SRO rules avoid unwarranted competitive and economic burdens. The SEC should allow customer margin levels consistent with those permitted in late 2011 for broker-dealer-FCMs.

GAO issued its first report following the Dodd-Frank Act in May 2012 [*See* GAO-12-625, *Opportunities Exist to Improve SEC's Oversight of the Financial Industry Regulatory Authority* (May 2012) [http://www.gao.gov/assets/600/591222.pdf] and observed , among other things, that a principal oversight mechanism for SEC is its authority to review and, where applicable, approve SRO proposed rules and proposed changes to existing rules, including those submitted by FINRA. Section 19(b)(2) of the Exchange Act, as amended, and related rules and regulations, contain the requirements for SRO proposed rule changes that are subject to SEC approval. These requirements include that an SRO file a proposed rule change with SEC and publish it on a publicly available website. The GAO report notes that SEC then sends a notice of the proposed rule change to the Federal Register and allows interested persons the opportunity to submit written comments concerning the proposed rule change. Concurrently, the SEC reviews the proposed rule change and, if applicable, considers public comments and the SRO's response. The SEC then determines whether the proposed rule change is consistent with the requirements of the Exchange Act and Exchange Act rules and regulations that are applicable to the SRO. The SEC has delegated authority to the Trading and Markets Division to approve proposed rule changes. With the passage of the Dodd-Frank Act, the SEC can now directly disapprove proposed rule changes that are subject to SEC approval if it does not find that they are consistent with the Exchange Act. FINRA Rule 4240 provides such a circumstance when woven together with the SEC FCM Letter.

[13] *See* testimony of Arthur Levitt, SEC Chairman , concerning appropriations for fiscal year 1998 before the Subcommittee on Commerce, Justice, and State, the Judiciary, and Related Agencies of the House Committee on Appropriations (Mar 14, 1997), which appears at http://www.sec.gov/news/testimony/testarchive/1997/tsty0497.txt

As noted above, life insurers oppose the use of stipulated buy-side multiples of clearinghouse margin for cleared trades. Although FCM's may require additional margin for individual counterparty credit purposes, this should not be systematic across all buy-side firms. Posting excess margin at FCMs creates increased counterparty risk for ACLI members, skews margin protections to the sell-side, increases costs, and creates a disincentive to clearing.

The short 21-day time period for comment after the approval of the FINRA rule amendment does not allow the thorough opportunity for analysis and input required for federal agency rulemaking under the Administrative Procedure Act. We reserve the opportunity to supplement the views expressed in this letter as appropriate.

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

Sincerely,

Carl B. Wilkerson

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CC: Elisse B. Walter, Chairman
Luis A. Aguilar, Commissioner
Troy A.Paredes, Commissioner
Daniel M. Gallagher, Commissioner