

November 19, 2018

Mr. Brent Fields
Secretary of the Commission
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: File Number S7-08-12; RIN 3235-AL12

Capital, Margin and Segregation Requirements for Security-Based Swap Dealers and Major Security Based Swap Participants and Capital Requirements for Broker Dealers

Dear Mr. Fields:

The International Swaps and Derivatives Association, Inc. (“**ISDA**” or “**we**”)¹ appreciates the decision of the U.S. Securities and Exchange Commission (“**SEC**” or “**Commission**”) to re-open the comment period (the “**Re-Opening**”)² on the Commission’s previously proposed rules (“**Original Proposal**”) addressing capital, margin, and segregation requirements for security-based swap dealers (“**SBSDs**”) (collectively, the “**Proposal**”).³ ISDA recognizes the Commission’s ongoing commitment to open dialogue with security-based swap market participants on the Proposal, and its important efforts to coordinate with other regulators, both inside and outside of the United States. The Proposal addresses matters of significant

¹ Information regarding ISDA is contained in the Appendix.

² *Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers*, 83 Fed. Reg. 53007 (Oct. 19, 2018).

³ The Original Proposal was comprised of three different proposing releases from the Commission. These releases are set forth below:

Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 Fed. Reg. 70214 (Nov. 23, 2012).

Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 78 Fed. Reg. 30968 (May 23, 2013).

Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers, 79 Fed. Reg. 25194 (May 2, 2014).

ISDA has previously provided comments on certain aspects of the Proposal, and we incorporate into this submission those prior comment letters. *See, e.g.:*

Letter from Robert Pickel, Chief Executive Officer, International Swaps and Derivatives Association (Jan. 23, 2014).

Letter from International Swaps and Derivatives Association, et al. (Oct. 24, 2018).

importance and ISDA agrees with the Commission that prudent capital, margin and segregation requirements for SBSDs can serve to enhance the stability of the financial system.

ISDA generally supports many aspects of the Proposal and appreciates the Commission’s efforts to address earlier industry comments on the Proposal by including in the Re-Opening a series of potential modifications that the Commission could make to the Original Proposal (the “**Proposed Modifications**”). However, ISDA has concerns with certain aspects of the Proposal, including with respect to certain aspects of the Proposed Modifications, as described further below.

Executive Summary

Harmonization

ISDA recommends that the Commission revise certain aspects of the Proposal to harmonize the uncleared margin and segregation rules with international standards, including the BCBS-IOSCO Framework⁴ and the rules that have been adopted by the Commodity Futures Trading Commission (“**CFTC**”)⁵ and the U.S. banking regulators (the “**Prudential Regulators**”).⁶ ISDA offers the following specific harmonization comments, each of which are discussed in greater detail, below:

1. **Industry Standard Margin Models:** The SEC should permit nonbank SBSDs to apply for approval to use industry standard margin models, such as the ISDA Standard Initial Margin Model (or “**SIMM Model**”)⁷, for the calculation of IM for all security-based swaps, including equity security-based swaps.
2. **IM Threshold:** The SEC’s threshold for collecting initial margin (“**IM**”) from a counterparty should be based on the same fixed \$50 million level that was adopted by the CFTC and the Prudential Regulators with respect to swaps and the threshold should be calculated on a portfolio basis across all uncleared products subject to regulatory IM requirements.

⁴ See Basel Committee on Banking Supervision (“**BCBS**”), International Organization of Securities Commissions (“**IOSCO**”), *Margin Requirements for Non-Centrally Cleared Derivatives* (Mar. 2015)

⁵ See CFTC, *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants* (Jan. 6, 2016).

⁶ The Prudential Regulators include the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency. The rules of the Prudential Regulators are set forth in a joint release. See *Margin and Capital Requirements for Covered Swap Entities*, 50 Fed. Reg. 229 (Nov. 30, 2015).

⁷ See ISDA, *ISDA SIMMTM Deployed Today; New Industry Standard for Calculating Initial Margin Widely Adopted by Market Participants* (Sept. 1, 2016), available at: <https://www.isda.org/2016/09/01/isda-simm-deployed-today-new-industry-standard-for-calculating-initial-margin-widely-adopted-by-market-participants/>.

3. **Minimum Transfer Amount:** The SEC should allow a de-minimis minimum transfer amount up to \$500,000 in order to align with the CFTC, Prudential Regulators and the BCBS-IOSCO Framework.
4. **Scope of Counterparties subject to IM and AANA Levels.** Each of the SEC, CFTC and the Prudential Regulators should jointly coordinate with international standard setting bodies to define the scope of SBSD counterparties that will be subject to IM requirements and to address impending substantive challenges with the phase-in requirements set currently forth in the BCBS-IOSCO Framework.⁸ Importantly, the lowest tier of aggregate average notional amount (“AANA”) that may cause any swap or security-based swap counterparty to a swap dealer or SBSD to be in-scope for purposes of the IM aspects of the margin rules should be raised from \$8 billion to \$100 billion.
5. **Interdealer IM Collection:** ISDA’s members encourage the SEC to pursue both U.S. and international harmonization to the greatest extent possible, including with respect to the rules that address the posting of IM on uncleared security-based swap transactions between SBSBs. ISDA understands, however, that idiosyncratic SEC capital and segregation rules affect the appropriateness of the posting of IM on uncleared security-based swap transactions between SBSBs. In this context, ISDA urges the SEC to avoid adopting any final rules that, in conjunction with or when acting in concert with other SEC requirements, such as the capital and segregation requirements for broker-dealers, could create an uneven playing field.
6. **Inter-affiliate Exemption.** Consistent with the CFTC’s rules, the SEC’s rules should ensure that inter-affiliate transactions are exempt from the IM requirement.
7. **Portfolio Margining:** ISDA supports portfolio margining of swaps and security-based swaps and encourages the Commission to coordinate with the CFTC, Prudential Regulators, international standard setting bodies, and the industry to implement portfolio margining rules that are uniform, consistent, and practical as implemented across rule sets and jurisdictions.
8. **Segregation:** We also ask the SEC to coordinate with U.S. regulators and international standard setting bodies to implement unified and consistent segregation requirements.

Substituted Compliance

In addition to the harmonization comments above, ISDA also encourages the SEC to finalize principles-based substituted compliance determinations that will permit non-U.S. market participants to comply with their home jurisdiction rules as an alternative to the SEC’s rules. The substituted compliance determinations should look for a comparable comprehensive regime in the home jurisdiction, and the review must not become a line-by-line comparison of SEC rules against the home jurisdiction law and regulations.

⁸ ISDA has previously commented on the issues posed by the phase-in requirements in the BCBS-IOSCO Framework. See ISDA, et. al, *Re: Margin Requirements for Non-Centrally Cleared Derivatives – Final Stages of Initial Margin Phase-In* (Sep. 12, 2018) (“September 2018 Advocacy Letter”).

We also urge the Commission to further consult with market participants and regulators, and ultimately publish, in a single document, a unified re-proposal of these rules, including a full cost-benefit analysis, reflecting changes that can be made to incorporate the comments received in response to the Re-Opening and on the Proposed Modifications.

Harmonization

The Proposal, as amended by the Proposed Modifications, differs in several important respects from the final rules adopted by the CFTC and the Prudential Regulators and from relevant international standards. ISDA requests that the Commission ensure that its margin and segregation rules for security-based swaps are compatible with the rules issued by the CFTC and the Prudential Regulators, as well as the standards set forth in the BCBS-IOSCO Framework issued by the Working Group on Margining Requirements. ISDA believes that in the context of a global business such as the security-based swap markets, if the margin or segregation requirements under the SEC's rules differ from the rules of the CFTC, the Prudential Regulators or the international standards, it will be disruptive to business, creating unnecessary cost with no corresponding regulatory or customer protection benefit.

1. Market participants would benefit from the use of industry standard IM models.

The Commission's Proposed Modifications would permit nonbank SBSBs to apply to use models to compute IM for non-equity security based-swaps in lieu of the standardized deductions ("**Model Proposal**"). ISDA supports the Model Proposal, but ISDA believes the rules have to go further. In-scope firms should be permitted to apply to use an industry standard margin model, such as the ISDA Standard Initial Margin Model (ISDA SIMMTM), to compute IM on a portfolio basis for all uncleared products subject to regulatory margin requirements.⁹ Importantly, ISDA believes that SBSBs should be permitted to apply to use industry standard models to calculate IM with respect to swaps and all security-based swaps (without a distinction as between equity- and debt- security-based swaps).¹⁰ Distinguishing between debt and equity-based security based swaps would create an artificial regulatory distinction in the context of a trading business that, from an operational and economic perspective, functions as a single unit would create unnecessary and costly disruption.

In the Re-Opening, the Commission acknowledged the widespread adoption of the ISDA SIMM by swap dealers subject to the rules of the CFTC or the Prudential Regulators. Requiring these swap dealers to use any other approach for IM calculations in the context of security-based swaps would result in operational issues and would cause a disruption in the continuity afforded to swap dealers already utilizing the ISDA SIMM. ISDA believes the ISDA SIMM has previously demonstrated and achieved conceptual soundness at the industry level and allowing SBSBs to apply to use the ISDA SIMM would increase market efficiency and ensure a level

⁹ ISDA provides additional comments on Portfolio Margining below.

¹⁰ While ISDA supports the use of the ISDA SIMM model, ISDA supports a rule that would permit firms to request approval of any model of their choice

playing field.¹¹ As we expect a number of swap dealer affiliates of SBSDs will have already obtained approval to use ISDA SIMM by the CFTC and/or other global regulators, the SEC should streamline and align their approval process with the CFTC's to avoid duplicative, onerous, or conflicting approval requirements.

2. ISDA recommends the use of a fixed \$50 million threshold for the collection of IM.

ISDA believes the SEC's threshold for collecting IM from a counterparty should be based on the same fixed \$50 million level in net exposure that was adopted by the CFTC and the Prudential Regulators with respect to swaps.

ISDA recognizes and appreciates the Commission's effort to establish a threshold that is scalable and has a more direct relation to the risk to the nonbank SBSD arising from its security-based swap activities. However, ISDA believes that a scalable threshold would cause significant operational challenges and inefficiencies by subjecting individual SBSDs, as well as different SBSDs across multiple jurisdictions, to different thresholds for the collection of IM.

3. ISDA recommends allowing a minimum transfer amount up to \$500,000

ISDA recommends that the SEC allows a SBSD and its counterparty to agree to a minimum transfer amount of up to \$500,000, rather than the proposed \$100,000, below which the parties would not be required to exchange margin. This level aligns with the requirements of the CFTC, the Prudential Regulators and the BCBS-IOSCO Framework.¹² The use of a minimum transfer amount mitigates the cost of delivering and retaining small amounts of collateral. Since minimum transfer amounts are applied globally to margin amounts at the portfolio level for each of IM and variation margin ("VM"), it is essential that the SEC align with global standards already in effect as a separate settlement would not occur for security-based swaps alone to which an alternative standard could be applied. The parties should also be allowed to agree in advance to split the minimum transfer amount between their VM and IM margin amounts, since these exchanges often occur separately.

4. ISDA asks the Commission to coordinate with global regulators to define the scope of SBSD counterparties that will be subject to IM requirements as well as to address substantive challenges currently presented by the BCBS-IOSCO Framework.

ISDA believes that the SEC should harmonize its requirements with respect to the scope of SBSD counterparties that may be subject to IM by following the AANA approach that has been adopted by the CFTC, the Prudential Regulators, and global regulators. Margin requirements on non-centrally cleared derivatives will represent a significant policy change for most market participants and a phase-in regime with AANA thresholds that are globally consistent will facilitate seamless implementation of the margin rules.

¹¹ ISDA stands ready to provide the Commission with any information that it may wish to review relating to ISDA's development and ongoing review of the SIMM Model.

¹² Requirement 2.3 provides that all margin transfers may be subject to a de-minimus minimum transfer amount not to exceed EUR 500,000.

In connection with this request, we note that ISDA has previously advocated for and continues to advocate for a number of changes to address substantive challenges that would result from implementation of the requirements as currently set forth in the BCBS-IOSCO Framework and we refer the Commission to those comments.¹³ While ISDA supports the requirements set forth in the BCBS-IOSCO Framework as a baseline, we recommend that each of the SEC, CFTC and the Prudential Regulators jointly coordinate with international standard setting bodies to revise the requirements in order to address these substantive challenges.

Most importantly, ISDA supports an increase in the lowest tier of AANA threshold that will subject a counterparty to IM to \$100 billion, raising it from the current threshold of \$8 billion. ISDA has conducted a study that supports setting the lowest tier of AANA threshold at \$100 billion. This level allows the regulatory margin requirements to bring in-scope the overwhelming majority of the notional exposure in the markets—by focusing on the largest participants—while also significantly minimizing the number of small and medium sized firms that could be in scope.

For these small and medium sized firms, becoming in scope for purposes of the regulatory IM requirements requires a full re-documentation of their relationships with each of their dealers, additional compliance policies and procedures, as well as setting up the operational infrastructure to comply with the rules. These are meaningful costs that cannot be incurred on a sliding scale basis. That is, even if the expected IM to be posted by a small or medium sized firm is relatively de minimis (due to their relatively small trading portfolio), the firm must incur all of the administrative and operational cost that is required to become compliant.

If the SEC implements a lowest tier AANA threshold that is consistent with the BCBS-IOSCO Framework, ISDA also encourages the SEC to permit SBSBs to exclude physically settled foreign exchange swaps and forwards from the AANA calculations. Eliminating these instruments from the AANA calculations will prevent the application of the regulatory IM requirements entities who otherwise would be subject to little or no regulatory IM. An entity should not become in scope for the margin rules based on its activities in a product set that is not itself subject to margin requirements.

5. Interdealer IM

ISDA's members encourage the SEC to pursue both U.S. and international harmonization to the greatest extent possible, including with respect to the rules that will address the posting of IM on uncleared security-based swap transactions between SBSBs. However, and notwithstanding that the Alternative B set forth in the Re-Opening would harmonize the SEC's interdealer IM requirements with those of the CFTC and the Prudential Regulators, ISDA understands that other idiosyncratic SEC capital and segregation rules affect the appropriateness of the posting of IM on uncleared security-based swap transactions between SBSBs. In this context, ISDA urges the SEC to avoid adopting any final rules with respect to interdealer IM that, in conjunction with or when acting in concert with other SEC requirements, such as the capital and segregation

¹³ See September 2018 Advocacy Letter.

requirements for broker-dealers, could create an uneven playing field between SBSDs and other U.S. and foreign regulated entities.

6. Inter-affiliate Exemption

To ensure consistency with the CFTC's swap rules, ISDA also requests that the SEC expressly provide for an exemption from the collection of IM for inter-affiliate security-based swap transactions. ISDA believes that this exemption is appropriate given that inter-affiliate transactions do not increase the overall risk profile or leverage of the SBSD.

7. Portfolio Margining

ISDA supports portfolio margining of over-the-counter derivatives and urges the Commission to permit portfolio margining of swaps and security-based swaps in the final margin rules. Flexibility in choosing a broader product set for calculation of IM will greatly facilitate the process of margin collection by allowing each counterparty pair to choose the set that is best suited to the calculation of margin and management of risk for the portfolio of trades between the particular counterparty pair. This flexibility is entirely consistent with the risk-reduction goals of the margin rules and with the use of one industry standard model to calculate margin. ISDA asks the Commission to coordinate with the CFTC, Prudential Regulators, international standard setting bodies, and the industry to implement portfolio margining rules that are uniform, consistent, and practical as implemented across rule sets and jurisdictions.

ISDA highlights that the CFTC has previously granted no-action relief and has allowed security-based swaps to be included in the same product set as swaps for the calculation of initial margin.¹⁴

8. Segregation

ISDA specifically urges the SEC to coordinate with the CFTC, the Prudential Regulators and international standard setting bodies to harmonize the segregation rules. Under the same principles as discussed above, differing requirements for individual SBSDs that are subject to the CFTC rules, the Prudential Regulators, or the rules of international standard setting bodies will introduce regulatory burdens and operational issues that could fragment the security-based swap market in a manner that is detrimental to security-based swap market participants or that would otherwise impose unreasonable burdens on SBSDs.

Substituted Compliance

ISDA broadly supports substituted compliance and encourages the SEC to consider substituted compliance as a key component in its cross-border approach to security-based swap regulation.¹⁵

¹⁴ See CFTC No-Action Letter 16-71, *Request to Include Security-Based Swaps in Product Set for Initial Margin for Uncleared Swaps* (Aug. 23, 2016).

Mutual commitment to cross-border regulatory deference means that market participants can rely on one set of rules – in their totality – without fear that another jurisdiction will seek to selectively impose an additional layer of regulatory obligations. This approach is essential to ensuring strong and stable derivatives markets that support economic growth both within the United States and around the globe. The terms of a substituted compliance determination should be straightforward and unconditional to prevent the fragmentation of markets, protectionism, and regulatory arbitrage that the SEC should seek to avoid.

Specifically, ISDA recommends the SEC permit substituted compliance determinations for SBSBs that are already subject to an existing comprehensive regime adopted by foreign or U.S. regulators. Doing so would allow the SEC to leverage the expertise of global regulators who are likely best suited to tailor and adopt rules for their own domestic markets.

In ISDA's view it is of paramount importance that the substituted compliance determinations do not become a rule by rule, line by line analysis of the SEC rules against foreign law and regulations. Such a process does not give due deference to foreign regulators and implies a one-size-fits-all for every jurisdiction and derivatives market in the world. ISDA believes that the focus of substituted compliance determinations should be the comprehensiveness of the regime – does the regime have the key features of a comprehensive derivatives regime (for example, margining, reporting, documentation, customer protection and regulatory enforcement provisions)? It simply is not the case that the SEC rules are the proper framework for every derivatives market in the world.

For example, an entity that is subject to derivatives regulation in the European Union, while also registered as a SBSB in the United States, should be permitted to comply with the European Union's regulations as a substitute for the SEC rules. As noted above, we encourage the SEC to coordinate with global and U.S. regulators to harmonize the security-based swap segregation rules into a uniform, global set of rules. However, to the extent that the SEC's segregation requirements ultimately differ from those of the international standard setting bodies, the CFTC rules or the Prudential Regulator rules, substituted compliance should be available to those security-based swap dealers who are already subject to a comprehensive derivatives rule regime.

Compliance Date

ISDA appreciates the Commission's request for comment on the proposed compliance date for the final capital, margin, and segregation rules for security-based swaps. ISDA requests that the Commission implement a compliance date that is the later of eighteen (18) months after the first date on which SBSBs are required to register with the SEC, or the date on which the SEC has adopted substituted compliance determinations with respect to non-U.S. SBSBs (the

¹⁵ ISDA has previously published a white-paper addressing cross-border harmonization and substituted compliance. See ISDA, *Whitepaper: Cross-Border Harmonization of Derivatives Regulatory Regimes: A risk-based framework for substituted compliance via cross-border principles* (Sep. 2017).

“**Registration Compliance Date**”). Moreover, we suggest that the rules not come into effect until after a sufficient time for the Commission to approve all model applications submitted by nonbank SBSBs that register by the Registration Compliance Date.

While ISDA currently believes that the above described compliance phase-in period would be appropriate, we ask the Commission to consider the significant operational hurdles and logistical challenges that would result if market participants need to comply with differing rules from different regulators and international bodies.

Conclusion and Request for a Re-Proposal

ISDA appreciates the work of the Commission to issue the Re-Opening and its efforts to address prior concerns raised by market participants through the Proposed Modifications. While ISDA is supportive of many aspects of the Proposed Modifications, ISDA believes that with further consultation between market participants and regulators, particularly on the topics raised in this letter, certain aspects of the Proposal can be improved. Importantly, several aspects of the Proposal must be revised to be consistent with the rules adopted by other U.S. regulators and international standards. ISDA notes that a significant amount of time has passed since the release of the Original Proposal.

ISDA encourages the Commission to publish, in a single document, a unified re-proposal of these rules, reflecting changes that can be made to incorporate the comments received in response to the Re-Opening and on the Proposed Modifications, and including a full cost-benefit analysis. We believe it is challenging to provide meaningful comment on a proposed set of rules where the underlying proposal is spread across three documents that were issued at three different times when over six years has elapsed since the first proposal and over four years since the latest proposal. More importantly, each modification to the Original Proposal will have implications for multiple components of these and other rules, and ISDA believes that publishing the entire set of proposed rules in single document is most effective way to facilitate the review and comment process, both for market participants and the Commission.

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ISDA appreciates the opportunity to provide these comments. If we may provide further information, please do not hesitate to contact the undersigned or ISDA staff.

Sincerely,

A handwritten signature in black ink, appearing to read "S. O'Malia". The signature is fluid and cursive, with a large initial "S" and "O".

Scott O'Malia
Chief Executive Officer

cc: *SEC Chairman*
Jay Clayton

SEC Commissioners

Kara M. Stein

Robert J. Jackson Jr.

Hester M. Peirce

Elad L. Roisman

APPENDIX

International Swaps and Derivatives Association, Inc. (ISDA)

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 70 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter @ISDA.