



Pension Investment
Association of Canada
Association canadienne des
gestionnaires de caisses de retraite



Association Européenne des Institutions Paritaires
European Association of Paritarian Institutions
Association Internationale de droit belge - aisbl - 1919

VIA EMAIL OR ONLINE SUBMISSION

November 24, 2014

Mr. Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW
Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219

Mr. Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA45
Federal Housing Finance Agency
Constitution Center (OGC Eighth Floor)
400 7th Street SW
Washington, DC 20024

Mr. Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve
System
20th Street and Constitution Ave. NW
Washington, DC 20551

Mr. Barry F. Mardock, Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Mr. Robert E. Feldman, Executive Secretary
Attention: Comments, Federal Deposit
Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Comments on Proposed Rules Related to Margin for Uncleared Swaps

- CFTC: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (RIN 3038-AC97)
- Board: Margin and Capital Requirements for Covered Swap Entities [Docket No. R-1415] (RIN 7100 AD74)
- FCA: Margin and Capital Requirements for Covered Swap Entities (RIN 3052-AC69)
- FDIC: Margin and Capital Requirements for Covered Swap Entities (RIN 3064-AE21)
- FHFA: Margin and Capital Requirements for Covered Swap Entities (RIN 2590-AA45)
- OCC: Margin and Capital Requirements for Covered Swap Entities [Docket No. OCC-2011-0008] (RIN 1557-AD43)

The Global Pension Coalition (“Coalition”)¹ appreciates this opportunity to provide comments to the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and Federal Housing Finance Agency (collectively, the “Prudential Regulators”) on their proposal regarding “Margin and Capital Requirements for Covered Swap Entities” (“Prudential Regulator Proposal”).² Additionally, the Coalition appreciates this opportunity to provide comments to the Commodity Futures Trading Commission (the “CFTC” and, collectively with the Prudential Regulators, the “Agencies”) on its proposal regarding “Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants” (“CFTC Proposal”).³ Unless noted otherwise, the Coalition’s comments in this letter are equally addressed to both the Prudential Regulator Proposal and the CFTC Proposal (collectively, the “Proposals”).

The Coalition represents a very significant portion of the largest private defined benefit and defined contribution pension plans in the U.S., Canada and Europe, as well as, in some instances, the companies that sponsor those pension plans. The pension plans represented by the Coalition provide retirement benefits for over a hundred million individuals in more than a dozen countries. Unlike some other market participants that may take risks with derivatives for business and competitive reasons, pension plans do not have such business or competitive motivations. Rather, pension plans exist solely to provide retirement security for pensioners and utilize derivatives primarily⁴ to hedge market risks which could jeopardize such retirement security.

Additionally, pension plans provide a crucial source of stable, risk-reducing liquidity to the derivatives markets because they are highly creditworthy and liquid counterparties, with practically little to no leverage. For these reasons, the Coalition continues to believe pension plans should not be subject to initial margin requirements for uncleared swaps.⁵ Nonetheless, the Coalition appreciates the Agencies’ consideration of its past comments and, with the exception of the requirement to aggregate the trades of “affiliates,” views the current Proposals as improvements over the Agencies’ previous attempts. The Coalition hopes the comments offered in this letter will assist the Agencies finalize thoughtful rules that strike a proper balance between implementing margin safeguards on major financial users of derivatives as Congress intended, and ensuring that pension plans and their affiliates are not unduly burdened with financial, operational, and compliance obligations that are unsupported by any meaningful economic analysis.

¹ The Coalition is comprised of the American Benefits Council, the Committee on Investment of Employee Benefit Assets, European Association of Paritarian Institutions, National Coordinating Committee for Multiemployer Plans, PensionsEurope, and the Pension Investment Association of Canada.

² 79 Fed. Reg. 57,348 (Sept. 24, 2014).

³ 79 Fed. Reg. 59,898 (Oct. 3, 2014).

⁴ Although pension plans in some jurisdictions may at times use derivatives to gain market exposure, the predominate use is for hedging purposes. In some other jurisdictions, pension plans are expressly prohibited from using derivatives to gain market exposure.

⁵ For a more fulsome articulation of this reasoning, please refer to the Coalition’s comment letter to the CFTC dated September 14, 2012, regarding its previous margin proposal for uncleared swaps.

I. Executive Summary

While some of the points discussed herein have been addressed by the Coalition before, many are new and respond to changes made or questions posed by the Agencies in the current Proposals. In particular, the Coalition wishes to emphasize the following three points:

- ***Inclusion of “affiliates” in a pension’s material swaps exposure calculation should be limited to entities to whom covered swap entities have recourse for relevant pension trades.*** Under the Proposals, for purposes of financial end users such as pension plans determining their “material swaps exposure” (“MSE”), or a covered swap entity (“CSE”)⁶ and *any* counterparty it faces determining the phased-in effective date of initial margin requirements, the uncleared trading activity of “affiliates” must be taken into account. For these purposes, pension plans should not be deemed to have affiliates other than entities to whom CSE counterparties have recourse for relevant pension trades. Such an approach would be consistent with how substantial positions or counterparty exposure is counted for purposes of the CFTC’s “major swap participant” (“MSP”) definition.
- ***The inclusion of additional entities as pension affiliates, other than those to whom CSE counterparties have recourse for relevant pension trades, would be unworkable.*** The inclusion of any other entity as an affiliate (and the inclusion of their trades for purposes of determining initial margin requirements of a pension plan) would be impractical, inconsistent with market practice, and would overstate the economic exposure that a CSE counterparty faces from such pension plan’s derivatives positions. It would have a negative financial impact on many pension plans (and entities which could be deemed to be affiliated under the Proposals) which otherwise would not meet the initial margin threshold based on their own derivatives activity, including the cost of implementing new monitoring and reporting systems to keep track of exposure levels across affiliates worldwide. Additionally, the inclusion of additional entities as affiliates potentially would foreclose pension plans from using as third-party custodians current pension trustees who are never responsible for a pension’s liabilities. However, the Agencies can avoid these burdensome consequences by clarifying that pension plans should not be deemed to have any affiliates other than those entities to whom a CSE counterparty has recourse for the relevant pension trades.
- ***The multi-jurisdiction enforceability requirement for third-party custodian agreements is legally impractical.*** Parties to a contract can never be assured that the contract will be enforceable due to numerous

⁶ For purposes of this letter, a “CSE” includes any swap dealer or major swap participant, regardless of whether such entity is subject to oversight by the Prudential Regulators.

principles of law that can be asserted to claim a breach. Additionally, legal enforceability opinions often are contingent upon the laws of a particular jurisdiction applying that relate to the enforcement of creditors' rights during insolvency proceedings, yet the application of these very laws would never allow the legal opinion to be clean. Accordingly, the enforceability requirement should be removed from any final rules.

II. “Affiliates” for Purposes of Calculating an Entity’s Material Swaps Exposure and Selecting a Third-Party Custodian

The Coalition has a number of serious concerns regarding the definition of “affiliate” for purposes of calculating a pension’s MSE and selecting a third-party custodian to hold initial margin for the pension.

A. *Pension plans should not be deemed to have affiliates other than entities to whom a CSE counterparty has recourse for the relevant pension trades.*

The Coalition strongly urges the Agencies to drop the Proposals’ requirement that “affiliate” trades be counted towards MSE and that third-party custodians cannot be affiliates of a counterparty. Should the Agencies maintain these requirements, the Coalition believes that any final uncleared margin rules should recognize the unique relationship that exists between pension plans and their sponsors, trustees, and investment advisers. Due to these unique relationships, any final rules should make clear that a pension plan does not have any affiliates other than entities to whom a CSE counterparty has recourse for the relevant pension trades. This should be the case for the following reasons:

- Plan assets are managed for the exclusive benefit of the plan participants. As a result, plan service providers, trustees and plans sponsors are not true “owners” of such plans and their control of plan assets is solely for the benefit of the true “beneficial owners” *i.e.*, the plan beneficiaries;
- Treating pension plans as having affiliates would be contrary to current counterparty credit treatment of plans. Dealers only look to the assets of the pension plan and not the assets of any plan sponsor, service provider, or investment vehicle invested in by the plan when making credit decisions on whether to trade with a pension plan. Similarly, when CSEs enter into trades with a plan sponsor, service provider, or investment vehicle invested in by a plan, they do not look to the assets of the pension plan;
- Plans have no control over, or direct economic interest in, the trading of plan sponsors, trustees, and investment advisers in their individual capacity;
- Plans do not typically have access to the swap trading details of plan sponsors, trustees, and investment advisers in their individual capacity or investment vehicles in which they invest;

- Treating pension plans as having affiliates would impose significant and unworkable compliance obligations which would unduly disrupt the normal business activities of true derivatives end users and apply to cross-border transactions with no nexus to the U.S. economy;
- Artificially including the positions of entities such as plan sponsors, trustees, and investment adviser service providers in MSE calculations would cause most pension plans (even those with insignificant swaps trading) to breach the \$3 billion position threshold for requiring initial margin; and
- The negative economic impact of pension plans making initial margin payments will cause serious operational and financial harm to the detriment of the plans' participants.

Moreover, the Coalition's request to limit pension plan affiliates to those entities to whom a CSE counterparty has recourse for relevant pension trades is consistent with the CFTC's existing methodology for determining whether a market participant has material positions or material counterparty exposure and thus is an MSP. The MSP definition already is well known to the main universe of derivatives counterparties who would need to calculate MSE under the Proposals—*i.e.*, non-dealer financial entities such as pension plans. Given the similar Congressional focus on significant swaps positions for purposes of both the MSP designation and uncleared margin requirements, it would not make sense to have a more narrow affiliate definition for one but not the other. The Agencies therefore should clarify that pension plan affiliates are limited to entities to whom CSE counterparties have recourse for relevant pension trades.

B. By including “affiliate” trades in the MSE calculation, the Proposals would impose new and unworkable monitoring and reporting compliance burdens on a large number of U.S. and foreign entities, many of whom lack significant derivatives activities.

The Proposals define “affiliate” to mean any company that controls, is controlled by, or is under common control with another company. The Proposals provide that “control” of another company means:

- (i) Ownership, control, or power to vote 25 percent or more of a class of voting securities of the company, directly or indirectly or acting through one or more other persons;
- (ii) Ownership or control of 25 percent or more of the total equity of the company, directly or indirectly or acting through one or more other persons; or
- (iii) Control in any manner of the election of a majority of the directors or trustees of the company.

The Coalition notes that the definition of “affiliate” and the reference to “control” are used in the context of a “company,” which under the Bank Holding Company Act (“BHCA”) definitions could include many types of legal entities, regardless of the form of organization (*e.g.*, a trust, limited liability company, partnership, corporation, etc.).⁷ Assuming that all legal entities are captured by the definition of “company,” the Coalition believes that the inclusion of such “affiliates” would impose new expensive and unworkable (both legally and practically) global compliance obligations on many U.S. and non-U.S. market participants in the following contexts:

Passive Investors of Investment Vehicles. The Proposals would require a pension plan that is a passive investor owning 25% or more of an investment vehicle’s voting securities (“25 Percent Limit”) to aggregate the positions of such investment vehicle with those of the pension plan for purposes of determining if the pension plan *or* the investment vehicle has breached the Proposals’ thresholds for initial margin.⁸ As a result, pension plans invested in collective investment vehicles will face unduly burdensome costs in applying the Prudential Regulator’s “affiliate” position aggregation requirements. For example, plans that meet or exceed the 25 Percent Limit will have to monitor the derivative trading positions of such investment vehicles and vice versa. If pension plan positions are attributed to investment vehicles, then investment vehicles may be reluctant to include as an investor any pension plan with significant derivatives positions outside the vehicle. Similarly, investment vehicles will be discouraged from utilizing legitimate and prudent derivatives strategies because vehicles’ positions will be attributed to their investors and could cause indirect economic harm to such investors through the imposition of initial margin.

This type of aggregation of investment vehicles’ positions with the positions of passive investors makes no sense. Passive investors such as pension plans, even those who have 25% or more ownership, do not control the trading of those investment vehicles and they would typically have little or no knowledge regarding such investment vehicles’ swap trading positions and decisions. Further, dealer counterparties to such investment vehicles will not be looking to the credit of the vehicles’ investors for the vehicles’ swap positions. Nor will dealers be looking to the credit of individual investment vehicles held by the pension plans when facing the pension plans as counterparties.

We urge the Prudential Regulators to consider the implications of requiring pension plans to aggregate their positions with investment vehicles, which would include

⁷ The Prudential Regulators note that these definitions are the same as the definitions in the BHCA and thus “should be familiar to market participants.” While the BHCA may be familiar to banks and bank affiliates, the Coalition does not believe the BHCA is familiar to most market participants, including most pension plans in the Coalition.

⁸ The Prudential Regulator Proposals specifically requests comments on whether its definition of “control” (also used in the CFTC Proposals) would cause advised and sponsored funds to be considered affiliated with their investment advisers or sponsors. The Coalition agrees with the position taken in the 2013 international framework established by BCBS/IOSCO (“International Framework”) that investment funds should not be considered to be affiliated with any adviser or non-pension plan sponsor if the funds are separate legal entities that are not collateralized or otherwise guaranteed or supported by the adviser or sponsor (including any of its other funds) in the event of an insolvency or bankruptcy. As for pension plans, whether or not guaranteed or supported by its corporate sponsor, the plan sponsor should not be considered to be affiliated. Likewise, trustees and investment advisers to pension plans should not be considered affiliates of the plan. The Agencies should explicitly codify this view into their rules.

onerous compliance costs to monitor the swap positions of, and report their own swap positions to, collective investment vehicles in which they invest for purposes of calculating MSE of the pension plan or the investment vehicle. Many, if not most, of the collective investment vehicles invested in by plans utilize some form of swaps in their portfolio management. A large plan could have hundreds of investments in collective investment vehicles. The Coalition does not believe that plans currently have the compliance systems or capabilities to monitor the swap positions of collective investment vehicles in which plans are invested. Nor is the Coalition confident that sponsors of collective investment vehicles will either be willing to provide such information or be capable of providing such information to investors on a real-time or periodic basis.

Sponsors of Pension Plans/Trustees and Investment Advisers to Pension Plans.

The Coalition is concerned that under the Proposals, a sponsor of a pension plan could be deemed to be an “affiliate” of such pension plan by appointing the sole trustee for a pension plan or trust because it would have the power to appoint “a majority of the directors or trustees of” the pension plan. In addition, under the Proposals, a sponsor, trustee or investment adviser to a pension plan could be deemed an affiliate of the pension plan if it “controls” “25 percent or more of the total equity of the [plan] ... directly or indirectly or acting through one or more other persons.” The Coalition is concerned that under such a definition of control, a pension plan sponsor would be deemed to be an affiliate of the pension plan as a result of appointing or directing a trustee or appointing an investment adviser to such plan or trust. Similarly, the Coalition is concerned that such service providers could be deemed affiliates of pension plans as a result of having investment or administrative “control” of “25 percent or more of the total equity” of a pension plan.

Pension plan sponsors or their affiliates may be responsible for the selection of a trustee service provider/investment adviser for a pension plan or trust. Plan fiduciaries (which may include the plan sponsor and/or its subsidiaries) may also be responsible for the investment of the plan’s assets. However, the assets of the plan are exclusively for the benefit of the participants and are not the assets of the plan sponsor. Accordingly, the plan sponsor (and its direct/indirect subsidiaries) should not be deemed to have control or ownership as a result of serving as a plan fiduciary with control over the assets of the plans or having the power to make such trustee/investment adviser selections, nor should the trustee/investment adviser be deemed an “affiliate” of the pension plan or trust as a result of providing services to the pension plan.

If plan sponsors, trustees, or investment advisers are deemed “affiliates” of pension plans, the negative practical implications of such treatment cannot be overstated. First, the inclusion of plan sponsors, trustees, or investment advisers as pension plan “affiliates” (i) will require each of those entities to establish new, expensive and burdensome compliance regimes under which affiliates report their trades to enable the global tabulation of “affiliate” trades; and (ii) will in essence “export” U.S. law to every derivatives trade in every country in the world if done by a foreign affiliate of a financial end-user. Second, such compliance monitoring is problematic (if not impossible) because it would require position sharing among entities that would typically not have a right to such information, and such entities may be deemed to obtain an unfair market advantage

or insider information as a result. Further, the operational complexities of this global compliance burden would be enormous, particularly since U.S. laws are in English and would require translation into virtually every other language and then training in each country to sensitize foreign nationals to those U.S. derivatives laws. Further exacerbating the compliance burden is the reality that covered derivatives under U.S. regulations do not always align with definitions of derivatives in other countries such that each of a financial end-user's global affiliates would have to become U.S. derivatives legal experts. This expensive undertaking is not justified by any cost/burden analysis.⁹

C. The Restriction on Affiliated Third-Party Custodians is Overly Restrictive and Unworkable.

The Coalition applauds the Agencies for requiring initial margin to be segregated with a third-party custodian. Indeed, plans favor the ability to use third-party custodians.¹⁰ However, if the Agencies do not clarify that pension plan affiliates are limited to those entities to whom a CSE counterparty has recourse for relevant pension trades, then the Proposals' prohibition on a pension plan using an affiliated third-party custodian will go beyond the immediate Congressional purpose, be inconsistent with existing law, and prove operationally unworkable.

As previously discussed, pension plans share a unique relationship with their sponsors, trustees, and investment advisers. Currently, many pension plans use trustees (or affiliates thereof) as third-party custodians. However, a pension plan would not have the ability to direct its trustee to withhold margin payments that its CSE counterparty otherwise is entitled to receive under the UCC custodial agreements used for these types of arrangements. Moreover, pension plans are legally prohibited from assuming the liabilities of any other legal entity. Thus, from a systemic risk perspective, initial margin held by a third-party custodian that is a pension plan trustee or trustee affiliate would be no more at risk upon a default by the pension plan than it would be if held by some other unaffiliated third-party custodian.

The Proposals' restrictions on pension plans go beyond even ERISA requirements, which encompass broad transactional prohibitions based on counterparty relationship type. Yet under ERISA, and consistent with widely utilized exemptions thereunder, a pension plan trust can use a custodian affiliated with either its counterparty or its trustee. Additionally, the CFTC's current elective margin segregation rules in effect allow for affiliated third-party custodians to hold initial margin for uncleared swaps.¹¹ Although tri-party arrangements today are required by

⁹ Due to the prohibition on initial margin being held by an "affiliate" of a counterparty, pension plans would be forced to develop numerous additional tri-party custody relationships if their plans sponsor, trustee, or investment adviser service providers (and their affiliates) are considered affiliates of the pension plan.

¹⁰ The Agencies should consider requiring CSEs to establish third-party custodian accounts for *any* initial margin it collects from an end user, regardless of whether the CSE is required to collect it, if the end user so requests, consistent with CEA section 4s(l) and CFTC Rules 23.700-704.

¹¹ See 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, 66627 (Nov. 6, 2013) (codified at 17 C.F.R. 23.702).

law for registered mutual funds, even the SEC permits the use of affiliated entities acting as the tri-party custodian under certain conditions. Neither mutual funds nor their counterparties have viewed such affiliations as creating undue risk. The CFTC Proposal's departure from this position is neither harmonized sufficiently with its current rules nor explained, thus leaving open many questions about the interplay of its margin segregation rules.

Finally, should the Agencies not clarify that pension plan affiliates are limited to those entities to whom a CSE counterparty has recourse for relevant pension trades, it could have serious operational effects on pension plans already accustomed to posting margin with third-party custodians who could be considered affiliated under the Proposals. Pension plans would be forced to expend legal and business resources towards time consuming and expensive negotiations for multiple new tri-party agreements with custodian banks not affiliated with *any* potential counterparties. Additionally, the new custodial relationships will require expensive IT builds and ongoing operational resources to support the inevitable reconciliations of funds that will be required.

D. The Proposals' Inclusion of "Affiliate" Trades in Calculating An Entity's MSE Violates Congressional Intent

Including non-financial end-user affiliate trades which were exempted by Congress. In the CFTC release accompanying its proposal, the CFTC noted that non-financial end-user derivative positions "pose less risk to CSEs than financial entities."¹² Accordingly, the CFTC Proposal excludes non-financial end-users from initial margin obligations on their uncleared swaps. The CFTC noted that this exclusion was "consistent with Congressional intent" and that Dodd-Frank exempted "non-financial end users from the requirement that they submit trades to clearing."¹³ The CFTC further noted that if the CFTC "required end-users to post margin for uncleared trades, the clearing exemption could be weakened."¹⁴ Congress clearly intended to avoid imposing the economic burden of initial margin on non-financial end-users.

However, the Proposals do an end-run around the non-financial end-user exemption by indirectly imposing the economic burden of initial margin on financial end-user subsidiaries and affiliates that are non-financial end-users (which as defined under the Proposals could include sponsored pension plans). The Proposals would require a financial end-user with non-financial end-user affiliates to aggregate with its own positions the trades of such affiliated non-financial end-users.¹⁵ The end result is to

¹² CFTC Proposal, 79 Fed. Reg. at 59906.

¹³ CFTC Proposal, 79 Fed. Reg. at 59906.

¹⁴ *Id.*

¹⁵ For purposes of the phase-in schedule for margin requirements, the Proposals do not limit the CSE "counterparty" that is required to perform the exposure threshold calculation to only swap entities and financial end users. Yet neither Proposal would require non-financial end users to post initial or variation margin (subject to the limited authority in the Prudential Regulator Proposal described in Section IV, *infra*). Accordingly, the Agencies should clarify that non-

increase the initial margin requirements of the financial end-user, even when the financial end-user itself may have insignificant derivatives trading, solely because affiliated non-financial end-users hold uncleared swap positions. As noted above, non-financial end-user swaps should not be included because Congress exempted such trades from the initial margin requirements of clearing and deemed them to pose less risk to dealer counterparties.

Inclusion of “affiliate” trades otherwise excluded from the extra-territorial reach of U.S. derivatives regulation. The extra-territorial reach of U.S. derivatives laws was limited by Congress under the Commodity Exchange Act to those activities outside the United States which “have a direct and significant connection with activities in, or effect on, commerce of the United States.”¹⁶ The Proposals, however, ignore such Congressional limitation by requiring financial end-users to include all derivatives activities of their affiliates in their MSE calculation irrespective of whether such affiliates’ derivatives activities meet the Dodd-Frank standard. In essence, the Proposals deem *all* affiliates’ derivatives activities – regardless of the type of entity (financial or non-financial), purpose of trade (*e.g.* for hedging), amount, location, counterparty or economic significance to a U.S. affiliate – to have a “direct and significant connection” to the U.S. We believe this treatment of affiliate trades is a clear violation of Congressional intent and the plain meaning of the statute.

III. Initial Margin Segregation

Enforceability of custodial agreements. The Proposals sets forth a requirement that tri-party custodial agreements be “enforceable in insolvency.” While the Coalition views this requirement as well intentioned, from a practical standpoint it is simply unworkable. First, parties can never be assured that a contract always will be enforceable (whether in insolvency or otherwise) because many principles of law can be asserted to undo contractual provisions. For example, the parties’ conduct either before or after contract formation can be utilized to claim that the contract or particular terms thereof should not be enforced. In such an instance, the parties could claim that there was “fraud in the inducement” of the contract or that parties acted in “bad faith” in the performance of the contract.

Second, there could be multiple insolvency regimes (domestic and international) implicated by a tri-party custodial agreement and the enforceability thereof in any particular regime may be conditioned on the contract being governed by the laws of the regime’s jurisdiction. For these and other reasons, one of the key exceptions to the enforcement of a law firm opinion is the applicability of federal or state bankruptcy, insolvency, fraudulent conveyance, reorganization, moratorium, or similar laws relating to or affecting the enforcement of creditors’ rights generally, now or hereafter in effect, and to any judicially developed doctrines related thereto. As a result (and most importantly), market participants will be unable to obtain “clean”

financial end users facing a CSE on an uncleared trade are not required to perform the exposure threshold calculation for purposes of the phase-in schedule.

¹⁶ 7 U.S.C. § 2(i).

legal opinions as to the enforceability of these tri-party agreements. Based on the impracticality of this requirement, the Coalition requests the Agencies delete it.

Rehypothecation. The Proposals also would prohibit the custodian from rehypothecating, pledging, reusing or otherwise transferring (through securities lending, repurchase agreement, reverse repurchase agreement, or other means) the funds or other property held by the custodian as the required initial margin, except for certain substitutions or reinvestment directed by the posting party. Recognizing the International Framework, the Agencies seek comment on whether it would be commercially viable to allow a CSE the ability, on a 1-time basis, to rehypothecate, repledge or reuse initial margin posted by a non-dealer financial end user in order to hedge the CSE's exposure to the financial end user. The Coalition does not favor granting a CSE this one-time ability to rehypothecate for purposes of hedging its exposure or any other ability to rehypothecate, repledge or reuse initial margin posted by any end user unless the end user expressly consents to such rehypothecation, repledging or reuse.

IV. Two-Way Margin

The Coalition supports the Proposals' requirement that, in addition to collecting margin, a CSE would be *required to post* variation margin to all pension plans, as well as initial margin to pension plans that are financial end users with MSE (such plans, "larger plans"). However, the Coalition urges the Prudential Regulators to conform the Prudential Regulator Proposal to the CFTC Proposal with respect to initial margin requirements for pension plans that are financial end users without MSE (such plans, "smaller plans"). Under the Prudential Regulator Proposal, CSEs never would be obligated to post initial margin to smaller plans, but could require that smaller plans post initial margin if the CSE determines it appropriate to "address the credit risk posed by the counterparty and the risks of [their uncleared swaps]."¹⁷ The CFTC Proposal does not provide similar authority for CSEs to require initial margin from smaller plans.¹⁸ At a minimum, the Prudential Regulator Proposal should always provide smaller plans with the ability to elect reciprocal posting of initial margin to the extent the CSE requires posting initial margin.¹⁹

V. Eligible Margin Collateral

The Coalition continues to believe that the Proposals are too restrictive in the types of collateral that are eligible to be posted as margin.

Variation margin. In a step backwards from previous proposals, the current Proposals no longer would allow U.S. Treasuries as eligible collateral for variation margin. Rather, the Proposals limit variation margin collateral to cash (either U.S.

¹⁷ See Prudential Regulator Proposal at §_3(d).

¹⁸ See CFTC Proposal, 79 Fed. Reg. at 59,906.

¹⁹ The same issue exists under the Prudential Regulator Proposal with respect to the ability to require variation margin from non-financial end users, who should have a similar ability to elect reciprocal posting of variation margin.

dollars or the currency in which payment obligations under the uncleared swap are required to be settled). As recognized by the International Framework, the scope of permitted collateral for uncleared swaps should be broad enough to ensure that there is sufficient eligible collateral available to market participants.

The Coalition is concerned that the Proposals ultimately would decrease diversification in pension plans' investment portfolios and could serve to increase overall funding risks. Limiting variation margin to cash could unnecessarily force pension plans to hold a greater percentage of cash than might otherwise be prudent and cause a cash drag on performance. Furthermore, this cash limitation could have the perverse effect of expanding counterparty credit risk by consolidating cash at certain banks, thus injecting the risk of a bank insolvency into the counterparty relationship. At a minimum, therefore, U.S. Treasuries and other government agencies should be permitted for variation margin collateral, as allowed for under the International Framework.

Initial margin. The Coalition appreciates the Agencies' broadening of the types of collateral that are eligible to be posted as initial margin. Among other expanded types of eligible collateral for initial margin, the Proposals now would permit publicly-traded equities in the S&P Composite 1500 Index or any other index where a CSE can demonstrate the equities are as liquid and readily marketable, including an index recognized by a foreign regulator for the purpose of including equities as initial margin. We urge the Agencies to further expand eligible collateral for initial margin to include money market funds and certificates of deposit, which are widely considered to be liquid and readily marketable to the same extent as the indices now included in the current Proposals (and certainly more liquid than gold, which also would now be eligible collateral for initial margin).

VI. Material Swaps Exposure

In general, the Proposals would only require a CSE to post and collect initial margin to/from a financial end-user with MSE (*e.g.*, large plans). MSE would exist when, calculated across all counterparties in the aggregate for June, July, and August of the previous year, an entity *and its affiliates* have an average daily notional value of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps that exceeds \$3 billion (calculated only for business days). In addition to the concerns previously discussed regarding the inclusion of affiliate trades in the calculation, the Coalition requests that the Agencies consider the following modifications and clarifications.

Inclusion of foreign exchange products. The Coalition requests that the Agencies eliminate from the MSE calculation foreign exchange forwards and foreign exchange swaps determined by the U.S. Treasury Secretary to be exempt from the "swap" definition for purposes of CFTC regulation.²⁰ Similar to FX spot trades, these Treasury-exempted products involve an exchange of physical currencies, so to the

²⁰ Similarly, the Coalition requests clarification that FX spot trades should not be included in the MSE calculation.

extent FX spot is not counted, neither should exempt FX forwards and swaps. The Coalition disagrees that systemic risk would be mitigated by counting products “that would not themselves be subject to margin requirements” simply because “they are uncleared derivatives that pose risk.”²¹ If an entity’s derivatives portfolio consisted of solely Treasury-exempted products in excess of the MSE threshold, the Proposals would do nothing to mitigate the portfolio’s supposed risk (nor could they). As a result of including these products, an entity that does not otherwise engage in a substantial amount of uncleared derivatives would needlessly be required to pay initial margin for the insubstantial amount of its covered transactions.

MSE threshold level. The Coalition also requests that the Agencies set the initial MSE threshold at a level higher than \$3 billion, in line with the \$11 billion threshold called for by the International Framework. Unless the Agencies and foreign regulators can find common ground on MSE threshold levels, these disparities in non-cleared margin regimes will prove to be operationally unwieldy for both CSEs and pension plans, ultimately risking a flight from the U.S. to international regimes that allow for higher MSE thresholds.

Hedging transactions. Consistent with its recommendation to align the affiliate definition for pension plans with the MSP definition concept of dealer counterparty recourse, the Coalition also believes that hedging positions should not be counted towards MSE due to Congress’ recognition that hedging transactions pose less systemic risk than do speculative trades.

VII. Initial Margin Calculation Methods

Choice of methodology. The Proposals provide CSEs with sole discretion to determine the methodology by which initial margin will be calculated. The Coalition urges the Agencies to allow financial end-users to play a role in determining this methodology, particularly financial end-users such as large plans to whom CSEs will be required to post initial margin. At a minimum, if a CSE’s approved internal model calculates an initial margin payment that is higher than otherwise would be required under a table-based approach, the CSE should be required to obtain the financial end-user’s consent to posting such an amount. Furthermore, the Coalition also supports the International Framework principle that CSEs should not be allowed to switch between approved methodologies in order to benefit from the most favorable initial margin terms given the counterparty and trade. CSEs should be required to take a consistent approach over time and should not be able to switch models without the specific consent of a financial end-user.

Transparency of methodology. CSEs should be required to disclose the specifics of any internal model, including methodologies, inputs and key assumptions, to non-CSE counterparties from whom they require margin. For variation margin, the Proposals would require documentation be accessible to non-CSE counterparties that sets forth the methodology with sufficient specificity such that the non-CSE

²¹ See CFTC Proposals, 79 Fed. Reg. at 59,904 n.36.

counterparty can independently approximate the variation margin requirement. The same should be required for approved internal models for initial margin.

While the Coalition agrees with the Proposals that initial margin models must be approved by the relevant regulator, it bears emphasizing that these models and calculations should be consistent with commonly accepted market practices used today.²² In addition, if the Agencies permit CSEs to use internal margin models available for licensing by registered derivatives clearing organizations or third-party vendors, the Coalition believes that those initial margin models should also be open for review by market participants in all material respects.

Close-out period assumption. The Proposals would require a 10-day close-out period assumption. The Coalition continues to believe that a 10-day liquidation period substantially overstates the risk of many uncleared swaps and will create unnecessarily high initial margin requirements, particularly since models must use a 99-percent confidence interval and be calibrated to a period of financial stress. Internal models should be based on less than a 10-day period, closer to the current practice for cleared swaps of a 1-5 day close-out period assumption. Accordingly, consistent with prior proposals and the International Framework, the Coalition supports using a 3-5 day close-out period in initial margin models, which is sufficient to allow close-out, offset or other risk mitigation for uncleared swaps.

Risk offsets. The Proposals would prohibit risk offsets across different asset classes and divide commodities into even narrower asset classes. The Coalition believes that internal models for initial margin should permit risk offsets across instruments *and asset classes*, similar to the net-to-gross ratio concept in the Proposals for a standardized initial margin amount. Common trading practices recognize the risk-reducing relationship between cash positions and derivatives on related underliers or a combination of derivative types, each targeting a different component of the individual risks presented by the cash position. The calculation of initial margin should give full recognition to the risk mitigating benefits arising from related trades across risk profiles as well as across related derivatives and cash positions. Otherwise, pension plans will be forced to incur the unjustified expense of re-writing credit documentation to reflect this change in risk modeling.

VIII. Timing Requirements for Posting Margin

The Proposals would require a counterparty to post initial margin "on or before the business day *following the day* it enters into such non-cleared swap." Variation margin would be required to be posted once per business day. The Coalition appreciates the Agencies extending the posting timeframe for initial margin, and would support even further extensions of posting schedules for both initial and variation margin. Longer time periods to post margin could mitigate significant operational disruptions, errors, and costs as a result of industry-wide operational limitations.

²² For example, no initial margin model should be considered reasonable if it results in a pension plan counterparty that already paid the full premium for an option being required to post initial margin for the same option.

IX. Phase-in Schedule

Under the Proposals, phase-in exposure levels would apply separately to i) the CSE and its affiliates, and ii) the CSE's counterparty and the counterparty's affiliates. This means that not only will a financial end-user need to monitor its MSE, but a CSE also must keep track of its MSE in order to determine when initial margin requirements become effective. By imposing an aggregate notional amount for each counterparty, a CSE will not be able to determine what the compliance date is for swaps with a pension plan unless the CSE knows what the pension plan's notional exposure is. This in effect could provide a justification for the CSE to demand that the plan provide otherwise confidential information on the plan's uncleared positions with all of its other CSE counterparties.

The Coalition does not see any reason for requiring pension plans or other non-CSEs to provide such information. Virtually no plans (nor any other non-CSEs) will have aggregate notional amounts in the trillions of dollars that are relevant to the phase-in. In addition, any mechanism such as self-reporting to one of the Agencies for purposes of counterparties checking each other's status raises serious business confidentiality concerns with possible implications under the trader confidentiality provisions in Section 8 of the Commodity Exchange Act.

Accordingly, the Coalition suggests that the phase-in provisions be revised to apply only to uncleared trades between CSEs and that non-CSEs not be required to comply with initial margin requirements until December of 2019, as likely would be the case for non-CSEs already. Should the Agencies nonetheless decide to proceed with the phase-in as proposed, the Agencies should follow the common practice under many regulatory schemes of considering as sufficient a simple representation from a person as to their status as, for example, an "eligible contract participant" or QIB. A similar representation also should suffice for determining whether a financial end-user has MSE. To facilitate this representation, the Coalition would support the use of an ISDA protocol or representation letter.

Additionally, while most market participants currently have standardized credit documentation in place such as an ISDA Credit Support Annex, this documentation likely will need to be updated to reflect the substantive requirements in the Proposals (*e.g.*, restrictions on collateral and minimum transfer amounts). In light of these changes, the Coalition believes the December 1, 2015 effective date for variation margin requirements is too aggressive. Rather, the Coalition supports a 1-2 year additional delay before these variation margin requirements come into effect to give market participants ample time to update their trading documentation and internal compliance and operational systems.

X. International Harmonization

The Proposals both set forth how the Agencies will apply their non-cleared margin rules in a cross-border context. The Coalition urges the Agencies to strive for consistency among international rules for non-cleared margin.

If international regulations are not consistent, the Coalition believes that pension plans should be able to avail themselves of the best protections that exist globally and should not be limited by the rules of their home jurisdiction where those rules provide less protection than another jurisdiction. For example, if a U.S. pension plan desires to avail itself of collateral protections that are offered only in Europe and enters in a transaction in Europe with a counterparty to avail itself of such protections, local European regulation should prevail and the U.S. pension plan should not lose such protections solely because they are not offered in the U.S.

XI. Conclusion

On behalf of its membership, the Coalition thanks the Agencies for this opportunity to comment on the Proposals and hopes that the comments provided herein will illustrate the negative impacts that certain aspects of the Proposals would have on pension plans and their sponsors, trustees, and investment advisers. Notwithstanding these comments, the Coalition continues to believe that pension plans are unique from other financial end-users and therefore should not be subject to initial margin requirements. At a minimum, the Coalition urges the Agencies to revisit the MSE calculation and third-party custodial agreement requirements, clarifying in these contexts that affiliates of pension plans are limited to those entities to whom a CSE counterparty has recourse for relevant pension trades. Such treatment is consistent with previous CFTC views regarding when an entity's use of derivatives is significant enough to warrant additional regulation.

Thank you in advance for your consideration of the Coalition's views.

American Benefits Council
The Committee on Investment of Employee Benefit Assets
European Association of Paritarian Institutions
National Coordinating Committee for Multiemployer Plans
PensionsEurope
Pension Investment Association of Canada