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Alternative Investment Management Association

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission,
100 F Street, NE
Washington, DC 20549–1090

By electronic submission: http://www.sec.gov/rules/proposed.shtml

22 February 2013

Dear Sirs,

AIMA's response to the Securities and Exchange Commission's Proposed Rule, 'Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers' (RIN 3235-AL12)

The Alternative Investment Management Association Limited (AIMA)[1] welcomes the opportunity to respond to the Securities and Exchange Commission's (the Commission) 'Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers; Proposed Rule'[2] (the Proposed Rules).

AIMA supports the Commission's efforts to enhance security-based swaps (SBS) customer protections and reduce risk in the SBS market through measured capital, margin and segregation requirements for security-based swap dealers (SBSDs) and major security-based swap participants.

1. AIMA support for the MFA Submission in respect of the Proposed Segregation Rules

AIMA has been closely following the work of the Managed Funds Association[3] on the Proposed Rules and would like to express its support for the position of the MFA in its submission in relation to the Proposed Rules dated 22 February 2013 (the MFA Submission).[4]

In particular, AIMA would like to register its agreement with respect to the position of the MFA on the Commission's proposals for the segregation of collateral for cleared and non-cleared SBS. AIMA agrees with the MFA Submission which recommends the Commission:

i. harmonise its segregation rules with the Commodity Futures Trading Commission (CFTC) final segregation rules for cleared swaps by adopting the legal segregation with operational commingling (LSOC) model as the default segregation model;
ii. permit a customer to waive LSOC protections and elect omnibus segregation for its cleared SBS; and
iii. preserve the option to implement an optional individual segregation model for cleared SBS collateral in the future.

In addition to the above, AIMA refers to its previous submissions[5] to the CFTC wherein AIMA recommends that the CFTC should ideally introduce full segregation of collateral with independent third parties, as only under this model will customers have confidence that their margin will be fully protected.

1 AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, funds of hedge fund managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,300 corporate bodies in over 50 countries

2 The Proposed Rules, available at: http://www.gpo.gov/fdsys/pkg/FR-2012-11-23/pdf/2012-26164.pdf

3 Managed Funds Association (**MFA**) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and all other regions where MFA members are market participants

4 MFA Submission, available at: https://www.managedfunds.org/wp-content/uploads/2013/02/SEC-Proposed-Capital-Margin-and-Segregation-Rules-Final-MFA-Letter.pdf

As stated in those previous submissions, although AIMA believes that LSOC would mitigate fellow customer risk, we do not believe that this would provide the fullest protection for clients and may not allow for the immediate transfer of collateral upon a clearing member's failure (i.e., where assets and positions are transferred individually). We therefore encourage the Commission, in line with the CFTC's approach, to explore the individual segregation model with a view to customers having the option for an enhanced segregation framework beyond the LSOC model.[6]

2. Further AIMA Support for the MFA Submission in respect of the Proposed Margin Rules and Proposed Capital Rules

We further agree with the following recommendations made in the MFA Submission:

i. **Capital charge -** in connection with the Commission ensuring that the individual segregation model is a realistic option for customers, it is necessary for the Commission to remove the proposed capital charge on non-bank SBSDs in the event that their non-commercial end-user counterparties elect to have their initial margin segregated in an account at an independent third-party custodian. We agree with the MFA's position that since customers will ultimately incur the additional cost, the proposed capital charge would make electing individual segregation prohibitively expensive;
ii. **Bilateral exchange of VM -** require SBSDs to both collect and post variation margin (VM) with regard to SBS that they enter into with non-commercial end-users, such as financial entity counterparties, especially given this would ensure international uniformity with the Working Group on Margining Requirements of the Basel Committee of Banking Supervision and the International Organization of Securities Commissions proposal for universal two-way exchange of VM;[7] and
iii. **Qualifying netting agreements -** permit robust netting practices with respect to both initial margin (IM) and VM for cleared and non-cleared derivatives. We agree with the MFA that without extending the scope there is a risk that such a limitation would "result in inadequate allowances for netting, which would in turn lead to over-collateralization of otherwise offsetting positions"[8];
iv. **Cross-product portfolio margining -** permit SBSDs' internal models for calculating IM to account for risk on a portfolio basis, specifically accounting for risk offsets within asset classes which would account for risk on a portfolio basis under cross-product master netting agreements rather than derivatives that are subject to a single, legally enforceable netting agreement. Again, we agree with the MFA that this would "substantially mitigate the potential issue of a shortfall in eligible collateral in the wake of global regulatory reforms in the derivatives markets by allowing counterparties to recognize offsets for correlated financial instruments, including cleared and non-cleared derivatives".[9]

We hope you will find our submission helpful and please do let us know if you would like to discuss any of the above comments in more detail.

Yours faithfully,

Adam Jacobs
Director of Markets Regulation

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5 AIMA submission, 'Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies' dated 18 January 2011, available at: http://comments.Commission.gov/PublicComments/ViewComment.aspx?id=27132&SearchText=; AIMA comment letter, 'MF Global Inc. and its implications for Commission rulemaking under Title VII of the Dodd-Frank Act' dated 6 January 2012, available at: http://www.aima.org/objects_store/aima_comments_to_the_cftc_on_mf_global_-_6_january_2012.pdf

6 We refer here to the CFTC's consideration of further enhancements to the segregation model in further rulemaking at the two-day roundtable discussion held on February 29, 2012. Day one transcripts available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/transcript022912am.pdf and http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/transcript022912pm.pdf; Day two transcripts available at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/transcript030112.pdf

7 Basel-IOSCO Consultative Document dated July 2012, 'Margin Requirements for Non-Centrally-Cleared Derivatives', available at: http://www.bis.org/publ/bcbs226.pdf and the Second Consultative Document dated 15 February 2013, 'Margin Requirements for Non-Centrally-Cleared Derivatives', available at http://www.bis.org/publ/bcbs242.pdf

8 Page 13 of the MFA Submission

9 Page 14 of the MFA Submission