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Issued on July 21, 2023.

Victor Wicklund,

Deputy Director, Compliance & Airworthiness Division, Aircraft Certification Service.

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 23

RIN 3038–AF36

Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants

AGENCY: Commodity Futures Trading Commission

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (''Commission'' or ''CFTC'') is proposing to amend the margin requirements for uncleared swaps applicable to swap dealers (''SDs'') and major swap participants (''MSPs'') for which there is no prudential regulator. The proposed amendment would revise the definition of ''margin affiliate'' to provide that certain collective investment vehicles (''investment funds'' or ''funds'') that receive all of their start-up capital, or a portion thereof, from a sponsor entity (''seeded funds'') would be deemed not to have any margin affiliates for the purposes of calculating certain thresholds that trigger the requirement to exchange initial margin (''IM'') for uncleared swaps. This proposed amendment (''Seeded Funds Proposal'') would effectively relieve SDs and MSPs from the requirement to post and collect IM with certain eligible seeded funds for their uncleared swaps for a period of three years from the date on which the eligible seeded fund's asset manager first begins making investments on behalf of the fund (''trading inception date''). The Commission is also proposing to eliminate a provision disqualifying the securities issued by certain pooled investment funds (''money market and similar funds'') that transfer their assets through securities lending, securities borrowing, repurchase agreements, reverse repurchase agreements, and similar arrangements from being used as eligible IM collateral, thereby expanding the scope of assets that qualify as eligible collateral (''Money Market Funds Proposal''). Additionally, the Commission is proposing an amendment to the haircut schedule set forth in a Commission Regulation to add a footnote that was inadvertently omitted when the rule was originally promulgated.

DATES: With respect to the proposed amendments, comments must be received on or before October 10, 2023.

ADDRESSES: You may submit comments, identified by RIN 3038–AF36, by any of the following methods:

- *CFTC Comments Portal: https://comments.cftc.gov.* Select the ''Submit Comments'' link for this rulemaking and follow the instructions on the Public Comment Form.
- *Mail:* Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Center, 1155 21st Street NW, Washington, DC 20581.
- *Hand Delivery/Courier:* Follow the same instructions as for Mail, above.

Please submit your comments using only one of these methods. Submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *https://comments.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (''FOIA''), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission's regulations.[1]

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from *https://comments.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the FOIA.

FOR FURTHER INFORMATION CONTACT: Amanda L. Olear, Director, 202–418–5283, *aolear@cftc.gov;* Thomas J. Smith, Deputy Director, 202–418–5495, *tsmith@cftc.gov;* Warren Gorlick, Associate Director, 202–418–5195, *wgorlick@cftc.gov;* Rafael Martinez, Associate Director, 202–418–5462, *rmartinez@cftc.gov;* or Liliya Bozhanova, Special Counsel, 202–418–6232, *lbozhanova@cftc.gov*, Market Participants Division, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Statutory and Regulatory Background

Section 4s(e) of the Commodity Exchange Act (''CEA'' or ''Act'')[2] requires the Commission to adopt rules establishing minimum initial and variation margin requirements for all swaps[3] that are: (i) entered into by an SD[4] or MSP[5] for which there is no prudential regulator[6] (collectively, ''covered swap entities'' or ''CSEs'');[7] and (ii) not cleared by a registered derivatives clearing organization (''uncleared swaps'').[8] To offset the greater risk to the SD or MSP and the financial system arising from the use of uncleared swaps, these requirements must: (i) help ensure the safety and soundness of the SD or MSP; and (ii) be appropriate for the risk associated with

[1] 17 CFR 145.9. Commission regulations referred to herein are found at 17 CFR Chapter I.

[2] 7 U.S.C. 6s(e) (capital and margin requirements).

[3] CEA section 1a(47), 7 U.S.C. 1a(47) (swap definition); Commission Regulation 1.3, 17 CFR 1.3 (further definition of a swap). A swap includes, among other things, an interest rate swap, commodity swap, credit default swap, and currency swap.

[4] CEA section 1a(49), 7 U.S.C. 1a(49) (swap dealer definition); Commission Regulation 1.3 (further definition of swap dealer).

[5] CEA section 1a(32), 7 U.S.C. 1a(32) (major swap participant definition); Commission Regulation 1.3 (further definition of major swap participant).

[6] CEA section 1a(39), 7 U.S.C. 1a(39) (defining the term ''prudential regulator'' to 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 definition of ''prudential regulator'' further specifies the entities for which these agencies act as prudential regulators. The prudential regulators published final margin requirements in November 2015. *See generally* Margin and Capital Requirements for Covered Swap Entities, 80 FR 74840 (Nov. 30, 2015) (''Prudential Regulators Margin Rule''). The Prudential Regulators Margin Rule is substantially similar to the CFTC Margin Rule.

[7] CEA section 4s(e)(1)(B), 7 U.S.C. 6s(e)(1)(B). SDs and MSPs for which there is a prudential regulator must meet the margin requirements for uncleared swaps established by the applicable prudential regulator. CEA section 4s(e)(1)(A), 7 U.S.C. 6s(e)(1)(A).

[8] CEA section 4s(e)(2)(B)(ii), 7 U.S.C. 6s(e)(2)(B)(ii). In Commission Regulation 23.151, the Commission further defined this statutory language to mean all swaps that are not cleared by a registered derivatives clearing organization or a derivatives clearing organization that the Commission has exempted from registration as provided under the CEA. 17 CFR 23.151.

the uncleared swaps held by the SD or MSP.[9] In 2016, the Commission promulgated Commission Regulations 23.150 through 23.161 (''CFTC Margin Rule'') to implement section 4s(e).[10]

The CFTC Margin Rule imposes IM requirements on uncleared swaps entered into by CSEs and certain specified counterparties. More specifically, Commission Regulation 23.152 requires CSEs to collect and post IM[11] with each counterparty that is an SD, MSP or financial end user (''FEU'') with material swaps exposure (''MSE'').[12] Commission Regulation 23.151 defines the term FEU by listing entities, persons, and arrangements whose business is financial in nature, including certain funds.[13]

Commission Regulation 23.161 sets forth a phase-in schedule for compliance with the CFTC Margin Rule.[14] Under the schedule, which commenced on September 1, 2016 and concluded on September 1, 2022, entities have been required to comply with the IM requirements with respect to their uncleared swaps in staggered phases, starting with entities with higher average aggregate notional amount of uncleared swaps and certain other financial products (''AANA''), and then successively those with lesser AANA.[15] The AANA is calculated at a group level (*i.e.,* taking into consideration the AANA of the CSE combined with its margin affiliates,[16] and the AANA of the counterparty combined with its margin affiliates). During the last phase of compliance, which started on September 1, 2022, CSEs and eligible covered counterparties[17] that had not come into the scope of the IM requirements in prior phases of the phase-in schedule, including FEUs with MSE of more than $8 billion, became subject to the IM requirements.

Under this phase-in approach, a fund with MSE will come within the scope of the IM requirements if it undertakes an uncleared swap with a CSE. The CSE and the fund will not be required to post and collect IM for their uncleared swaps until the IM threshold amount of $50 million has been exceeded. The IM threshold amount will be calculated based on the credit exposure from uncleared swaps between the CSE and its margin affiliates on the one hand, and the fund and its margin affiliates on the other.[18]

The CFTC Margin Rule provides that the IM requirements may be satisfied with only certain types of collateral. Commission Regulation 23.156(a)(1) sets forth the types of collateral that CSEs can post or collect as IM with covered counterparties, including cash funds, certain securities issued by the U.S. government or other sovereign entities, certain publicly traded debt or equity securities, securities issued by money market and similar funds, and gold.[19]

Under Commission Regulation 23.156(a)(1)(ix), the securities of money market and similar funds[20] may qualify as eligible collateral if the investments of the fund are limited to securities that are issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of Treasury, and immediately-available cash denominated in U.S. dollars;[21] or to securities denominated in a common currency and issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank, or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to swap dealers subject to regulation by a prudential regulator, and immediately-available cash denominated in the same currency.[22] Also, the asset managers of the money market and similar fund may not transfer the assets of the fund through securities lending, securities borrowing, repurchase agreements, or other means (''repurchase or similar arrangements'') that involve the fund having rights to acquire the same or similar assets from the transferee (''asset transfer restriction'').[23]

II. Market Participant Feedback

In January 2020, the CFTC's Global Markets Advisory Committee (''GMAC'') established a subcommittee of market participants to consider issues raised by

[9] CEA section 4s(e)(3)(A), 7 U.S.C. 6s(e)(3)(A).

[10] *See generally* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016) (''Final Margin Rule'') (adopting the CFTC Margin Rule). The CFTC Margin Rule became effective April 1, 2016 and is codified in part 23 of the Commission's regulations. 17 CFR 23.150–23.159, 23.161. In May 2016, the Commission amended the CFTC Margin Rule to add Commission Regulation 23.160, 17 CFR 23.160, providing rules on its cross-border application. *See generally* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements, 81 FR 34818 (May 31, 2016).

[11] IM (or initial margin) is the collateral (calculated as provided by Commission Regulation 23.154) that is collected or posted in connection with one or more uncleared swaps pursuant to Commission Regulation 23.152. IM is intended to secure potential future exposure following default of a counterparty (*i.e.,* adverse changes in the value of an uncleared swap that may arise during the period of time when it is being closed out). *See* CFTC Margin Rule, 81 FR at 683.

[12] *See* 17 CFR 23.152. Commission Regulation 23.151 provides that MSE for an entity means that the entity and its margin affiliates have an average month-end aggregate notional amount of uncleared swaps, uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps with all counterparties for March, April, or May of the current calendar year that exceeds $8 billion, where such amount is calculated only for the last day of the month. 17 CFR 23.151.

[13] *See* 17 CFR 23.151 for a full list of entities subject to the FEU definition as well as a list of entities excluded from the definition. Among other entities, persons, and arrangements, whose business is financial in nature, the definition of FEU includes counterparties that are not an SD or MSP and are: (i) investment companies registered with the Securities and Exchange Commission under the Investment Company Act of 1940; (ii) private funds as defined in section 202(a) of the Investment Advisers Act of 1940; entities that would be investment companies under section 3 of the Investment Company Act of 1940; or entities that are deemed not to be investment companies under section 3 of the Investment Company Act of 1940 pursuant to Investment Company Act Rule 3a–7 of the Securities and Exchange Commission; (iii) commodity pools; and (iv) entities, persons, or arrangements that are, or hold themselves out as being, entities, persons, or arrangements that raise money from investors, accept money from clients, or use their own money primarily for investing, or trading, or facilitating the investing or trading, in loans, securities, swaps, funds, or other assets.

[14] 17 CFR 23.161.

[15] *Id.*

[16] Commission Regulation 23.151 provides that a company is a ''margin affiliate'' of another company if: (i) either company consolidates the other on a financial statement prepared in accordance with U.S. Generally Accepted Accounting Principles (''U.S. GAAP''), the International Financial Reporting Standards (''IFRS''), or other similar standards; (ii) both companies are consolidated with a third company on a financial statement prepared in accordance with such principles or standards; or (iii) for a company that is not subject to such principles or standards, if consolidation as described in paragraph (1) or (2) of this definition would have occurred if such principles or standards had applied. 17 CFR 23.151.

[17] The term ''covered counterparty'' is defined in Commission Regulation 23.151 as FEU with MSE or a swap entity, including an SD or MSP, that enters into swaps with a CSE. *See* 17 CFR 23.151.

[18] Commission Regulation 23.151 defines the term ''IM threshold amount'' to mean an aggregate credit exposure of $50 million resulting from all uncleared swaps between an SD and its margin affiliates (or an MSP and its margin affiliates) on the one hand, and the SD's (or MSP's) counterparty and its margin affiliates on the other. *See* 17 CFR 23.151.

[19] *See* 17 CFR 23.156(a)(1).

[20] Although the scope of the eligible pooled investment funds described in Commission Regulation 23.156(a)(1)(ix) does not fully coincide with the regulatory definition of money market funds in Rule 2a–7 under the Investment Company Act (17 CFR 270.2a–7), for simplicity purposes, these funds will be referred to as ''money market and similar funds.'' The securities of money market and similar funds may also be used as collateral for variation margin (''VM'') for uncleared swaps between a CSE and a financial end user, provided that the securities qualify as eligible collateral under Commission Regulation 23.156(a)(1)(ix). *See* 17 CFR 23.156(b)(1)(ii). VM (or variation margin), as defined in Commission Regulation 23.151, is the collateral provided by a party to its counterparty to meet the performance of its obligations under one or more uncleared swaps between the parties as a result of a change in the value of such obligations since the trade was executed or the last time such collateral was provided. 17 CFR 23.151.

[21] 17 CFR 23.156(a)(1)(ix)(A).

[22] 17 CFR 23.156(a)(1)(ix)(B).

[23] 17 CFR 23.156(a)(1)(ix)(C).

the implementation of margin requirements for non-cleared swaps, to identify challenges associated with forthcoming implementation phases, and to prepare a report with recommendations.[24] The subcommittee issued a report with its recommendations in May 2020 (''Margin Subcommittee Report'' or ''Report''), and the GMAC voted to adopt the Margin Subcommittee Report and recommended to the Commission that it consider adopting the Report's recommendations.[25]

Among other things, the Margin Subcommittee Report asserted that the current criteria for determining whether a counterparty comes within the scope of the IM requirements unduly penalizes certain funds. Because, under accounting consolidation principles, a fund will generally be consolidated with its sponsor entity during the period in which the start-up capital provided by the sponsor entity exceeds that of third-party investors and represents up to 100 percent of the ownership interest in the fund (''seeding period''), such fund, referred to as a seeded fund, will be considered a margin affiliate of the sponsor entity.[26] As such, the seeded fund will be required to calculate AANA on an aggregate basis with the sponsor entity and the sponsor entity's margin affiliates. Although the fund may individually have small amounts of AANA, due to its affiliation with the sponsor entity and its margin affiliates, the fund may have MSE, on a collective basis with the sponsor entity and its margin affiliates, and may come within the scope of the IM requirements. As such, a CSE that undertakes uncleared swaps with the fund would be required to exchange IM with the fund.

The Report noted that regulators in other major financial markets, including Australia, Canada, the European Union (''EU''), and Japan, have adopted the Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions' (''BCBS/IOSCO'') Framework for margin requirements for non-centrally cleared derivatives (''BCBS/IOSCO Framework'')[27] without requiring seeded funds to be consolidated with the sponsor and to be treated as a margin affiliate of the sponsor.[28]

The Margin Subcommittee Report also recommended that the Commission eliminate the asset transfer restriction in paragraph (C) of Commission Regulation 23.156(a)(1)(ix). The Report stated that ''the ability to use redeemable securities in a pooled investment fund, more typically referred to as a money market fund (''MMF''), as eligible collateral in the U.S. has been severely restricted by [such] condition.''[29]

The Report noted that MMFs use repurchase and similar arrangements to earn returns on cash and other high quality assets, to avoid any cash drag on performance, to diversify their investments, and to mitigate their potential exposure to their custodian's insolvency and any consolidation issues with respect to any cash held at the custodian.[30] MMF asset managers, as fiduciaries, determine the types of investments and transactions that are in the best interest of the MMF and its investors.[31] The Report further stated that nearly all U.S. MMFs engage in some form of repurchase or similar arrangements, and cited research that found that, given the asset transfer restriction, the securities of only four MMFs, would qualify as eligible collateral.[32]

Having considered the GMAC Subcommittee's arguments and based on its experience administering the CFTC Margin Rule for several years, the Commission preliminarily believes that, for the purpose of determining whether a CSE should exchange IM with a seeded fund for their uncleared swaps, the seeded fund should be treated as a separate legal entity, not affiliated with the sponsor entity, for a period of three years and subject to certain limitations. Similarly, the Commission preliminarily believes that the current restriction on the use of securities of money market and similar funds that transfer their assets through repurchase and similar arrangements should be removed.

III. Proposals

A. Seeded Funds Proposal

The Commission is proposing to revise the definition of ''margin affiliate'' to provide that a seeded fund that meets certain requirements (described in further detail below) (''eligible seeded fund''), would be deemed not to have any margin affiliates for the purpose of calculating the fund's MSE and the IM threshold amount, for a period of three years from the fund's trading inception date (''eligible seeded fund exception''). The Commission is also proposing to define the term ''eligible seeded fund'' to set forth the conditions that investment funds must meet to qualify for the eligible seeded fund exception.

1. Commission Regulation 23.151—Amendments to the Definition of ''Margin Affiliate''

Under the CFTC Margin Rule, a company is a ''margin affiliate'' of another company if, based on accounting principles, either company consolidates the other, or both companies are consolidated with a third company, on a financial statement.[33] The Commission is proposing to adopt the eligible seeded fund exception through an amendment of the definition of ''margin affiliate,'' which would provide that an eligible seeded fund would be deemed not to have margin affiliates solely for the purposes of calculating the fund's MSE and the IM threshold amount for a period of three years after the fund's trading inception date, notwithstanding the consolidation of the fund with another entity under U.S. GAAP, IFRS, or other similar accounting standards.

This proposed eligible seeded fund exception would effectively relieve CSEs that enter into uncleared swaps with an eligible seeded fund from the requirement to exchange IM with such fund for three years after the fund's trading inception date. In addition, uncleared swaps entered into between a CSE and an eligible seeded fund during the three-year period would continue to

[24] Membership of the GMAC Subcommittee on Margin Requirements was comprised of a wide range of industry participants that had expertise in, and experience with, margin requirements for non-cleared swaps and the impact of the requirements on the marketplace and market participants. The Subcommittee included representatives of SDs, FEUs, asset managers, and third-party service providers, among other market participants. The full list of members is available at *https://www.cftc.gov/About/AdvisoryCommittees/GMAC.*

[25] *See Recommendations to Improve Scoping and Implementation of Initial Margin Requirements for Non-Cleared Swaps,* Report to the CFTC's Global Markets Advisory Committee by the Subcommittee on Margin Requirements for Non-Cleared Swaps (May 2020), *https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download.*

[26] *Supra note* 16. *See also* CFTC Margin Rule, 81 FR at 646–47.

[27] *See* BCBS/IOSCO, Margin requirements for non-centrally cleared derivatives (April 2020), *https://www.bis.org/bcbs/publ/d499.pdf.* The BCBS/IOSCO Framework, which was established in 2013 and most recently amended in 2020, sets out minimum standards for margin requirements for non-centrally cleared derivatives. In connection with the requirement for all covered entities to exchange IM with a threshold not to exceed €50 million applied at the level of the consolidated group, the Framework specifies that ''investment funds that are managed by an investment advisor are considered distinct entities that are treated separately when applying the threshold as long as the funds are distinct legal entities that are not collateralized by or are otherwise guaranteed or supported by other investment funds or the investment advisor in the event of fund insolvency or bankruptcy.''

[28] Margin Subcommittee Report at 7 and 29.

[29] *Id.* at 6.

[30] *Id.* at 27.

[31] *Id.*

[32] Margin Subcommittee Report at 24.

[33] *Supra* note 16.

be relieved from the IM requirement after expiration of such period.[34] At the end of the three-year period, a fund that meets the accounting standards for consolidation due to a sponsor entity holding a significant equity stake in the fund would be deemed to have margin affiliates. As a result, a CSE would be required to exchange IM with the fund, if the fund, on a consolidated group basis, has MSE and the IM threshold amount has been exceeded, for swaps entered into following the expiration of the three-year period.

The proposed eligible seeded fund exception is intended to address challenges confronted by seeded funds that have limited individual swaps exposure, but, due to their affiliation with an entity or group of entities, have on a collective basis sufficient AANA to meet the MSE threshold, therefore requiring CSEs undertaking uncleared swaps with the funds to post and collect IM with such funds. To limit the relief to only such funds, the proposed treatment would be applicable only to funds that have one or more margin affiliates that are already subject to the IM requirements and post and collect IM pursuant to Commission Regulation 23.152. Also, the Commission notes that notwithstanding the proposed eligible seeded fund exception, CSEs would still be required to count the uncleared swaps that they undertake with eligible seeded funds for purposes of calculating their own AANA.

Market participants, including the members of the GMAC Margin Subcommittee, have argued that absent relief, seeded funds would experience a performance drag given that a portion of their investment would be committed to, and segregated as, IM and would also incur operational costs that are not commensurate with the size of their uncleared swaps activity and the risks of their swaps. In addition, the overall ability of start-up funds to attract new investors may be compromised as a result.[35]

In its Report, the GMAC Margin Subcommittee discussed the costs that seeded funds would incur if the funds were consolidated with their sponsor entities and were treated as margin affiliates of their sponsor entities, including the cost of setting up and maintaining margin accounts and establishing custodial arrangements to segregate IM collateral under Commission Regulation 23.157.[36] The seeded funds would also be required to engage in negotiation of complex margin documentation and develop compliance infrastructures to handle the exchange of IM.[37] The Report further observed that, given their typically small size, seeded funds are likely to encounter difficulties in establishing the necessary margin documentation and processes, as CSEs and custodians, which face competing demands for resources and services to operationalize the exchange of IM, may prioritize larger counterparties.[38]

The Margin Subcommittee Report stated that although seeded funds may be consolidated with other entities on a financial statement, they are legally and operationally distinct and, as a result, may not be able to share information about their exposure for purposes of managing the $50 million IM threshold amount above which IM for uncleared swaps must be exchanged. In addition to operational challenges, the Report indicated that potential confidentiality obligations may prevent the different affiliates within the seeded fund's consolidated group from sharing uncleared swaps exposure information. As an example, the Report noted that because of regulatory restrictions, an insurance company that sponsors a seeded fund would not be permitted to share information about the fund's trading activity with an affiliate engaging in swap transactions for purposes of hedging general insurance risk.

Finally, the Report stated that seeded funds that do not otherwise hold assets qualifying as eligible IM collateral under Commission Regulation 23.156[39] would need to hold larger cash reserves, which would be unavailable to implement the fund's investment strategy, or would need to incur the costs of converting fund assets into eligible IM collateral. The operational costs and potential difficulties arising in the execution of margin documentation could also either negatively impact a seeded fund's performance or inhibit its ability to trade, defeating the purpose of the original seed capital.[40]

The Commission notes that the proposed eligible seeded fund exception is consistent with the approach in other countries. Jurisdictions such as Australia, Canada and the EU have adopted provisions that permit investment funds to be treated as distinct, separate entities for purposes of calculating the relevant IM thresholds, subject to conditions similar to those that the Commission intends to adopt through the proposed definition of ''eligible seeded fund'' discussed below.[41]

The proposed approach is also consistent with the BCBS–IOSCO Framework, which provides that investment funds should be treated as separate legal entities when applying the IM threshold amount provided that they are distinct legal entities that are not collateralized or otherwise guaranteed or supported by other investment funds or the investment advisor in the event of fund insolvency or bankruptcy.[42] As such, the proposed approach would contribute to global harmonization with respect to the treatment of investment funds, preventing potential reductions in liquidity or trading disruptions due to non-U.S. funds' limiting their trading activities to non-U.S. counterparties to take advantage of approaches to

[34] For purposes of clarity, the Commission notes, however, that if at any point during the three-year period from the fund's trading inception date, the fund's AANA, calculated on an individual entity basis, exceeds the MSE threshold and the fund, individually, with its counterparty and the counterparty's margin affiliates crosses the IM threshold amount, the exchange of IM would be required.

[35] Margin Subcommittee Report at 32.

[36] For purposes of clarity, these arguments, as well as the proposed rule amendments, pertain only to the margin requirements for uncleared swap transactions. The proposed amendments would not impact any potential margin requirements that a seeded fund would have to meet in connection with futures contracts or cleared swap transactions.

[37] Margin Subcommittee Report at 32.

[38] *Id.*

[39] *Id.*

[40] Margin Subcommittee Report at 31.

[41] Margin Subcommittee Report at 29. As noted in the Report, Canada has excluded investment funds from consolidated margin calculations via the Office of the Superintendent for Financial Institutions of Canada Guideline E–22 Margin Requirements for Non-centrally Cleared Derivatives effective as of June 2017, Section 1.1. Scope of Applicability, Footnote 2, available at *https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/e22.aspx*; the EU adopted a similar approach via Commission Delegated Regulation No. 2016/2251 of October 4, 2016, Supplementing Regulation (EU) No.648/2012 of the European Parliament and of the Council of July 4, 2012 on OTC Derivatives, Central Counterparties and Trade Repositories with Regard to Regulatory Technical Standards for Risk-Mitigation Techniques for OTC Derivative Contracts Not Cleared by a Central Counterparty, 2016 O.J. L340/11, Articles 28(3); 29(3) and 39(2), available at *https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2016.340.01.0009.01.ENG;* and the Australian Prudential Regulatory Authority noted, in paragraph 25 of Prudential Standard CPS 226 (available here *https://www.apra.gov.au/sites/default/files/prudential_standard_cps_226_margining_and_risk_mitigation_for_non-centrally_cleared_derivatives.pdf*) that for purposes of calculating the IM threshold, an investment fund may be treated separately from the investment adviser and other investment vehicles, provided certain conditions are met. The Margin Subcommittee Report also noted that Japan has adopted a similar approach, however, the Commission could not verify that assertion because the Report did not provide a citation to the relevant Japanese rules.

[42] BCBS–IOSCO Framework, Footnote 10, *supra* note 27.

consolidation that exist in other jurisdictions.

The Commission recognizes, however, that the proposed amendments would be a departure from the prudential regulators' approach, whose margin requirements for uncleared swaps include a definition of ''margin affiliate'' that is equivalent to the current definition in the CFTC Margin Rule. Furthermore, the prudential regulators have reserved the right to include any entity as an affiliate or a subsidiary based on the conclusion that an entity may provide significant support to, or may be materially subject to the risks of losses of, another entity.[43] As noted below, the Commission requests comment on whether it should proceed with the Seeded Funds Proposal if the prudential regulators do not amend their rules in a manner consistent with the proposal.

The Commission preliminarily believes that the proposed approach supports the CFTC Margin Rule's objective of imposing margin requirements that are commensurate with the risk of uncleared swaps entered into by CSEs.[44] The Commission preliminarily believes, as discussed in the Margin Subcommittee Report, that seeded investment funds do not pose significant risks to their swap counterparties or the financial system given that typically their capitalization does not exceed $50–100 million and the funds have limited notional exposure. The Report cited the results of an informal sampling conducted in 2018 among members of the Securities Industry and Financial Markets Association's Asset Management Group (''SIFMA AMG'') and the American Council of Life Insurers. According to the Report, the respondents identified a total of 33 funds that would be within the scope of the IM requirements due to their derivatives notional exposures being consolidated with entities with MSE. The average gross notional exposure for each seeded fund was $32 million. As the Report concluded, none of these funds would be within the scope of the IM requirements absent consolidation with their sponsor entity. Given their size and limited individual swap activity, the Commission preliminarily believes that affording relief to seeded funds at the early stages of formation from coming within the scope of the IM requirements is consistent with the CFTC Margin Rule's risk-based approach.

The Commission also preliminarily believes that safeguards already present in the CEA and CFTC regulations would mitigate the increase in uncollateralized credit risk resulting from swap transactions between CSEs and seeded funds that would be relieved from the IM requirements given the disaggregation of eligible seeded funds from their sponsor entities and other affiliated entities for purposes of calculating the funds' MSE and the IM threshold amount. The Commission notes that notwithstanding the relief, uncleared swap transactions between CSEs and eligible seeded funds would still be subject to the VM requirements.[45] Moreover, section 4s(j)(2) of the CEA mandates CSEs to adopt a robust and professional risk management system adequate for the management of their swap activities[46] and Commission Regulation 23.600 requires that CSEs, in establishing a risk management program to monitor and manage risks associated with their swap activities, must account for credit risk and must set risk tolerance limits.[47]

As an additional safeguard, the proposed eligible seeded fund exception would be applicable only for a period of three years from an eligible seeded fund's trading inception date. The three-year term is designed to cover the period during which the fund would work towards establishing a performance track record and towards attracting unaffiliated investors.[48]

In adopting the CFTC Margin Rule, the Commission stated that the requirement to calculate MSE and the IM threshold amount on a consolidated basis was intended to prevent CSEs and their counterparties from creating legal entities and netting sets that have no economic basis and are constructed solely for the purpose of applying additional thresholds to evade margin requirements.[49] Consistent with this goal, the Commission intends for the eligible seeded fund exception to be applied only for purposes of calculating MSE and the IM threshold amount of the eligible seeded fund. Under the Seeded Funds Proposal, a fund's sponsor entity and other margin affiliates would continue to include the eligible seeded fund's exposure in the calculation of their MSE and the IM threshold amount, unless they independently qualify for the proposed eligible seeded fund exception. As such, the proposed treatment for eligible seeded funds would not serve as an incentive for a sponsor entity to create seeded funds merely to reduce its own exposure and circumvent the applicability of the IM requirements.

In addition, the Commission proposes to make the eligible seeded fund exception available only with respect to funds that have a bona fide business and economic purpose, meaning that the funds are not created for the sole purpose of evading the IM compliance thresholds. Rather, the exception is intended for funds that engage in genuine efforts to test their investment strategy and distribute the funds' shares to third-party investors.[50] To that end, in addition to relying on anti-evasion provisions already existing in the Commission regulations[51] to address

[43] *See* Prudential Regulators Margin Rule at 74859–60.

[44] *See* Section 4s(e)(3)(A)(2) of the CEA (directing the Commission to adopt margin requirements ''appropriate to the risks associated with'' the uncleared swaps held by the SD or the MSP). 7 U.S.C. 6s(e)(3)(A).

[45] *See* 17 CFR 23.153.

[46] *See* 7 U.S.C. 6s(j).

[47] 17 CFR 23.600.

[48] Market participants have noted that after three years, investment funds have typically established a sufficient record to draw in third-party investors and are no longer consolidated with their sponsor entity for AANA calculation purposes. *See* Margin Subcommittee Report at 30.

[49] CFTC Margin Rule, 81 FR at 652.

[50] The Commission notes that this position is consistent with the policy approach taken by the prudential regulators and the Commission in the regulations implementing the requirements of section 619 of the Dodd-Frank Act, commonly referred to as the ''Volcker Rule.'' The implementing regulations recognize the concept of a seeding period and exempt banking entities that acquire and retain an ownership interest in a covered fund (as the concept is defined under the implementing regulations) from some of the prohibitions of the Rule during the seeding period, under certain conditions. *See* 12 CFR 248.12(a)(1) and (2). In particular, these conditions include that the covered fund must actively seek unaffiliated investors to reduce, through redemption, sale, dilution, or other methods, the aggregate amount of all ownership interests of the banking entity in the covered fund to the amount permitted under the regulations. 12 CFR 248.12(a)(2)(i). Also, the aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds acquired and retained under the relevant exemptions must not exceed 3 percent of the tier 1 capital of the banking entity. 12 CFR 248.12(a)(2)(iii). Although the Commission is not proposing identical conditions, the Commission is proposing to incorporate a number of requirements to achieve the same purpose as appropriate in the context of the CFTC Margin Rule, including the requirement in the proposed definition discussed below that an ''eligible seeded fund'' be managed pursuant to a written investment strategy that follows a written plan to reduce each sponsor entity's ownership interest in the fund.

[51] *See* Commission regulation 23.402(a)(1)(ii) (requiring CSEs to have written policies and procedures to prevent the evasion, or participation in or facilitation of an evasion, of any provision of the CEA or Commission regulation). 17 CFR 23.402(a)(1)(ii). *See also* the definition of MSE in Commission Regulation 23.151 (stating that activities not carried out in the regular course of business and willfully designed to circumvent the calculation of the AANA at month-end to evade meeting the definition of MSE shall be prohibited). 17 CFR 23.151. The Commission also reminds market participants that section 4b of the CEA prohibits any person entering into a swap with another person from cheating, defrauding, or

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the potential circumvention of the IM compliance thresholds, the Commission proposes to limit the availability of the proposed treatment for seeded funds to entities that meet certain requirements. These requirements would be incorporated in the proposed definition of ''eligible seeded fund'' discussed below.

2. Commission Regulation 23.151—Definition of ''Eligible Seeded Fund''

The Commission proposes to amend Commission Regulation 23.151 by adding a definition for the term ''eligible seeded fund.'' ''Eligible seeded fund'' would be defined as a collective investment vehicle that has received a part or all of its start-up capital from a parent and/or affiliate (each, a sponsor entity) and that meets certain specified conditions.

A seeded fund would meet the proposed definition of eligible seeded fund if, among other conditions: (i) the fund is a distinct legal entity from each sponsor entity; (ii) the fund is managed by an asset manager pursuant to an agreement that requires the fund's assets to be managed in accordance with a specified written investment strategy; (iii) the fund's asset manager has independence in carrying out its management responsibilities and exercising its investment discretion, and to the extent applicable, has independent fiduciary duties to other investors of the fund; and (iv) the fund's written investment strategy includes a written plan for reducing each sponsor entity's ownership interests in the fund that stipulates divestiture targets over the three-year period after the seeded fund's trading inception date. Additionally, to meet the ''eligible seeded fund'' definition, in respect of any of the seeded fund's obligations, a fund must not be collateralized, guaranteed, or otherwise supported, directly or indirectly, by any sponsor entity, any margin affiliate of any sponsor entity, other collective investment vehicles, or the fund's asset manager. These conditions are designed to ensure that the sponsor entity would not retain a level of influence or exposure that is materially above that of other minority or passive investors and that the fund would follow a genuine plan to emerge from the seeding phase by attracting unaffiliated investors.

To ensure that the three-year period contemplated by the eligible seeded fund exception is not reinstated, due to rollovers of fund assets or similar activities, the proposed definition would require that the seeded fund has not received any of its assets, directly or indirectly, from an eligible seeded fund that has relied on the proposed exception.

Furthermore, the Seeded Funds Proposal is intended to be limited to those seeded funds that, absent amendments to the CFTC Margin Rule, would have to exchange IM due to their consolidation with a group that collectively exceeds the thresholds triggering compliance with the IM requirements. That is, the Seeded Funds Proposal, consistent with the Margin Subcommittee Report, is intended to address seeded funds that are ''seeded'' by parent entities that have MSE and thus cause the seeded funds to come within the scope of the IM requirements. For purposes of targeting these seeded funds, the proposed definition of ''eligible seeded fund'' would require as a condition for qualification that at least one of the seeded fund's margin affiliates must be subject to the IM requirements and must be required to post and collect IM pursuant to Commission Regulation 23.152.

Finally, the proposed definition of ''eligible seeded fund'' would provide that the seeded fund must not be a securitization vehicle. This condition is designed to further limit the proposed treatment of seeded funds only to funds subject to the Margin Subcommittee Report's recommendation. The Commission notes that in adopting the CFTC Margin Rule, despite receiving multiple comments from industry representatives to exclude securitization vehicles from the definition of FEU, and recommendations subsequent to the adoption of the rule, the Commission has maintained the position that there are sufficient reasons to keep these entities within the scope of the IM requirements. The Commission stated in the preamble to the final CFTC Margin Rule that the relevant IM compliance thresholds would address concerns related to the applicability of the IM requirements to these entities.[52] At this time, the Commission does not believe that it is prudent to extend the proposed eligible seeded fund exception to such entities.

In adopting the CFTC Margin Rule, the Commission modified the proposed definition of ''margin affiliate,'' which relied on the concept of legal control as a criterion for affiliation, to the current definition based on accounting consolidation, in consideration of a concern that the proposed definition may have been over-inclusive. The Commission noted that the accounting consolidation analysis typically results in a positive outcome (consolidation) at a higher level of an affiliation relationship than the 25 percent voting interest standard of the legal control test.[53]

The Commission recognized, however, that consolidation between a seeded fund and the sponsor may occur during the seeding period or other periods in which the sponsor may hold an outsized portion of the fund's interest. The Commission stated that during those periods, when an entity may hold up to 100 percent of the ownership interests of an investment fund, it was appropriate to treat the investment fund as an affiliate.[54] The Commission further stated that such treatment may be likewise justified for a sponsor or asset manager and a special purpose entity created for asset management when accounting standards, such as GAAP and IFRS variable interest standards, require consolidation for such entities even though the manager might not hold an interest comparable to a majority equity or voting control share given the level of influence and exposure typically retained by the manager.[55]

The Commission notes that subsequently, in letters to the CFTC, SIFMA AMG (on behalf of its asset manager members) requested relief from the treatment as margin affiliate for seeded funds, consistent with the arguments made in the Margin Subcommittee Report described above. While acknowledging that a sponsor of a seeded investment fund has influence beyond that of a passive, unaffiliated investor, SIFMA AMG urged that seeded funds not be consolidated with their sponsors in applying the CFTC's margin requirements because there are structural and contractual safeguards that limit the sponsor's influence and exposure with respect to the seeded fund.[56] In particular, SIFMA AMG noted that each seeded fund is a distinct legal entity that is managed by an investment manager pursuant to an investment advisory agreement that, among other things, requires the assets of the fund to be managed in accordance with specified investment guidelines, objectives, and strategies, and not

willfully deceiving, or attempting to cheat, defraud, or deceive, the other person. 7 U.S.C. 6b.

[52] *See* CFTC Margin Rule, 81 FR at 683.

[53] *Id.* at 647.

[54] *Id.*

[55] *Id.*

[56] Letter by SIFMA AMG to the Commission and the Prudential Regulators Regarding Final Margin Rules for Uncleared Swap Transactions (Jan., 19, 2016) (''SIFMA AMG 2016 Letter'') at 3; *see also* Margin Subcommittee Report at 16.

capriciously at the desire of the fund sponsor.[57]

Further, the Margin Subcommittee Report noted that neither the sponsor nor its commonly consolidated entities controls or has transparency into the management or trading of the seeded fund.[58] Moreover, the Report stated that, typically, the sponsor or affiliate of a seeded fund does not guarantee the obligations of the seeded fund or participate in or control the management of the fund.[59] The Report further noted that the sponsor's exposure to the seeded fund is generally capped at its investment, similar to any other passive investor in a third-party instrument or vehicle.[60]

These arguments highlight the safeguards generally exhibited in seeded funds. As previously noted, the Commission is proposing to incorporate these safeguards, among other conditions, in the proposed definition of ''eligible seeded fund'' as requirements to be met by a fund in order to benefit from the proposed treatment for eligible seeded funds, discussed in more detail above. In proposing these conditions, the Commission seeks to ensure that eligible seeded funds are sufficiently independent and risk-remote from other entities in their group such that treating them separately for purposes of determining whether the thresholds for compliance with the IM requirements have been met would be justified.

In particular, the proposed requirements that the fund is managed in accordance with a written investment strategy, by an asset manager that maintains independence in carrying out its management responsibilities and exercising its investment discretion, and that, to the extent applicable, has independent fiduciary duties to other investors in the fund, seek to ensure that no sponsor entity or an affiliate of a sponsor entity has control or transparency into the management or trading of the seeded fund. Furthermore, the proposed condition that the fund's investment strategy follows a written plan for reducing each sponsor entity's ownership interest in the fund aims to reserve the benefit of the proposed approach to seeded funds that have a genuine economic purpose and intentions to emerge from the seeding phase.

In addition, the proposed definition of ''eligible seeded fund'' would prohibit a fund sponsor entity, entities affiliated with a sponsor entity, other collective investment vehicles, or the fund's asset manager from collateralizing, guaranteeing or otherwise directly or indirectly providing support in respect of any of the fund's obligations. The Commission proposes this condition in recognition that the sponsor of a seeded fund or its asset manager may be motivated to provide financial assistance to the seeded fund whose uncleared swaps may be uncollateralized as a result of the Seeded Funds Proposal, which might heighten the risk of the fund's swap positions and weaken the fund's financial condition. The sponsor entity or the asset manager may also be inclined to provide financial assistance to the fund because of reputational or other concerns even in the absence of a guarantee or formal commitment, and at the risk of exhausting its own resources, raising the risk of contagion and systemic risk, in particular during times of widespread financial stress. The Commission preliminarily believes that the requirements in the proposed definition of ''eligible seeded fund,'' which seek to ensure the fund's genuine independence, would serve as effective safeguards against financial contagion.

The Commission also intends to rely on tools that already exist under the CEA and the Commission regulations to address evasion concerns. In particular, the Commission notes that Commission Regulation 23.402(a)(ii) requires CSEs to have written policies and procedures to prevent the evasion, or participation in or facilitation of an evasion, of any provision of the CEA or the Commission regulations.[61] The Commission also reminds market participants that section 4b of the CEA prohibits any person entering into a swap with another person from cheating, defrauding, or willfully deceiving, or attempting to cheat, defraud, or deceive, the other person.[62]

Request for comments: The Commission requests comments regarding the proposed amendments to Commission Regulation 23.151, generally. The Commission specifically requests comment on the following questions:

1. Under the Seeded Funds Proposal, eligible seeded funds would be deemed not to have margin affiliates for purposes of calculating the fund's MSE and the IM threshold amount during a period of three years from the fund's trading inception date. As such, CSEs that undertake uncleared swaps with such funds and would otherwise be required to exchange IM with the funds, may be relieved from such obligation, as only each fund's individual exposure would be considered in determining whether the IM requirements apply to uncleared swaps between CSEs and the fund. As a result, less margin may be collected and posted for uncleared swaps than would be otherwise required under the current requirements. Is the Seeded Funds Proposal appropriate in light of the resulting potential uncollateralized swap risk?

2. The Commission recognizes that the proposed eligible seeded fund exception would not only benefit the eligible seeded funds but would also relieve CSEs from their obligation to post IM with seeded funds that would otherwise come within the scope of the CFTC IM requirements. Should only the eligible seeded fund, and not its CSE counterparty, be relieved of the IM obligation?

3. Should the Commission impose any additional limits or conditions to the proposed eligible seeded fund exception such as: (i) imposing a separate MSE and/or IM threshold amount, calculated on the basis of the eligible seeded fund's individual exposure and proportionate to the perceived risks associated with funds' swap activities, (ii) imposing a limit on the total number of eligible seeded funds to which a sponsor entity provides start-up capital that may rely on the eligible seeded fund exception, or (iii) requiring that all eligible seeded funds, consolidated within the same group on the basis of accounting principles, aggregate their exposures for purposes of calculating the MSE and IM threshold amounts that apply to such funds?

4. What are the costs associated with a seeded fund calculating IM and establishing a relationship with a custodian to transfer IM?

5. The proposed amendments to Commission Regulation 23.151, in particular the requirements in the proposed definition of ''eligible seeded fund,'' aim to ensure that the relevant funds are genuinely and practically independent and risk-remote from their sponsor entities and other affiliates. Do the proposed amendments incorporate sufficient safeguards to achieve this goal? Given that other entities such as sponsor entities or the asset manager may be incentivized to provide resources to a seeded fund in financial distress even in the absence of an

[57] SIFMA AMG 2016 Letter at 3.

[58] Margin Subcommittee Report at 16.

[59] Margin Subcommittee Report at 6 and16.

[60] Margin Subcommittee Report at 16.

[61] 17 CFR 23.402(a)(ii). As discussed above, the Commission also notes that the definition of MSE in Commission Regulation 23.151 prohibits activities not carried out in the regular course of business and willfully designed to circumvent the calculation of the AANA at month-end to evade meeting the definition of MSE shall be prohibited. 17 CFR 23.151.

[62] 7 U.S.C. 6b.

explicit business arrangement or guarantee, potentially putting their own financial position at risk and thereby increasing the risk of contagion and systemic risk, what measures could the Commission take to limit the potential risks to such other entities and ultimately to the financial system?

6. The Commission proposes to include, among other conditions, a requirement providing that a fund would qualify as an eligible seeded fund only if one or more of the seeded fund's margin affiliates is required to post and collect IM pursuant to Commission Regulation 23.152. This condition is intended to limit the availability of the proposed eligible seeded fund exception only to funds that, for reasons described in the Margin Subcommittee Report, are disadvantaged domestically and globally due to their affiliation with a group that has MSE. Is this condition appropriate? Should the condition be amended to ensure that the Commission is appropriately circumscribing the proposed treatment of eligible seeded funds?

7. The Commission also proposes to include, among other conditions, a requirement providing that to qualify as an eligible seeded fund, the seeded fund's investment strategy must follow a written plan for reducing each sponsor entity's ownership interest in the seeded fund that stipulates divestiture targets over the three-year period after the seeded fund's trading inception date. Should the Commission include more specific requirements in connection with the written plan?

8. The Prudential Regulators Margin Rule contains a definition of ''margin affiliate'' that is equivalent to the current definition under the CFTC Margin Rule. Furthermore, the prudential regulators have reserved the right to include any entity as an affiliate or a subsidiary based on the conclusion that an entity may provide significant support to, or may be materially subject to the risks or losses of, another entity. If the Commission amends Commission Regulation 23.151, counterparties that trade with both prudentially regulated SDs and CFTC-regulated SDs may need to adjust their swap-related documentation and collateral management systems to reflect the different margin requirements that may apply under the CFTC's and the prudential regulators' rules. In that regard, the Commission requests information on the potential additional costs associated with maintaining two separate and distinct documentation and collateral management processes. How much weight should the Commission give with respect to the possible challenge that counterparties may need to maintain two separate and distinct documentation and collateral management systems? Should the Commission proceed to adopt the proposed amendments to Commission Regulation 23.151 if the prudential regulators do not adopt similar regulatory changes?

9. The Commission intends that the final rule will become effective 30 days after its publication in the **Federal Register**. With respect to the Seeded Funds Proposal, are there any comments on the effective date?

B. Money Market Funds Proposal

The Commission proposes to amend Commission Regulation 23.156(a)(1)(ix) to eliminate the restriction on the use of securities of money market and similar funds that transfer their assets through repurchase or similar arrangement (the asset transfer restriction). The Commission is also proposing an amendment to the haircut schedule set forth in Commission Regulation 23.156(a)(3)(i)(B) to add a footnote that was inadvertently omitted when the rule was originally promulgated.

1. Commission Regulation 23.156(a)(1)(ix)—Elimination of the Asset Transfer Restriction

In adopting the CFTC Margin Rule, the Commission added redeemable securities in money market and similar funds to the list of eligible collateral in response to comments arguing for the inclusion of MMF securities as eligible collateral for IM.[63] The Commission explained that the addition of money market and similar fund securities to the list of eligible collateral would provide flexibility while maintaining a level of safety, noting that to qualify, such fund securities would need to meet the conditions in Commission Regulation 23.156(a)(1)(ix), including the asset transfer restriction in paragraph (C), which has the effect of disqualifying the securities of funds that transfer their assets through repurchase or similar arrangements.[64]

As discussed above, market participants, and the GMAC Margin Subcommittee, have urged the Commission to eliminate the asset transfer restriction in paragraph (C), noting that it disqualifies the securities of most MMFs and significantly restricts the ability of swap counterparties to use such form of collateral.[65] Based on its experience implementing the margin requirements for several years and for the reasons described below, the Commission preliminarily recommends the elimination of the restriction.

MMFs are regulated, short-term investment vehicles that are subject to liquidity and diversification requirements under U.S. regulations, such as SEC Rule 2a–7.[66] The MMFs that could qualify as eligible IM collateral under Commission Regulation 23.156 invest in high quality underlying instruments, namely securities issued or unconditionally guaranteed as to the timely payment of principle and interest by the U.S. Department of the Treasury and cash. More generally, the Margin Subcommittee Report stated that the Commission has recognized MMFs as safe, high quality investments, noting that, for example, Commission Regulation 1.25 permits the investment of customer margin by futures commission merchants (''FCM'') in MMFs without an asset transfer restriction.[67]

The elimination of the asset transfer restriction in paragraph (C) of Commission Regulation 23.156(a)(1)(ix) would allow for a broader range of money market and similar fund securities to qualify as eligible IM collateral.[68] This is consistent with the Commission's intent in identifying certain fund securities as eligible collateral when it adopted the CFTC Margin Rule. The Commission stated that it intended to permit MMF securities to be pledged as IM collateral in order to permit flexibility, while also ''maintaining a level of safety.''[69] As noted above, according to the Margin Subcommittee Report, most multi-billion dollar MMFs available to the institutional marketplace use repurchase or similar arrangements as part of their management strategy.[70] Given the widespread use of repurchase and similar arrangements by MMFs,

[63] *See* CFTC Margin Rule, 81 FR at 666.

[64] *Id.*

[65] Margin Subcommittee Report at 23.

[66] 17 CFR 270.2a–7.

[67] Margin Subcommittee Report at 26. In the Commission's view, the fact that Commission Regulation 1.25 permits investments in interests in money market funds without imposing restrictions on repurchase agreements and similar arrangements is not dispositive in considering the proposed amendment to Commission Regulation 23.156(a)(1)(ix). Commission Regulation 1.25 was adopted under a different regime (concerning FCMs and derivative clearing organizations) and addresses different concerns than those Commission Regulation 23.156 aims to target.

[68] If adopted, the amendment would also result in an expanded scope of money market and similar fund securities that can serve as VM for uncleared swap transactions between a CSE and an FEU, given that Commission Regulation 23.156(b)(1)(ii), defining the types of assets qualifying as VM collateral for these transactions, incorporates the assets identified as eligible collateral for IM in Commission Regulation 23.156(a)(1).

[69] *See* 81 FR at 666.

[70] Margin Subcommittee Report at 27.

only a few of the MMFs currently available to institutional clients satisfy the asset transfer restriction in paragraph (C).[71] As a result, unless the restriction is eliminated, this form of margin collateral would be of very limited availability to swap counterparties, contrary to the intent of the Commission.

The Commission preliminarily believes that expanding the scope of eligible money market and similar fund securities may lead to more efficient collateral management practices. In particular with respect to the use of MMF securities as IM collateral, the Margin Subcommittee Report noted that many custodians offer money market sweep programs, which facilitate buy-side market participants' timely meeting margin calls in cash that is subsequently used to purchase MMF securities, thereby avoiding the settlement delays or additional costs associated with the purchase and posting of non-cash assets.[72] This is particularly important given that under the custodian arrangement rules under Commission Regulation 23.157, IM collateral in cash must be promptly converted into other types of eligible collateral, such as securities of MMF or similar funds, to avoid the possibility that cash collateral may become a deposit liability of the custodian and to prevent rehypothecation by the custodian.[73]

Moreover, the Report stated that the use of MMF securities as collateral may enable market participants to avoid potential negative interest rate charges that may be applied by custodian banks on cash collateral.[74] Finally, according to the Report, the sweep of cash into MMF securities helps market participants mitigate the risk of custodian insolvency as non-cash assets would not be consolidated with the custodian's balance sheet or estate from a supplemental leverage ratio[75] or bankruptcy perspective.[76]

Allowing a broader selection of money market and similar fund securities to serve as collateral may address the potential concentration of margin collateral in the securities of a few MMFs.[77] The removal of the asset transfer restriction could lead to an increased use of MMF securities as margin collateral. The Commission acknowledges the risk of concentration of collateral in particular assets and reiterates, as stated in the preamble to the CFTC Margin Rule, that CSEs should take concentration into account and prudently manage their margin collateral.[78] For the same reasons, the Commission preliminarily believes that CSEs should consider the overall investment strategy of a money market or similar fund, including the terms of repurchase or similar arrangements the fund may undertake, in determining whether to use the fund's securities to meet margin obligations under the CFTC rules.

The Commission explained in the preamble to the CFTC Margin Rule that the asset transfer restriction in paragraph (C) of Commission Regulation 23.156(a)(1)(ix) was included to ensure consistency with the prohibition against rehypothecation of IM collateral under Commission Regulation 23.157(c)(1). After further consideration and based on its experience implementing the margin requirements for several years, the Commission now preliminarily believes that although these rules are similar in that they aim to mitigate loss, the objectives of these rules are distinguishable as further discussed below.

Commission Regulation 23.157 provides for the segregation of IM collateral with a third-party custodian to ensure that: (i) the IM is available to a counterparty when its counterparty defaults and a loss is realized that exceeds the amount of VM that has been collected as of the time of default; and (ii) the IM is returned to the posting party after its swap obligations have been fully discharged.[79] In this context, the prohibition in Commission Regulation 23.157(c)(1) against rehypothecation, repledging, reuse, or other transfer (through securities lending, repurchase agreement, reverse repurchase agreement, or other means) of funds or property held by the custodian advances the Commission's goal of ensuring that the pledged assets are available to the non-defaulting party in the event of a default by its counterparty.[80] In the preamble to the CFTC Margin Rule, the Commission explained that rehypothecation could allow the collateral posted by one counterparty to be used by the other counterparty as collateral for additional swaps, resulting in rehypothecation chains and embedded leverage throughout the financial system.[81]

In contrast, Commission Regulation 23.156(a) aims to identify assets as eligible collateral that are liquid, and, with haircuts, will hold their value in times of financial stress.[82] Current paragraph (C) of Commission Regulation 23.156(a)(1)(ix) furthers the goal that money market and similar fund securities posted as IM collateral remain liquid and retain their value during times of financial stress. More specifically, paragraph (C) disqualifies the securities of money market and similar funds that transfer their assets through repurchase or similar arrangements to mitigate the potential impact of such transfers on the liquidity or value of fund securities.

For example, if the counterparty to a money market and similar fund in a repurchase or similar arrangement does not fulfill its obligation under the

[71] *Id.* at 24 (noting that a leading custodial bank has researched all the U.S. MMFs currently available to its institutional clients in the U.S. and found that only four would meet the requirements of Commission Regulation 23.156(a)(1)(ix)).

[72] Under Commission Regulation 23.157, a custodian may accept and hold cash collateral as IM only if the funds are subsequently used to purchase an asset that qualifies as an eligible form of collateral under Commission Regulation 23.156(a)(1)(ii) through (x).

[73] *See* 81 FR at 671.

[74] *See* Margin Subcommittee Report at 27.

[75] The supplementary leverage ratio represents the amount of common equity capital that banks or bank holding companies must hold relative to their total leverage exposure. CSEs and SD or MSP counterparties that are banks or bank holding companies and supervised by a U.S. banking regulator may be subject to this requirement. For further information, *see* Regulatory Capital Rules: Regulatory Capital, Revisions to the Supplementary Leverage Ratio, 79 FR 57725 (Sept. 26, 2014).

[76] Margin Subcommittee Report at 26–27.

[77] As noted above, according to the Margin Subcommittee Report (citing research by a leading custodian bank), only four MMFs have securities that qualify as eligible collateral under the current rules. *See* Margin Subcommittee Report at 24.

[78] *See* 81 FR at 666.

[79] *Id.* at 670.

[80] In this regard, the Margin Subcommittee Report stated that ''in [ ] MMF sweep arrangements, under no circumstances does the pledgor's custodian have any right to rehypothecate, reuse the IM collateral or take any other independent actions with respect to the pledged MMF shares. Instead, the CSE and financial end user agree upfront in the collateral documentation to the list of eligible MMFs and any associated haircuts, as pledgor any cash sweep into a MMF is instructed by the financial end user or its manager and absent any default, any transfers into and out of the collateral account by the custodian is instructed by the financial end user and agreed to by the CSE (as secured party).'' Margin Subcommittee Report at 25.

[81] *Id.* at 688, n. 392 (describing as an example, the situation where a default or liquidity event that occurs at one link along the rehypothecation chain may induce further defaults or liquidity events for other links in the rehypothecation chain as access to the collateral for other positions may be obstructed by a default further up the chain, and also explaining that in the event of default along a rehypothecation chain, there is an increased chance that each party along the chain will ask for the rehypothecated collateral to be returned to them at the same time, leaving just one party with the collateral).

[82] *Id.* at 665.

arrangement, the fund may be left holding assets that might not be easily resold or that might not provide sufficient compensation for the assets tendered in the repurchase arrangement, in particular during a period of financial stress, reducing the overall net asset value of the fund and the price of the fund's securities. Also, the inability to liquidate assets that a money market and similar fund might be left holding upon the failure of a repurchase or similar arrangement, or the inability to extract assets originally tendered in the repurchase arrangement, may impact a fund's ability to promptly respond to redemption requests, which may hinder the liquidity of the money market and similar funds' securities, making the securities less suitable as margin collateral.[83] Repurchase and similar arrangements may therefore undermine efforts that collateral be ''subject to low credit, market, and liquidity risk.'' [84]

As discussed above, the asset transfer restriction was included in the CFTC Margin Rule to provide consistency with the prohibition against rehypothecation of IM collateral, given the possibility that assets exchanged by parties in a repurchase or similar arrangement might be lost in a chain of transactions similar to the chain of hypothecations that the Commission intended to avert by prohibiting the rehypothecation of IM collateral by custodians under Commission Regulation 23.157(c)(1). However, unlike in the rehypothecation situation, where collateral might be lost at any link of the chain with the posting counterparty in the uncleared swap transaction potentially losing its collateral without any recourse, in the repurchase or similar arrangement context, each party to the arrangement would be partially secured because the parties would exchange assets with each other under the arrangement. Hence, the risk of loss would be mitigated. If a party to the repurchase arrangement defaults by failing to return assets tendered by its counterparty, the counterparty would not lose the entire value of its assets as it would hold the assets committed by the other party under the arrangement.[85]

While acknowledging the concerns associated with repurchase and similar arrangements, the Commission preliminarily believes that the flexibility and safety that it aimed to achieve by specifically identifying assets as eligible collateral, including certain money market and similar fund securities, may be advanced even if repurchase and similar arrangements are not restricted for the purpose of qualifying money market and similar fund securities as eligible collateral. In that regard, based on its experience administering the CFTC Margin Rule, the Commission preliminarily believes that risks associated with repurchase and similar arrangements would be adequately addressed even in the absence of the asset transfer restriction by safeguards already present in the CFTC regulations, as further discussed below, which, in the Commission's view, can achieve the desired level of safety with respect to fund securities without restricting a fund's ability to undertake repurchase or similar transactions.

First, Commission Regulation 23.156(a)(1)(ix)(A) and (B) qualify as eligible collateral the securities of money market and similar funds that invest only in securities issued or unconditionally guaranteed by the U.S. Department of the Treasury, the European Central Bank or certain other sovereign entities, and cash. The Commission preliminarily believes that these provisions ensure that money market and similar fund securities present the fundamental characteristics of liquidity and value stability contemplated by the CFTC Margin Rule.[86] In addition, the Commission notes that subparagraphs (A) and (B) of Commission Regulation 23.156(a)(1)(ix) effectively limit the types of assets that a money market and similar fund can receive in repurchase or similar arrangements. As such, the securities of money market and similar funds will qualify as eligible collateral only if the types of assets that the fund receives in a repurchase or similar arrangement are those described in subparagraphs (A) and (B).

Second, Commission Regulation 23.156(c) requires that CSEs monitor the market value and eligibility of all collateral and, to the extent that the market value has declined, promptly collect or post additional eligible collateral to maintain compliance with Commission Regulations 23.150 through 23.161.[87] Thus, even if the value or liquidity of pledged money market and similar fund securities may be affected by a repurchase or similar arrangement undertaken by the fund, CSEs have the obligation to monitor the value and suitability of the fund's securities as margin collateral and collect or post additional eligible collateral to compensate for collateral deficiencies.

In addition, section 4s(j)(2) of the CEA requires CSEs to adopt a robust and professional risk management system that is adequate for the management of their swap activities,[88] and Commission Regulation 23.600 mandates that CSEs establish a risk management program to monitor and manage risks associated with their swap activities including, among other things, credit and liquidity risks. In particular, pursuant to Commission Regulation 23.600(c)(4), credit risk policies and procedures should provide for the regular valuation of collateral used to cover credit exposures and the safeguarding of collateral to prevent loss, disposal, rehypothecation, or use unless appropriately authorized, and liquidity risk policies and procedures should provide for, among other things, the assessment of procedures for liquidating all non-cash collateral in a timely manner and without a significant effect on price, and the application of appropriate collateral haircuts that accurately reflect market and credit risk.[89]

Given these safeguards and the recognition that the asset transfer restriction is severely limiting the use of money market and similar fund securities as eligible collateral, the Commission preliminary believes that it is appropriate to eliminate the asset transfer restriction. The Commission also notes that the elimination of the restriction would bring the CFTC's eligible collateral framework more in line with the SEC approach, which does not impose asset transfer restrictions on funds whose securities are used as collateral for margining purposes and expressly permits the use of government money market fund securities as collateral, thereby potentially leading to a reduction in costs for those market participants that dually register as SDs and security-based swap SDs with the CFTC and the SEC, respectively.

[83] The Commission, however, notes that any potential risk of such a repurchase or similar arrangement may be mitigated by the standard industry practice of applying haircuts to non-cash collateral in repurchase or similar arrangements to compensate for the risk that the value of the collateral may decline over the term of the arrangement. *See* Primer: Money Market Funds and the Repo Market, Prepared by the staff of the Division of Investment Management, U.S. Securities and Exchange Commission at pp. 5–6.

[84] 81 FR at 667 (noting that the CFTC Margin Rule does not allow CSEs to fulfill the margin requirements with any asset not included in the list of eligible collateral set forth in Commission Regulation 23.156, as the use of alternative types of collateral could introduce liquidity, price volatility, or other risks of collateral during a period of stress that could further exacerbate such stress and could undermine efforts to ensure that collateral be subject to low credit, market, and liquidity risk).

[85] Of course, it might experience some loss as the retained assets might not fully compensate such party for the unreturned assets.

[86] *See* 81 FR at 665.

[87] 17 CFR 23.156(c).

[88] *See* 7 U.S.C. 6s(j).

[89] 17 CFR 23.600.

2. Commission Regulation 23.156(a)(3)—Amendments to the Haircut Schedule

Commission Regulation 23.156(a)(3) sets forth percentage discounts to be applied to the value of eligible collateral collected or posted to satisfy IM requirements, varying according to asset class (''haircut requirements'').[90] The haircut requirements are intended to address the possibility that the value of non-cash eligible collateral may decline between a counterparty's default and the close out of such counterparty's swap positions by the CSE.[91]

Although the Commission intended to align its margin rule for uncleared swaps with the Prudential Regulators Margin Rule, in adopting its rule, the Commission inadvertently omitted a footnote to the haircut schedule included in the Prudential Regulators Margin Rule.[92] The Commission is therefore proposing an amendment to Commission Regulation 23.156(a)(3) to incorporate the omitted footnote. The footnote, consistent with the footnote in the Prudential Regulators Margin Rule, would describe the haircut applicable to the securities of money market and similar funds. The haircut for such money market and similar fund securities would be the weighted average discount on all assets within the funds (the discount for each asset is specified in Commission Regulation 23.156(a)(3)) at the end of the prior month. The footnote would further specify that the weights to be applied in the weighted average should be calculated as a fraction of each fund's total market value that is invested in each asset with a given discount amount.

Request for comments: The Commission requests comment regarding the proposed amendments to Commission Regulation 23.156, generally. The Commission specifically requests comment on the following questions:

10. Does the existing asset transfer restriction significantly limit the use of money market and similar fund securities as eligible collateral under the CFTC Margin Rule?

11. Under the Money Market Funds Proposal, the securities of certain money market and similar funds that engage in repurchase or similar arrangements would qualify as eligible collateral. A money market and similar fund that engages in asset transfer transactions under a repurchase or similar arrangement may be exposed to increased risks, which may affect the liquidity and value of the fund's securities pledged as collateral under the CFTC Margin Rule. In light of the potential increased risk, should the Commission consider an alternative to the proposed rule amendment, such as allowing the securities of money market and similar funds to qualify as eligible collateral only if a fund's repurchase or similar arrangements are cleared? Should the Commission impose any additional limits or conditions, such as restrictions on the type and terms of the repurchase or similar arrangements permitted for money market and similar funds for their shares to qualify as eligible collateral?

12. If the Commission eliminates the asset transfer restriction, should the Commission impose an additional haircut beyond that required by the haircut schedule in Commission Regulation 23.156(a)(3), as revised by the proposed amendment? If an additional haircut were to be adopted, what should the haircut be and how should the haircut be calculated? Should such an additional haircut be proportionate to the net asset value of the assets of a money market and similar fund that are subject to repurchase or similar arrangements? Or instead, should the additional haircut be a fixed percentage similar to the percentages applicable to other assets that qualify as eligible collateral under the haircut schedule, as it may be less complex to administer? Should such additional fixed haircut apply to all securities of money market and similar funds that are used as eligible collateral, or be applicable only to such securities of money market and similar funds that engage in repurchase or similar arrangements?

13. Given the potential impact that repurchase or similar agreements may have on the liquidity and value of securities of money market and similar funds that may be used as eligible collateral, should there be a percentage cap on the amount of assets that a fund can use for repurchase or similar arrangements, such as 10 percent of the total net asset value of the fund?

14. To gain a better understanding of the risks posed by repurchase and similar arrangements, the Commission requests information concerning the types of counterparties that typically face money market and similar funds in repurchase or similar agreements; the extent to which repurchase and similar arrangements are used by money market and similar funds; and whether the market treats differently money market and similar funds according to the types of repurchase and similar arrangements the funds enter into and the extent of repurchase agreements or arrangements the funds engage in. Further, the Commission requests comment with respect to the manner in which, and the extent to which, CSEs will meet their obligation to monitor the value and suitability of securities of money market and similar funds pledged as margin collateral where the funds engage in repurchase or similar arrangements.

15. Are the regulatory safeguards referenced in the Money Market Funds Proposal adequate to address the potential risks that may arise from the proposal? Are there other regulatory safeguards that the Commission should consider?

16. Are there any risks associated with the Money Market Funds Proposal that the Commission has not considered? In addition to the possible measures discussed above, including a possible additive haircut, or a percentage cap on the amount of assets that funds could use in repurchase and similar agreements, are there other measures that the Commission could take to mitigate such risks?

17. The Prudential Regulators Margin Rule contains an equivalent asset transfer restriction. If the Commission amends Commission Regulation 23.156, counterparties that trade with both prudentially regulated SDs and CFTC-regulated SDs may need to adjust their swap-related documentation and collateral management systems to reflect the different treatments for fund securities under the CFTC's and the prudential regulators' rules. In that regard, the Commission requests information on the potential additional costs associated with maintaining two separate and distinct documentation and collateral management processes. How much weight should the Commission give with respect to the possible challenge that counterparties may need to maintain two separate and distinct documentation and collateral management systems? Should the Commission proceed to adopt the proposed amendments to Commission Regulation 23.156 if the prudential regulators do not adopt similar regulatory changes?

18. The Commission intends that the final rule will become effective 30 days after its publication in the **Federal Register**. With respect to the Money Market Funds Proposal, are there any comments on the effective date?

[90] 17 CFR 23.156(a)(3). Also, Commission Regulation 23.156(b)(1)(ii) provides that assets that qualify as eligible collateral for IM can be used as collateral for VM for swap transactions between a CSE and a FEU, subject to the applicable haircuts for each asset. *See also supra* note 20.

[91] 81 FR at 668.

[92] Prudential Regulators Margin Rule at 74910.

IV. Administrative Compliance

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA'') requires Federal agencies to consider whether the rules they propose pursuant to the notice-and-comment provisions of the Administrative Procedure Act, or any other law, will have a significant economic impact on a substantial number of small entities and provide a regulatory flexibility analysis respecting the impact or issue a certification that the rule does not have such impact.[93] The Commission previously has established certain definitions of ''small entities'' to be used in evaluating the impact of its regulations on small entities in accordance with the RFA.[94] The proposed amendments would only affect certain SDs and MSPs and their counterparties, which must be eligible contract participants (''ECPs'').[95] The Commission has previously established that SDs, MSPs and ECPs are not small entities for purposes of the RFA.[96]

Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed amendments will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (''PRA'')[97] imposes certain requirements on Federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA. The Commission may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid Office of Management and Budget control number. The proposed amendments contain no requirements subject to the PRA.

C. Cost-Benefit Considerations

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA.[98] Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) considerations, and seeks comments from interested persons regarding the nature and extent of such costs and benefits.

As described in more detail above, under the Seeded Funds Proposal, the Commission is proposing to amend the definition of ''margin affiliate'' to provide for a limited eligible seeded fund exception, pursuant to which, during a period of three years after the fund's trading inception date, a seeded fund meeting certain specified requirements would be deemed to not have margin affiliates for purposes of calculating the fund's MSE and the IM threshold. This proposed treatment for eligible seeded funds would effectively relieve CSEs that enter into uncleared swaps with certain seeded funds from the requirement to exchange IM with the seeded funds during the three-year period after the funds' trading inception date. The Seeded Funds Proposal would make the proposed treatment available only with respect to eligible seeded funds that, among other requirements: (i) are distinct legal entities from each sponsor entity; (ii) have one or more margin affiliates that are required to post and collect IM; (iii) are managed by an asset manager pursuant to an agreement that requires the assets of the fund to be managed in accordance with a specified written investment strategy; (iv) have an asset manager who maintains independence in carrying out its management responsibilities and exercising its investment discretion, and has independent fiduciary duties to other investors in the fund (if any), such that no sponsor entity or any margin affiliate of a sponsor entity controls or has transparency into the management or trading of the seeded fund; (v) follow a written plan for the reduction of the sponsor entity's ownership interest in the fund that stipulates divestiture targets over the three-year period after the seeded fund's trading inception date; (vi) are not collateralized, guaranteed or otherwise supported, directly or indirectly by any sponsor entity, any margin affiliate of a sponsor entity, other collective investment vehicles, or the seeded fund's asset manager, in respect of any of the fund's obligations; (vii) have not received any of their assets, directly or indirectly, from an eligible seeded fund that has relied on the proposed eligible seeded fund exception; and (viii) are not securitization vehicles.

Under the Money Market Funds Proposal, the Commission is proposing to eliminate the asset transfer restriction in paragraph (C) of Commission Regulation 23.156(a)(1)(ix), which has the effect of disqualifying as eligible collateral the securities of money market and similar funds that transfer their assets through repurchase or similar arrangements. The Margin Subcommittee Report indicated that the asset transfer restriction significantly limits the money market fund securities that are available for use as collateral under the CFTC Margin Rule.[99]

The baseline against which the benefits and costs associated with the proposed rule amendments are compared is the uncleared swaps markets as they exist today, including the treatment of seeded funds and the securities of money market and similar funds under the current CFTC Margin Rule.

The Commission notes that the consideration of costs and benefits below is based on the understanding that the markets function internationally, with many transactions involving U.S. firms taking place across international boundaries; with some Commission registrants being organized outside of the United States; with leading industry members typically conducting operations both within and outside the United States; and with industry members commonly following substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the below discussion of costs and benefits refers to the effects of these proposed amendments on all activity subject to the proposed amended regulations, whether by virtue of the activity's physical location in the United States or by virtue of the activity's connection with activities in, or effect on, U.S.

[93] *See* 5 U.S.C. 601(2), 603, 604, and 605.

[94] *See* Registration of Swap Dealers and Major Swap Participants, 77 FR 2613 (Jan. 19, 2012).

[95] Pursuant to section 2(e) of the CEA, 7 U.S.C. 2(e), each counterparty to an uncleared swap must be an ECP, as defined in section 1a(18) of the CEA, 7 U.S.C. 1a(18). Section 1a(18) of the CEA defines ECP by listing certain entities and individuals whose business is financial in nature or that meet defined asset or net worth thresholds, as well certain government entities.

[96] *See* Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' '''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant,'' 77 FR 30596, 30701 (May 23, 2012).

[97] 44 U.S.C. 3501 *et seq.*

[98] 7 U.S.C. 19(a).

[99] As previously noted, according to the Margin Subcommittee Report (citing research by a leading custodian bank), the securities of only four MMFs would qualify as eligible collateral under the current rules. *See* Margin Subcommittee Report at 24.

commerce under section 2(i) of the CEA.[100]

The Commission recognizes that the proposed rules may impose additional costs on market participants, including CSEs. Although the Commission has endeavored to assess the expected costs and benefits of the proposed rulemaking in quantitative terms, due to the lack of data and information to estimate those costs, the Commission has identified and considered the costs and benefits of the proposal in qualitative terms. The lack of data and information to estimate costs is attributable to the nature of the proposal and uncertainty relating to how particular market participants would implement the proposed rules. The Commission specifically requests data and information from market participants and other commenters to allow it to better estimate the costs of the proposal.

1. General Cost-Benefits Considerations

Seeded Funds Proposal

(a) Benefits

The Seeded Funds Proposal would effectively relieve CSEs entering into uncleared swaps with eligible seeded funds from the requirement to collect IM from the funds, subject to specified conditions. Absent the Seeded Funds Proposal, seeded funds would be disadvantaged domestically and globally in comparison to similar investment funds that are not margin affiliates of an entity required to exchange IM or are subject to the rules of jurisdictions such as Australia, Canada and the EU that treat certain investment funds as separate legal entities, consistent with the international standards established by the BCBS–IOSCO Framework.[101] The Seeded Funds Proposal would therefore level the playing field domestically and globally with respect to the treatment of seeded funds. However, the Seeded Funds Proposal may incentivize trading with CSEs over SDs or MSPs subject to the U.S. prudential regulators' margin rules given that the prudential regulators might not revise their rules in a manner consistent with the Seeded Funds Proposal and the prudential regulators' rules may continue to require that seeded funds calculate the MSE and IM threshold amount on a consolidated basis with their margin affiliates.

The Commission preliminarily believes that the Seeded Funds Proposal would tend to benefit seeded funds whose AANA falls below the $8 billion MSE threshold and that, given their level of swap activity, such seeded funds would pose relatively low risk to the uncleared swaps market and the U.S financial system in general. In that regard, the Margin Subcommittee Report stated that seeded funds have limited notional exposure and their capitalization typically does not exceed $50–100 million.[102] The Report further cited an informal sampling of members of SIFMA AMG and the American Council of Life Insurers conducted in 2018, which indicated that a total of 33 funds would be in scope of the CFTC margin requirements due to their derivatives notional exposures being consolidated with entities with MSE. Individually, each of the funds had an average gross notional exposure of $32 million.[103]

As a result, in the Commission's preliminary view, the Seeded Funds Proposal, if adopted, would address seeded funds that tend to engage in less uncleared swap trading activity and, in the aggregate, pose less systemic risk than entities that meet the MSE threshold. The impacted eligible seeded funds, which would be in an initial stage of development, would presumably have fewer resources to devote to IM compliance and hence would benefit from being discharged from posting IM during their seeding period without contributing significantly to systemic risk. The eligible seeded fund's sponsor entities and their margin affiliates that do not independently qualify for the proposed eligible seeded fund exception would continue to include the eligible seeded funds' exposure in their calculation of the MSE and IM threshold amount. The CSE counterparty to the eligible seeded fund would also still be required to count the uncleared swaps that it undertakes with the eligible seeded fund for purposes of calculating its own AANA. The Commission preliminarily believes that the flexibility provided by the eligible seeded fund exception would be instrumental for investment funds during the seeding period when funds typically use all their resources to establish a performance track record to attract unaffiliated investors.

In addition, the Commission believes that the Seeded Funds Proposal would be beneficial for CSEs that enter into swap transactions with investment funds. As a result of the proposed amendments, CSEs would apply a consistent approach in their swap dealing activities with U.S. and non-U.S. investment funds, which may lead to cost efficiencies. Also, as noted in the Margin Subcommittee Report, a consistent approach to seeded funds would reduce the incentive for non-U.S. funds to avoid business with CSEs given the perceived more onerous treatment of funds in the U.S.[104]

The proposed eligible seeded fund exception may also incentivize some market participants to expand their swap business or enter into the swaps markets because, by counting their AANA and uncleared swaps credit exposure individually, seeded funds may not meet the thresholds that would bring them within the scope of the IM requirements. This would relieve CSEs entering into uncleared swaps with the funds from the requirement to exchange IM with the funds. In turn, the elimination of IM-related costs may encourage uncleared swaps trading between CSEs and investment funds and increase the pool of potential swap counterparties, enhancing competition and liquidity and facilitating price discovery in the uncleared swaps markets.

(b) Costs

Amending the definition of "margin affiliate" to provide for a limited eligible seeded fund exception under which seeded funds would be deemed to not have margin affiliates for purposes of calculating the funds' MSE and the IM threshold amount, subject to specified conditions, may lead to the exchange of less margin between a CSE and a seeded fund. The Commission recognizes that the uncollateralized exposure that may result from the proposed change to the "margin affiliate" definition could increase credit risk associated with uncleared swaps. The Commission believes, however, that a number of safeguards exist to mitigate this risk. The Commission notes that seeded funds that would qualify for the eligible seeded fund exception would typically be smaller entities that have limited swaps activity.[105] To grow in size, the funds would have to attract unaffiliated investors, which may result in such funds no longer being subject to consolidation with their sponsor entity.

As such, the eligible seeded fund exception under the Seeded Funds Proposal would primarily impact the exchange of IM between a CSE and investment funds that are in their seeding period. During that period, such investment funds would pose less risk to a CSE counterparty and the financial system as a whole given the small size of the funds and the scope of their derivatives activity. To ensure that

[100] 7 U.S.C. 2(i).

[101] Margin Subcommittee Report at 7, 30 and 33.

[102] Margin Subcommittee Report at 31.

[103] *Id.*

[104] Margin Subcommittee Report at 30.

[105] See Margin Subcommittee Report at 31.

eligible seeded funds are afforded the benefit of a separate treatment from margin affiliates only during the seeding period, the Commission proposes to limit the applicability of the eligible seeded fund exception only to three years after the fund's trading inception date. To ensure that the three-year period is not reinstated as a result of rollovers of fund assets or similar activities, the proposed definition of eligible seeded fund would include a condition that the seeded fund has not received, directly or indirectly, any of its assets from an eligible seeded fund that has relied on the eligible seeded fund exception to the definition of ''margin affiliate.'' The Commission further notes that, pursuant to section 4s(j)(2) of the CEA and Commission Regulation 23.600, CSEs are required to monitor and manage risks related to their swap activities, including credit risk, and set risk tolerance limits.[106] Thus, if the credit risk associated with CSEs' transactions with eligible seeded funds exceeds the CSEs' risk tolerance limits, CSEs would be expected to take mitigating measures.

In certain circumstances, the increase in uncollateralized credit risk resulting from the Seeded Funds Proposal could also negatively impact the sponsor entity or the asset manager of a seeded fund. In particular, if a seeded fund is facing financial distress, a sponsor entity or the fund's asset manager may be incentivized to intervene, because of reputational risks or other concerns, and contribute additional resources even in the absence of an explicit business arrangement to provide financial support or a guarantee. Similarly, if the fund is suffering the consequences of a swap counterparty default, the sponsor entity or the asset manager may contribute financial resources to improve the fund's condition and increase its own exposure, potentially putting at risk its own financial position. Thus, the fund's uncollateralized exposure may lead the sponsor entity or the asset manager to incur risks, increasing the potential for contagion and systemic risk. To account for these risks, the Commission is proposing to define the term ''eligible seeded fund'' to incorporate requirements meant to ensure that seeded funds are genuinely independent and that the risks associated with their activities are not assumed by other entities such as their sponsor entities or asset managers. Specifically, among other conditions, the seeded fund would have to be a distinct legal entity from each sponsor entity that is not collateralized, guaranteed, or otherwise supported, directly or indirectly, by any sponsor entity, any margin affiliate of any sponsor entity, other collective investment vehicles, or the seeded fund's asset manager, in respect of any of the fund's obligations. This should mitigate the incentive for the sponsor's assets to be used if the seeded fund fails.

Treating seeded funds as separate unaffiliated legal entities for purposes of calculating the thresholds for determining whether compliance with the IM requirements is required could also incentivize swap counterparties to create legal entities that have no economic basis and are constructed solely for the purpose of applying additional thresholds to evade margin requirements. To address these concerns, the Commission proposes to limit the applicability of the eligible seeded fund exception by providing that eligible seeded funds would be deemed not to have margin affiliates solely for the purpose of calculating the fund's MSE and IM threshold amount. As such, under the Seeded Funds Proposal, the eligible seeded funds' sponsor entities and their margin affiliates would continue to include the eligible seeded funds' exposures in the calculation of the IM compliance thresholds applicable to such sponsor entities and margin affiliates. In addition, the Commission proposes to include, in the proposed definition of ''eligible seeded fund,'' conditions designed to ensure that funds that qualify as eligible seeded funds have a bona fide business purpose. In particular, the proposed definition provides that the eligible seeded fund must be managed by an asset manager pursuant to an agreement that requires that the assets of the fund be managed in accordance with a specified written investment strategy and that the asset manager has independence in carrying out its management responsibilities and exercising its investment discretion, and to the extent applicable, has independent fiduciary duties to other investors in the fund, such that no sponsor entity or a margin affiliate of a sponsor entity controls or has transparency into the management or trading of the seeded fund. Furthermore, the proposed definition of eligible seeded fund would require that the seeded fund's investment strategy must follow a written plan for reducing the sponsor entity's ownership interest in the fund.

The Commission, therefore, believes that the costs associated with the potential evasion of the IM requirements would be mitigated by the proposed rule amendment, which would be narrowly tailored to make available the proposed approach only for purposes of calculating the IM compliance thresholds applicable to seeded funds that meet specified requirements and only during the three years that follow the fund's trading inception date. In addition, the Commission intends to use its anti-evasion authority to prevent circumvention of the margin requirements.[107]

Furthermore, given that the U.S. prudential regulators may not amend their margin requirements in line with the Seeded Funds Proposal, if the Commission finalizes the proposal described herein, the Commission acknowledges the possibility that its requirements with respect to the treatment of eligible seeded funds may diverge from that of the U.S. prudential regulators, requiring funds that engage in swaps transactions with both CSEs and prudentially-regulated SDs to adjust their swap-related documentation and IM processes to reflect such different treatments. Thus, market participants may incur additional costs by having to maintain two separate and distinct types of documentation and IM management processes. Similar costs may also be incurred by CSEs that already transact with seeded funds that are currently consolidated. Also, as discussed previously, given that the Seeded Funds Proposal would provide for an eligible seeded fund exception from the definition of ''margin affiliate,'' effectively providing for the funds' deconsolidation for purposes of calculating the funds' MSE and IM threshold amount, seeded funds may favor CSEs as counterparties over SDs or MSPs subject to the prudential regulators' margin rules, which might not be revised to provide for a similar eligible seeded fund exception.

As noted above, to better assess the impact of a potential divergence between the CFTC Margin Rule and the Prudential Regulators Margin Rule, the Commission is requesting information on the potential costs associated with maintaining distinct documentation and IM management processes.

Money Market Funds Proposal

(a) Benefits

The Money Market Funds Proposal would expand the scope of assets that

[106] 7 U.S.C. 6s(j)(2) (mandating that CSEs adopt a robust and professional risk management system adequate for the management of day-to-day swap activities) and 17 CFR 23.600 (requiring CSEs, in establishing a risk management program for the monitoring and management of risk related to their swap activities, to account for credit risk and to set risk tolerance limits).

[107] *See* supra note 51.

qualify as eligible collateral. In this regard, the GMAC Margin Subcommittee Report stated that absent elimination of the asset transfer restriction, the securities of very few MMFs would qualify as eligible collateral, noting that nearly all U.S. MMFs engage in some form of repurchase or similar arrangements.[108] The Money Market Funds Proposal may therefore reduce the potential concentration of collateral in the few MMFs whose securities currently qualify as eligible collateral under Commission Regulation 23.156(a)(1)(ix), which could lead to greater diversity of assets used for collateral, thereby reducing the riskiness of IM assets.

Also, the Money Market Funds Proposal, by increasing the number of MMFs whose securities qualify as eligible collateral, may promote more efficient collateral management practices. The Margin Subcommittee Report stated that custodians offer money market sweep programs that afford institutional clients of such custodians the ability to timely and efficiently meet margin calls without settlement delay, avoiding other transaction costs that would otherwise arise in the absence of the sweep programs. Such direct sweeps from cash into MMF securities mitigate the risk of insolvency by the custodian because non-cash collateral deposited with the custodian will not be consolidated in the custodian's balance sheet. The Margin Subcommittee Report also stated that the use of MMFs may avoid the risk of potential negative interest rate charges that may be applied by custodian banks on cash collateral.

By eliminating the asset transfer restriction, the Money Market Funds Proposal could also promote asset management policies that improve the performance of money market and similar funds. Without the restriction, the funds may undertake repurchase or similar arrangements that increase returns for investors, including the return for CSEs that post money market and similar fund securities as margin collateral for uncleared swaps, contributing to the fund securities' liquidity and retention of value even during periods of financial stress.

In summary, these benefits will accrue to CSEs and their counterparties that enter into uncleared swaps transactions. As discussed above, the potential concentration in certain types of collateral has been acknowledged previously by the Commission as a potential risk that CSEs should consider in managing their margin collateral. CSEs and their counterparties will also benefit from the more efficient use of their capital as discussed above and enhanced returns on securities posted as collateral. Furthermore, the proposal may lead to reduced costs for those market participants that dually register as SDs and security-based swap SDs with the CFTC and the SEC, respectively, as the proposed amendment would bring the CFTC's eligible collateral framework more in line with the SEC approach, which does not impose asset transfer restrictions on funds whose securities are used as collateral for margining purposes and expressly permits the use of government money market fund securities as collateral.

(b) Costs

The elimination of the asset transfer restriction in paragraph (C) of Commission Regulation 23.156(a)(1)(ix) would remove a safeguard intended to ensure that money market and similar fund securities posted as margin collateral remain liquid and maintain their value in times of financial stress. More specifically, paragraph (C) prevents the transfer of money market and similar fund assets through repurchase or similar arrangements to mitigate the impact of such transfers on the liquidity or value of fund securities. For example, if a counterparty to a money market and similar fund in a repurchase or similar arrangement defaults, the fund may be left holding assets that, in times of financial stress, may not be easily resold and might not compensate for the value of assets tendered in the repurchase arrangement. Such a default would reduce the overall net asset value of the fund and the price of the fund's securities. Also, the inability to liquidate assets that a money market and similar fund might be left holding upon the failure of a repurchase or similar arrangement or the inability to extract assets originally tendered in the repurchase arrangement may impact the fund's ability to promptly respond to redemption requests, hindering the liquidity of the fund's securities, making them less suitable as margin collateral. The Commission, however, notes that subparagraphs (A) and (B) of Commission Regulation 23.156(a)(1)(ix), which are not being amended, limit the types of assets that a money market and similar fund can receive in repurchase or similar arrangements to those assets specifically identified in those paragraphs, alleviating in part the risks associated with repurchase or similar arrangements.

In light of the proposed elimination of the asset transfer restriction, the Commission is also seeking input on whether it would be appropriate to include an additional haircut beyond that required by the haircut schedule in Commission Regulation 23.156(a)(3), as corrected by the proposed amendment discussed herein.

The Commission further notes that Commission Regulation 23.156(c) requires that CSEs monitor the market value and eligibility of all collateral and, to the extent that the market value has declined, promptly collect or post additional eligible collateral to maintain compliance with Commission Regulations 23.150 through 23.161.[109] Thus, even if the value or liquidity of pledged money market and similar fund securities may be affected by repurchase or similar arrangements undertaken by the fund, CSEs have the obligation to monitor the value and suitability of the fund's securities as margin collateral and collect or post additional eligible collateral to compensate for collateral deficiencies.

The elimination of the asset transfer restriction could give rise to other costs. Given that the U.S. prudential regulators may not amend their margin requirements in line with the proposed rule amendments, if the amendments proposed herein are adopted as final, the CFTC and U.S. prudential regulators' margin rules would diverge with respect to the treatment of securities of money market and similar funds as eligible collateral, requiring parties that trade with both prudentially-regulated SDs and CSEs to adjust their swap-related documentation and collateral management systems to reflect such different treatments. Thus, market participants may incur additional costs by having to maintain two separate and distinct types of documentation and collateral management systems. Also, the Money Market Funds Proposal may incentivize trading with CSEs over SDs or MSPs subject to the U.S. prudential regulators' margin rules given that the prudential regulators might not revise their rules in a manner consistent with the Money Market Funds Proposal and the prudential regulators' rules may continue to restrict the use of securities of money market and similar funds that transfer their assets through repurchase and similar agreements.

At the same time, the Commission notes that the removal of the asset transfer restriction would bring the CFTC's eligible collateral framework closer to the approach adopted by the Securities and Exchange Commission (''SEC''), which does not impose asset

[108] Margin Subcommittee Report at 24.

[109] 17 CFR 23.156(c).

transfer restrictions with respect to money market and similar fund securities and expressly permits the use of government money market fund securities as collateral.[110] Therefore, although there is the potential for greater costs as a result of divergence with the U.S. prudential regulators, there may be lower costs overall, given that many CSEs are also cross-registered with the SEC as security-based SDs.

2. Section 15(a) Considerations

In light of the foregoing, the CFTC has evaluated the costs and benefits of the proposals pursuant to the five considerations identified in section 15(a) of the CEA as follows:

Seeded Funds Proposal

(a) Protection of Market Participants and the Public

As discussed, the Seeded Funds Proposal would provide that, during a period of three years from the fund's trading inception date, a seeded fund meeting specific requirements would be deemed not to have margin affiliates solely for purposes of calculating the fund's MSE and the IM threshold amount. As a result, only the seeded fund's individual AANA would be used to determine whether the fund has MSE, and only the individual credit exposure of the fund resulting from the fund's swaps with a CSE would be used to determine whether the posting and collection of IM is required, and not the exposures calculated on an aggregate basis with the fund's sponsor entities and other margin affiliates, as currently required under the CFTC Margin Rule.

The Seeded Funds Proposal is thus proposing an approach to eligible seeded funds that is consistent with the BCBS–IOSCO Framework and similar approaches adopted by jurisdictions such as Australia, Canada and the EU.[111] As such, the Seeded Funds Proposal would eliminate a disadvantage that U.S. investment funds face compared to non-U.S. funds that are not subject to a consolidation requirement. The Seeded Funds Proposal would also address the potential liquidity drain and trading disruptions that CSEs might encounter if non-U.S. investments funds were to avoid doing uncleared swaps business with the CSEs because of the current treatment of seeded funds in the U.S. under the CFTC Margin Rule. In addition, the Seeded Funds Proposal would level the playing field between U.S. seeded funds that are consolidated within a group of entities that collectively have MSE and other domestic investment funds that are not part of a group whose combined exposure exceeds the threshold for compliance with the IM requirements, while, at the same time, potentially spurring greater interest in seeded funds as potential counterparties.

As a result of the Seeded Funds Proposal, less collateral may be collected by seeded funds given that individually they may not meet the threshold for exchanging IM. A seeded fund's uncollateralized swaps exposure may negatively impact the sponsor entities of the fund or its asset manager, given that, for reputational reasons, a sponsor entity or the asset manager may provide financial support to the seeded fund in times of financial distress, potentially putting at risk their own financial position.

The Seeded Funds Proposal may also have implications for CSEs entering into uncleared swap transactions with the fund's sponsor entity. Specifically, a CSE evaluating the creditworthiness of its counterparty—the fund's sponsor entity—may not be aware of the sponsor entity's potentially weakened financial position. As such, the Seeded Funds Proposal, by allowing seeded funds' exposures to not be consolidated with the exposures of their sponsor entities and other margin affiliates for purposes of determining the applicability of the IM requirements, may increase the risk of contagion.

The Commission, however, believes that such concerns are mitigated by the requirements incorporated in the proposed definition of eligible seeded fund, including the condition that the seeded fund is not collateralized, guaranteed or otherwise supported, directly or indirectly by any sponsor entity, any margin affiliate of any sponsor entity, other collective investment vehicles, or the fund's asset manager in respect of any of the fund's obligations. These conditions are intended to ensure that seeded funds are genuinely independent and risk remote from the sponsor entities.

(b) Efficiency, Competitiveness, and Financial Integrity of Markets

The Seeded Funds Proposal would amend the definition of ''margin affiliate'' in Commission Regulation 23.151 to provide an exception for eligible seeded funds, which would effectively relieve CSEs from the requirement to exchange IM for uncleared swaps with such eligible seeded funds, subject to specified conditions. This eliminates a competitive disadvantage between seeded funds that are consolidated with their sponsor entities and margin affiliates, which collectively exceed the thresholds for compliance with the IM requirements on the one hand, from those investment funds whose sponsor entities and margin affiliates do not have collective exposures exceeding such thresholds on the other. This would potentially spur greater interest in seeded funds as potential counterparties. In addition, the proposed amendment to the ''margin affiliate'' definition would level the playing field between U.S. funds and non-U.S. investment funds from jurisdictions that do not require fund swaps exposures to be considered on a consolidated basis for purposes of determining whether compliance with the IM requirements is required.

The Seeded Funds Proposal would relieve CSEs entering into uncleared swaps with eligible seeded funds from the requirement to exchange IM with the funds if the funds meet specified requirements. This would reduce the operational costs associated with the exchange of IM for CSEs and their eligible seeded funds counterparties and would allow seeded funds to allocate their financial resources to testing their investment strategy and attracting unaffiliated investors. The cost reduction may also incentivize more market participants to enter into uncleared swaps. The Seeded Funds Proposal would thus promote efficiency in the uncleared swaps market by increasing the pool of swap counterparties and fostering competition.

Given that the Seeded Funds Proposal would relieve CSEs from the exchange of IM with certain eligible seeded funds for their uncleared swaps, the uncollateralized credit exposure for the uncleared swaps would increase and could undermine the integrity of the markets. The Commission, however, believes that the increased exposure would be limited given the relatively limited derivatives activity of seeded funds that would benefit from the eligible seeded fund exception. In

[110] *See* Capital, Margin and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers, Securities and Exchange Commission, 84 FR 43872, 43919 (Aug. 22, 2019). In the preamble to its final rule, the SEC noted that the final rule does not specifically exclude any type of security provided it has a ready market, is readily transferable, and does not consist of securities or money market instruments issued by the counterparty or a party related to the nonbank security-based SD or major security-based swap participant, or the counterparty. Generally, U.S. government money market funds should be able to serve as collateral under these conditions.

[111] *See supra* notes 27 and 41.

addition, the proposed relief is narrowly tailored given the requirements incorporated in the proposed definition of ''eligible seeded fund'' and the fact that it would only apply for purposes of calculating the MSE and IM threshold amount applicable to the eligible seeded funds, and not for the calculation of the IM compliance thresholds applicable to the funds' sponsor entities and margin affiliates that do not independently qualify as eligible seeded funds (nor for the funds' CSE counterparties).

(c) Price Discovery

By amending the definition of ''margin affiliate'' in Commission Regulation 23.151, the Seeded Funds Proposal would relieve CSEs from the requirement to exchange IM when entering into uncleared swaps with an eligible seeded fund. As a counterparty to a CSE, an eligible seeded fund therefore would not have to incur operational costs associated with setting up and maintaining processes and documentation to exchange IM. The relief would permit eligible seeded funds to direct more resources to building a successful performance track record and attracting new investors. As a result, the overall cost of entering into an uncleared swap transaction may decrease, incentivizing increased participation in the uncleared swaps markets. In turn, the trading of uncleared swaps may increase, leading to increased liquidity and enhanced price discovery.

(d) Sound Risk Management

Because the Seeded Funds Proposal would relieve CSEs from the obligation to exchange IM with certain seeded funds, less margin may be collected and posted to offset the risk of uncleared swaps, which could increase the risk of default. Nevertheless, the Commission believes that the uncollateralized risk would be mitigated because during the seeding period, investment funds are typically small and the extent of uncleared swap activity a seeded fund may undertake with CSEs may be limited. In addition, CSEs are required to manage the risk associated with their uncleared swaps, including those swaps that might be uncollateralized, by maintaining a robust and professional risk management program that provides, among other things, for the implementation of internal parameters for the monitoring and management of swap risk, including credit risk.

The Commission also notes that the Seeded Funds Proposal, by relieving CSEs from the requirement to exchange IM with certain seeded funds, would reduce the operational costs of both CSEs and their eligible seeded fund counterparties, potentially encouraging more market participants to enter the uncleared swaps market. As such, by increasing the pool of swap counterparties, the Seeded Funds Proposal would encourage the careful consideration and selection of counterparties, promoting sound risk management.

(e) Other Public Interest Considerations

By proposing a treatment of certain investment funds that is consistent with the BCBS/IOSCO Framework, the Seeded Funds Proposal would alleviate the potential disadvantage that U.S. seeded funds have compared to non-U.S. investment funds, which may be perceived to be subject to more favorable regulatory regimes than in the United States given the differing consolidation treatments applicable to funds.

However, given that the U.S. prudential regulators may not amend their margin requirements in line with the proposed amendments, the possibility exists that the CFTC and U.S. prudential regulators' differing rules may motivate certain investment funds to undertake swaps with particular SDs based on which U.S. regulatory agency is responsible for setting margin requirements for such SDs. In that sense, the change can lead to trades that do not reflect the relative merits of competing SDs. The divergence could also lead to additional costs for investment funds that trade with both CSEs and prudentially-regulated SDs because such funds would need to adjust their swap related documentation and collateral management systems to reflect the different margin requirements that may apply under the CFTC's and the prudential regulators' rules.

Money Market Funds Proposal

(a) Protection of Market Participants and the Public

The Commission believes that the Money Market Funds Proposal would protect market participants and the public by eliminating the asset transfer restriction and allowing a broader range of money market and similar fund securities to serve as collateral, thus addressing the potential that margin collateral may be concentrated in the securities of a few money market and similar funds and leading to greater diversification by increasing the range of assets that may be used as collateral.

The elimination of the asset transfer restriction would also promote effective asset management policies for the benefit of fund investors and market participants in general. Without the restriction, money market and similar funds that otherwise would have refrained from undertaking repurchase or similar arrangements to avoid the disqualification of their securities as eligible collateral may enter into such arrangements. The arrangements might generate higher returns for investors, including for CSEs that use money market and similar fund securities as margin collateral for uncleared swaps, and enable funds to meet their commitments to investors concerning fund performance.

Nevertheless, market participants might be harmed by the rule change if a counterparty to the money market or similar fund in a repurchase or similar arrangement defaults, and the fund is unable to recover assets tendered to the counterparty in the arrangement and is left holding assets of lesser value. The fund's overall net asset value may decline, reducing the value and liquidity of the fund's securities. This potential outcome would make the securities less suitable as collateral for margining uncleared swaps.

(b) Efficiency, Competitiveness, and Financial Integrity of Markets

By eliminating the asset transfer restriction, the Money Market Funds Proposal would allow a broader range of money market and similar fund securities to serve as collateral for margining uncleared swaps, increasing diversification in the assets that can be used as collateral, and fostering competition among the funds whose securities qualify as eligible collateral under the Proposal.

The elimination of the asset transfer restriction would also promote effective asset management policies for the benefit of fund investors and market participants in general. Without the restriction, money market or similar funds would be able to undertake repurchase and similar agreements, which may enable them to generate higher returns for investors, including for CSEs that use the funds' securities as collateral, and to meet commitments to investors concerning fund performance.

Notwithstanding these benefits, the proposed elimination of the asset transfer restriction might negatively impact market participants. If a money market and similar fund undertakes a repurchase or similar arrangement and the fund's counterparty in the arrangement defaults, the fund may be unable to recover assets it tendered in the arrangement and may be left holding assets of lesser value. The fund's overall net asset value may decrease, affecting the value and liquidity of the fund's securities. This potential outcome would make the fund's securities less suitable as collateral for margining uncleared swaps.

(c) Price Discovery

As previously discussed, with the removal of the asset transfer restriction, fund managers may have more flexibility in determining the type of investment and transactions that are in the best interest of their fund and investors, leading to higher returns for investors, including CSEs using money market and similar fund securities as margin collateral for uncleared swaps. With such increased returns, the overall costs of entering into an uncleared swap transaction may decrease, incentivizing increased participation in the uncleared swaps markets. In turn, trading in uncleared swaps may increase, leading to increased liquidity and enhanced price discovery.

(d) Sound Risk Management

The proposed amendment would eliminate the asset transfer restriction, allowing the use of securities of money market funds that undertake repurchase or similar arrangements as collateral for the margining of uncleared swaps. As such, even if the asset manager for a money market and similar fund, as a fiduciary, acts in the best interest of the fund and its investors, there is the risk that the fund may incur a loss if the fund's counterparty in a repurchase or similar arrangement defaults. Such a default would leave the fund holding assets that it may not be able to easily resell in times of financial stress, which might impact the value and liquidity of pledged fund securities and make them less suitable as margin collateral for uncleared swaps. The Commission, however, notes that any potential risk of such a repurchase or similar arrangement may be mitigated by the standard industry practice of applying haircuts to non-cash collateral in repurchase or similar arrangements to compensate for the risk that the value of collateral may decline over the term of the arrangement.[112]

In addition, the Commission notes that Commission Regulation 23.156(c) requires that CSEs monitor the market value and eligibility of all collateral and, to the extent that the market value has declined, promptly collect or post additional eligible collateral to maintain compliance with Commission Regulations 23.150 through 23.161. Thus, even if the value or liquidity of pledged money market and similar fund securities may be affected by repurchase or similar arrangements undertaken by the fund, CSEs have the obligation to monitor the value and suitability of the fund securities as margin collateral and collect or post additional eligible collateral to compensate for collateral deficiencies, although the risk that a fund's repurchase or similar arrangements may fail remains. The Commission further notes, however, that subparagraphs (A) and (B) of Commission Regulation 23.156(a)(1)(ix), which are not being amended, limit the types of assets that a money market and similar fund can receive in repurchase or similar arrangements to those assets specifically identified in those paragraphs, alleviating in part the risks associated with repurchase or similar arrangements.

While the Money Market Funds Proposal could lead to more variability in the value of the assets used as IM, it can also promote sound risk management in that it increases the range of money market and similar fund securities available as collateral for the margining of uncleared swaps, reducing the chance of concentration in a few money market and similar funds and the risks associated with such concentration. As such, the removal of the restriction may incentivize the increased use of money market and similar fund securities as collateral. Consistent with Commission Regulation 23.156(c), which requires CSEs to monitor the market value and eligibility of collateral posted or collected as margin for uncleared swaps, the Commission notes that CSEs must take into account the potential concentration of collateral in particular assets and prudently manage margin collateral.

(e) Other Public Interest Considerations

As is the case for the Seeded Funds Proposal, it is possible that the U.S. prudential regulators may not amend their margin rule in line with the Money Market Funds Proposal. As such, the prudential regulators and the Commission would diverge with respect to the treatment of money market and similar funds securities as eligible collateral for margining uncleared swaps. This divergence might lead to increased costs for market participants that trade both uncleared swaps subject to the CFTC's and the prudential regulators' margin rules, as they may need to adjust or even maintain separate documentation and collateral management systems to address the differing treatments for fund securities under the different rules.

On the other hand, the Money Market Funds Proposal may lead to reduced costs for those market participants that dually register as SDs and security-based swap SDs with the CFTC and the SEC, respectively, as the proposed amendment would bring the CFTC's eligible collateral framework more in line with the SEC approach, which does not impose asset transfer restrictions on funds whose securities are used as collateral for margining purposes and expressly permits the use of government money market fund securities as collateral.

Request for Comments on Cost-Benefit Considerations

The Commission invites public comment on its cost-benefit considerations, including the section 15(a) factors described above. Commenters are also invited to submit any data or other information they may have quantifying or qualifying the costs and benefits of the proposed amendments. In particular, the Commission seeks specific comment on the following:

1. Has the Commission accurately identified all the benefits of the proposed amendments? Are there other benefits to the Commission, market participants, and/or the public that may result from the adoption of the proposed amendments that the Commission should consider? Please provide specific examples and explanations of any such benefits.

2. Has the Commission accurately identified all the costs of the proposed amendments? Are there additional costs to the Commission, market participants and/or the public that may result from the adoption of the proposed amendments that the Commission should consider? Please provide specific examples and explanations of any such costs.

3. Do the proposed amendments impact the section 15(a) factors in any way that is not described above? Please provide specific examples and explanations of any such impact.

4. Does the existing asset transfer restriction significantly limit the use of money market and similar fund securities as eligible collateral under the CFTC Margin Rule?

D. Antitrust Laws

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of this Act, in issuing any order or adopting any Commission rule or regulation

[112] *See* Primer: Money Market Funds and the Repo Market, Prepared by the staff of the Division of Investment Management, U.S. Securities and Exchange Commission at pp. 5–6.

(including any exemption under section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule or regulation of a contract market or registered futures association established pursuant to section 17 of this Act.[113]

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requests comment on whether the proposed amendments implicate any other specific public interest to be protected by the antitrust laws.

The Commission has considered the proposed amendments to determine whether they are anticompetitive, and has preliminarily identified no anticompetitive effects. The Commission requests comment on whether the proposed amendments are anticompetitive and, if so, what the anticompetitive effects are.

Because the Commission has preliminarily determined that the proposed amendments are not anticompetitive and have no anticompetitive effects, the Commission has not identified any less competitive means of achieving the purposes of the Act. The Commission requests comment on whether there are less anticompetitive means of achieving the relevant purposes of the Act that would otherwise be served by adopting the proposed amendments.

List of Subjects in 17 CFR Part 23

Capital and margin requirements, Major Swap Participants, Swap Dealers, Swaps.

For the reasons stated in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR part 23 as set forth below:

PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

■ 1. The authority citation for Part 23 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b–1, 6c, 6p, 6r, 6s, 6t, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21. Section 23.160 also issued under 7 U.S.C. 2(i); Sec. 721(b), Pub. L. 111–203, 124 Stat. 1641 (2010).

■ 2. In § 23.151, add the definition of ''Eligible seeded fund'' in alphabetical order and revise the definition of ''Margin affiliate''.

The addition and revision read as follows:

§ 23.151 Definitions applicable to margin requirements.

* * * * *

Eligible seeded fund: An eligible seeded fund is a collective investment vehicle that has received a part or all of its start-up capital from a parent and/or affiliate (each, a sponsor entity) where:

(1) The seeded fund is a distinct legal entity from each sponsor entity;

(2) One or more of the seeded fund's margin affiliates is required to post and collect initial margin pursuant to § 23.152;

(3) The seeded fund is managed by an asset manager pursuant to an agreement that requires the seeded fund's assets to be managed in accordance with a specified written investment strategy;

(4) The seeded fund's asset manager has independence in carrying out its management responsibilities and exercising its investment discretion, and, to the extent applicable, has independent fiduciary duties to other investors in the fund, such that no sponsor entity or any of the sponsor entity's margin affiliates controls or has transparency into the management or trading of the seeded fund;

(5) The seeded fund's investment strategy follows a written plan for reducing each sponsor entity's ownership interest in the seeded fund that stipulates divestiture targets over the three-year period after the date on which the seeded fund's asset manager first begins to make investments on behalf of the fund;

(6) In respect of any of the seeded fund's obligations, the seeded fund is not collateralized, guaranteed, or otherwise supported, directly or indirectly, by any sponsor entity, any margin affiliate of any sponsor entity, other collective investment vehicle, or the seeded fund's asset manager;

(7) The seeded fund has not received any of its assets, directly or indirectly, from an eligible seeded fund that has relied on the exception provided in paragraph 2 of the definition of margin affiliate in § 23.151; and

(8) The seeded fund is not a securitization vehicle.

* * * * *

Margin affiliate has the following meaning:

(1) A company is a margin affiliate of another company if:

(i) Either company consolidates the other on a financial statement prepared in accordance with U.S. Generally Accepted Accounting Principles, the International Financial Reporting Standards, or other similar standards,

(ii) Both companies are consolidated with a third company on a financial statement prepared in accordance with such principles or standards, or

(iii) For a company that is not subject to such principles or standards, if consolidation as described in paragraph (i) or (ii) of this definition would have occurred if such principles or standards had applied.

(2) *Eligible seeded fund exception.* Notwithstanding paragraph (1) of this definition, until the date that is three years after the date on which an eligible seeded fund's asset manager first begins to make investments on behalf of the fund, an eligible seeded fund will be deemed not to have any margin affiliates solely for purposes of calculating the fund's material swaps exposure and the initial margin threshold amount.

* * * * *

■ 3. In § 23.156:

■ a. Republish the introductory text of paragraph (a)(1);

■ b. Republish the introductory text of paragraph (a)(1)(ix);

■ c. Republish paragraph (a)(1)(ix)(A);

■ d. Revise paragraph (a)(1)(ix)(B);

■ e. Remove paragraph (a)(1)(ix)(C);

■ f. Revise paragraph (a)(3)(i)(B).

The republications and revisions read as follows:

§ 23.156 Forms of Margin

(a) * * * (1) *Eligible collateral.* A covered swap entity shall collect and post as initial margin for trades with a covered counterparty only the following types of collateral:

* * * * *

(ix) Securities in the form of redeemable securities in a pooled investment fund representing the security-holder's proportional interest in the fund's net assets and that are issued and redeemed only on the basis of the market value of the fund's net assets prepared each business day after the security-holder makes its investment commitment or redemption request to the fund, if the fund's investments are limited to the following:

(A) Securities that are issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury, and immediately-available cash funds denominated in U.S. dollars; or

(B) Securities denominated in a common currency and issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to swap dealers subject to regulation by a prudential regulator, and immediately-available cash funds denominated in the same currency; or

* * * * *

(3) * * *

(i) * * *

(B) The discounts set forth in the following table:

[113] 7 U.S.C. 19(b).

STANDARDIZED HAIRCUT SCHEDULE [1]

Cash in same currency as swap obligation	0.0
Eligible government and related debt (*e.g.,* central bank, multilateral development bank, GSE securities identified in paragraph (a)(1)(v) of this section): Residual maturity less than one-year	0.5
Eligible government and related debt (*e.g.,* central bank, multilateral development bank, GSE securities identified in paragraph (a)(1)(v) of this section): Residual maturity between one and five years	2.0
Eligible government and related debt (*e.g.,* central bank, multilateral development bank, GSE securities identified in paragraph (a)(1)(v) of this section): Residual maturity greater than five years	4.0
Eligible corporate debt (including eligible GSE debt securities not identified in paragraph (a)(1)(v) of this section): Residual maturity less than one-year	1.0
Eligible corporate debt (including eligible GSE debt securities not identified in paragraph (a)(1)(v) of this section): Residual maturity between one and five years	4.0
Eligible corporate debt (including eligible GSE debt securities not identified in paragraph (a)(1)(v) of this section): Residual maturity greater than five years	8.0
Equities included in S&P 500 or related index	15.0
Equities included in S&P 1500 Composite or related index but not S&P 500 or related index	25.0
Gold	15.0
Additional (additive) haircut on asset in which the currency of the swap obligation differs from that of the collateral asset	8.0

[1] The discount to be applied to an eligible investment fund is the weighted average discount on all assets within the eligible investment fund at the end of the prior month. The weights to be applied in the weighted average should be calculated as a fraction of the fund's total market value that is invested in each asset with a given discount amount. As an example, an eligible investment fund that is comprised solely of $100 of 91 day Treasury bills and $100 of 3 year U.S. Treasury bonds would receive a discount of (100/200) * 0.5 + (100/200) * 2.0 = (0.5) * 0.5 + (0.5) * 2.0 = 1.25 percent.

* * * * *

Issued in Washington, DC, on July 31, 2023, by the Commission.

Robert Sidman,

Deputy Secretary of the Commission.

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Voting Summary and Chairman's and Commissioners' Statements

Appendix 1—Voting Summary

On this matter, Chairman Behnam and Commissioners Mersinger and Pham voted in the affirmative. Commissioner Goldsmith Romero voted in the negative. Commissioner Johnson voted to concur.

Appendix 2—Statement of Chairman Rostin Behnam

Today the Commission considered an eligible seeded funds proposal and a money market funds proposal within a notice of proposed rulemaking on margin requirements for uncleared swaps for swap dealers (SDs) and major swap participants (MSPs) for which there is no prudential regulator. The proposal would amend the CFTC's margin rule for SDs and MSPs, as promulgated in 2016, to incorporate two recommendations in the 2020 report to the CFTC's Global Markets Advisory Committee (GMAC) by the Subcommittee on Margin Requirements for Non-Cleared Swaps (the ''GMAC Subcommittee Report'').[1]

[1] *See Recommendations to Improve Scoping and Implementation of Initial Margin Requirements for Non-Cleared Swaps,* Report to the CFTC's Global Markets Advisory Committee by the Subcommittee on Margin Requirements for Non-Cleared Swaps (May 2020), *https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download.*

The seeded funds proposal would revise the definition of ''margin affiliate'' in Commission Regulation 23.151 to provide that certain investment funds that receive all of their start-up capital, or a portion thereof, from a sponsor entity would be deemed not to have any margin affiliates for the purposes of calculating certain thresholds that trigger the requirement to exchange initial margin for uncleared swaps. This proposed amendment would effectively relieve SDs and MSPs from the requirement to post and collect initial margin with a limited number of eligible seeded funds for their uncleared swaps for a period of three years from the date on which the eligible seeded fund's asset manager first begins making investments on behalf of the fund. While today's proposal builds upon the GMAC Subcommittee Report's 2020 recommendation, the proposal today also sets forth eight carefully calibrated conditions to ensure that only the investment funds that were intended to be targeted by the GMAC Subcommittee Report's recommendations are eligible to qualify for the seeded funds exception.

I support today's seeded funds proposal as it is consistent with the CFTC's margin rule risk-based approach of imposing margin requirements that are commensurate with the risk of uncleared swaps entered into by SDs and MSPs; is appropriately calibrated to acknowledge the operational challenges for start-up funds; and supports international harmonization as the approach is consistent with the BCBS–IOSCO Framework.

The money market funds proposal would eliminate the current provision in Commission Regulation 23.156(a)(1)(ix)(C) that disqualifies certain securities issued by certain money market funds (MMFs) from being used as eligible initial margin collateral. This would expand the scope of assets that qualify as eligible collateral. I support today's MMF proposal as it would remove a restriction that has unintentionally and severely restricted the use of securities of MMF and similar assets that transfer their assets through repurchase and similar arrangements. According to the GMAC Subcommittee Report, the impact of the restriction was that only securities of four U.S. MMFs would meet the requirements to be used as eligible collateral.[2]

Lastly, the proposal would also add a footnote that was inadvertently omitted for the haircut schedule in Regulation 23.156(a)(3)(i)(B), when the Commission originally promulgated the margin rule in 2016.

I look forward to receiving public comments on this proposal.

[2] *Id.* at 24.

Appendix 3—Dissenting Statement of Commissioner Christy Goldsmith Romero

I cannot support the proposed rule.

Seeded Funds

I am concerned that the proposed exception to initial margin requirements for seeded funds rolls back Dodd-Frank Act reforms designed for financial stability. I cannot support the Commission changing our existing requirements—requirements that match U.S. banking regulator requirements. The proposed change would relieve initial margin requirements for uncleared swaps that are not prudentially regulated in certain affiliate transactions known as ''seeded funds'' for three years.[1]

The buildup of uncleared swap positions during the crisis exposed swap entities to losses, putting the financial system at risk. Dodd-Frank Act reforms required *all* uncleared swaps be subject to initial and variation margin requirements, whether prudentially regulated or not.[2] Post Dodd-

[1] Seeded funds are investment vehicles that receive start-up capital from a sponsor entity. Under the Commission's current regulatory requirements, a seeded fund is treated as a margin affiliate of a sponsor entity for the purpose of triggering the exchange of initial margin for uncleared swaps.

[2] 7 U.S.C. 6s(e)(2)—Registration and regulation of swap dealers and major swap participants. Dodd Frank Act reforms provide that:

Frank, the Commission and federal banking agencies adopted margin rules to protect the safety and soundness of swap entities and to guard against risks to financial stability.

Dodd Frank Act reforms in the Commodity Exchange Act required that to offset the greater risk to the swap dealer or major swap participant and the financial system arising from the use of uncleared swaps, the Commission's margin requirements for uncleared swaps must (i) help ensure the safety and soundness of the swap dealer or major swap participant and (ii) be appropriate for the risk associated with the uncleared swaps held by the swap dealer or major swap participant.[3]

I do not find that standard to be met in the proposed rule. Post Dodd-Frank, regulators recognized that derivatives transactions with affiliated parties can pose important risks that necessitate margin requirements. The Commission and banking regulators adopted the same definition of ''margin affiliate'' to cover both swaps that are, and are not, prudentially regulated. The proposed rule would depart from that definition where there is not a prudential regulator.

The proposed rule raises concerns about the prudence of the Commission having two different definitions of ''margin affiliate'' for swap dealers, particularly when the majority of swap dealers (55 of 106) are prudentially regulated, and they account for a substantial majority of swap activity. In a regulatory system where jurisdiction is shared with other U.S. market and banking regulators, it is important that the Commission maintain regulatory harmonization with U.S. regulators where we can. Otherwise, we risk a race to the bottom.

The proposed rule discusses the importance of harmonization with global regulation but not U.S. banking regulations. And this proposed rule came from recommendations by the Global Markets Advisory Committee in 2020 (during the last Administration). The majority of the nonbank swap dealers are U.S.-domiciled (27 of 51). Also, importantly, the GMAC public interest representative from Better Markets at that time did not vote for these recommendations.

I have serious concerns with potentially increasing risks related to uncleared swaps, including risks to financial stability by adopting a definition that harmonizes with global regulation, but not domestic banking regulation. U.S. banking regulators are aware of the Basel Committee on Banking Supervision and the International Organization for Securities Commission's ''International Margin Framework,'' but have chosen not to change their definition of ''margin affiliate.''

Likewise, I do not support the Commission changing our existing definition. I appreciate that Commission staff have tried to put constraints on this initial margin exception.[4] The constraints are not enough in my view to break from U.S. banking regulators on the definition of margin affiliate. I am concerned that the effect of this proposal would be to roll back Dodd-Frank Act reforms. Given that those reforms were designed to promote the safety and soundness of U.S. financial institutions and our financial system, I am concerned that this change could produce unacceptable levels of risk, possibly even systemic risk and harm to financial stability. We do not know the full consequences of this change. While it may save costs for these start-up funds, we cannot increase any risk to financial stability of institutions or our financial system.

Therefore, I must dissent.

Money Market Funds

I have concerns about the Commission's proposal to expand money market funds that could be used for eligible non-cash collateral for swap dealers for initial margin. The proposal contemplates eliminating the restriction on the money market fund's use of repurchase agreements or similar agreements.

In Dodd-Frank Act reforms contained in the Commodity Exchange Act section 4s(e)(3)(C), Congress provided that ''[i]n prescribing margin requirements,'' the Commission ''shall permit the use of noncash collateral'' as ''determine[d] to be consistent with—preserving the financial integrity of markets trading'' non-cleared derivatives and ''preserving the stability of the United States financial system.'' I have not seen an analysis that such standard is met. I am very interested in public comment about whether that standard is met.

We must not forget the lessons of the 2008 financial crises, including when the Reserve Primary Fund ''broke the buck'', and the role it had in the 2008 crisis. Money market funds are designed to give retail customers and institutional investors a market-based instrument that is highly liquid with lower risk and limited volatility. For many Americans, money market funds often appear on their bank app, right next to checking and savings accounts, as they are financial vehicles often thought of as similar to a bank account. That's why it came as such a shock when the Reserve Primary Fund broke the buck.

I was counsel to the SEC Chairman when the Reserve Primary Fund broke the buck, which contributed to Lehman failing, and short-term lending drying up. Repurchase agreements also contributed to liquidity problems at financial institutions. In my role as the Special Inspector General for TARP, I reported to Congress about the interconnectedness of these events. These experiences show how interconnected money market funds and repurchase agreements are to the overall stability of our financial institutions and the broader financial system.

As a result, the SEC and other regulators implemented reforms to make money market funds more stable and repurchase agreements more transparent. Despite these reforms, in March 2020, during the Covid-19 pandemic, money market funds and the short-term funding markets experienced stress when institutional investors withdrew cash from money market funds to avoid liquidity fees and gates, safeguards that were part of post-crisis reforms.

With 2008 and 2020 as the backdrop, the Commission must be careful how it approaches changes to our regulations that impact money market funds and the short-term funding markets. These are highly interconnected markets. Changes in one can impact changes in the other markets. Before we take any action, it will be critical for the Commission to determine that the change is ''consistent with preserving the financial integrity of markets trading'' non-cleared derivatives and ''preserving the stability of the United States financial system.'' I look forward to public comment on whether the rule meets this standard.

I thank the staff for their work. I am also grateful to the former GMAC members. It must be remembered that advisory committees' role is to advise the Commission. While I may not agree with their recommendations, I am grateful for their service.

Appendix 4—Statement of Commissioner Caroline D. Pham

I support the notice of proposed rulemaking on margin requirements for uncleared swaps for swap dealers and major swap participants (Seeded Funds and MMFs Proposal) because it provides a solution for seeded funds, and it supports greater liquidity by providing more flexibility for money market and similar funds that use repos, among other things. I thank the team in the Market Participants Division for their dedication to ensuring the Commission's uncleared swaps rules do not unduly burden market participants, and for proposing workable solutions to challenges that arose during an implementation period. I specifically commend Amanda Olear, Tom Smith, Warren Gorlick, Rafael Martinez, and Liliya Bozhanova for their work on the proposal.

This Seeded Funds and MMFs Proposal, looking at the big picture, actually benefits

(A) Swap dealers and major swap participants that *are banks.* The prudential regulators, in consultation with the Commission and the Securities and Exchange Commission, shall jointly adopt rules for swap dealers and major swap participants, with respect to their activities as a swap dealer or major swap participant, for which there is a prudential regulator imposing—(i) capital requirements; and (ii) both initial and variation margin requirements on *all* swaps that are not cleared by a registered derivatives clearing organizations.

(B) Swap dealers and major swap participants that *are not banks.* The Commission shall adopt rules for swap dealers and major swap participants, with respect to their activities as a swap dealer or major swap participant, for which there is not a prudential regulator imposing—(i) capital requirements; and (ii) both initial and variation margin requirements on *all* swaps that are not cleared by a registered derivatives clearing organization (emphasis added). *See* Section 4s(e) of the Commodity Exchange Act.

[3] 7 U.S C. 6s(e)(3)(A); CEA section 4s(e)(3)(A).

[4] For example, the exception requires that the seeded fund ''is not a securitization vehicle.'' Should the Commission move forward with this proposed rule, I have other concerns that I invite public comment. This includes whether the proposed 3-year exception period is too long a runway. Also, whether the exemption is meant to apply to private funds? Private funds are part of a ''shadow banking system'', and unlike banks, are not fully subject to risk, liquidity, or capital restrictions. Private funds and shadow banking contributed to the 2008 financial crisis, which has grown larger since the crisis, and continues to pose risks to American investors, pensioners, and the U.S. financial system.

the end investors who will be able to more efficiently deploy capital, access liquidity, and provide investment returns at less cost to funds, such as pension plans that manage Americans' hard-earned savings. The key public interest here is providing more liquidity to markets. We have seen over the past several years many recent market stresses, which seem to occur with greater and greater frequency and high volatility, low liquidity market conditions. Where there is shallow depth of liquidity, costs for end users, customers, and investors go up, and access to markets is restricted. When there is not enough liquidity, risks to financial stability increase. The most significant and systemic financial crises in recent years, including the 2008 financial crisis, were caused by a critical lack of liquidity in markets, and our post-crisis reforms have traded less credit risk for more liquidity risk.

Simply put, less liquidity means higher costs and more risk. And risk to not only financial stability, but also systemic risk. In light of ongoing capital reforms, it is incumbent upon me to remind everyone that of course markets are interconnected, and that's why we need to take a holistic approach to market structure with a full understanding of the impact of various regulatory regimes, particularly the impact of prudential requirements on the ability of markets to function well, and especially the ability for market participants to access markets for the benefit of American savers.

As an advocate for good policy that enables growth, progress, and access to markets, I strongly support workable solutions to any problems with our rules. While regulations play a critical role in safeguarding our markets, we must acknowledge that issues—ranging from technical [1] to policy—must be continuously evaluated for regulations to remain both effective and relevant in an ever-changing landscape.

The first step in evaluating our regulations is to conduct thorough assessments and identify areas for improvement. Collaboration and open dialogue are key to formulating well-rounded solutions that consider the interests of all impacted. That is why I am grateful for the efforts of former Commissioner Dawn Stump, who, as sponsor of the Global Markets Advisory Committee (GMAC), established the GMAC's Subcommittee on Margin Requirements for Non-Cleared Swaps to evaluate the CFTC's uncleared margin rules.[2] The subcommittee's thorough assessment, engagement with stakeholders, and practical, flexible recommendations have given staff a comprehensive roadmap to follow in implementing fixes that minimize adverse impacts on market participants. I appreciate that staff is continuing [3] to try to adopt the recommendations that came out of the GMAC subcommittee.

The adoption of margin requirements for uncleared swaps was a key pillar of the 2008 financial crisis reform.[4] Today, we continue to appreciate that the requirements help ensure the exchange of margin between large, systemic, and interconnected financial institutions for their uncleared swap transactions.

Consistent with the G20 commitments, the Commodity Exchange Act (CEA or Act) [5] requires that the Commission adopt rules establishing margin requirements for all uncleared swaps that are entered into by a swap dealer or major swap participant for which there is no prudential regulator. These requirements help ensure the safety and soundness of the swap dealer or major swap participant. In 2016, the Commission adopted Regulations 23.150 through 23.161 to implement section 4s(e).[6]

Currently, a fund with material swaps exposure will fall within the scope of the initial margin requirements if it undertakes an uncleared swap with a covered swap entity. The covered swap entity and the fund will not be required to post and collect initial margin for their uncleared swaps until the initial margin threshold amount of $50 million has been exceeded. The initial margin threshold amount will be calculated based on the credit exposure from uncleared swaps between the covered swap entity and its margin affiliates on the one hand, and the fund and its margin affiliates on the other.[7] As discussed above, this requirement has unduly burdened certain funds.

Initial margin requirements may be satisfied with only certain types of collateral.[8] Under Regulation 23.156(a)(1)(ix), the securities of money market and similar funds [9] may qualify as eligible collateral if the investments of the fund are limited to securities that are issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of Treasury, and immediately-available cash denominated in U.S. dollars; [10] or to securities denominated in a common currency and issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank, or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to swap dealers subject to regulation by a prudential regulator, and immediately-available cash denominated in the same currency.[11] Also, the asset managers of the money market and similar fund may not transfer the assets of the fund through securities lending, securities borrowing, repurchase agreements, or any other means that involve the fund having rights to acquire the same or similar assets from the transferee.[12] As discussed above, this requirement has unintentionally restricted funds.

Of course, compliance with significant reforms necessarily entails significant resource expenditure by regulated entities. Because of the vast number of counterparties impacted by the uncleared margin rules, swap dealers and major swap participants have been forced to engage in significant operational and technological development to avoid disruptions which would limit their options for taking on and hedging risk.[13] As I have stated in the past, it is imperative that the Commission continuously—or at least periodically—evaluate its rules to ensure they are functioning as intended, and propose workable solutions to any challenges discovered to ensure that firms are able to effectively comply with our rules.[14]

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[1] Statement of Commissioner Caroline D. Pham on Staff Letter Regarding ADM Investor Services, Inc., U.S. Commodity Futures Trading Commission (June 16, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement061623.*

[2] CFTC Commissioner Stump Announces New GMAC Subcommittee on Margin Requirements for Non-Cleared Swaps, U.S. Commodity Futures Trading Commission (Oct. 28, 2019), *https://www.cftc.gov/PressRoom/PressReleases/8064-19.*

[3] In 2020, the Commission adopted rules that addressed different GMAC recommendations on the uncleared margin rules. *See* Statement of Commissioner Dawn D. Stump in Support of Final Uncleared Margin Rules Based on Recommendations of Global Markets Advisory Committee, U.S. Commodity Futures Trading Commission (Dec. 8, 2020), *https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement120820.* Commissioner Mersinger has advocated for adopting additional recommendations. *See* Dissenting Statement of Commissioner Summer K. Mersinger Regarding CFTC's Regulatory Agenda, U.S. Commodity Futures Trading Commission (Jan. 9, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/mersingerstatement010923.* Commissioner Pham now sponsors the GMAC. *See* Commissioner Pham Announces CFTC Global Markets Advisory Committee Meeting on July 17, U.S. Commodity Futures Trading Commission (July 17, 2023), *https://www.cftc.gov/PressRoom/Events/opaeventgmac071723.*

[4] G20 Pittsburgh Summit (Sept. 24–25, 2009).

[5] 7 U.S.C. 6s(e) (capital and margin requirements).

[6] *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016) (effective April 1, 2016 and codified in part 23 of the Commission's regulations). 17 CFR 23.150—23.159, and 23.161. In May 2016, the Commission added Regulation 23.160 (17 CFR 23.160), providing rules on its cross-border application. *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements, 81 FR 34818 (May 31, 2016).

[7] Commission Regulation 23.151 defines the term ''IM threshold amount'' to mean an aggregate credit exposure of $50 million resulting from all uncleared swaps between an SD and its margin affiliates (or an MSP and its margin affiliates) on the one hand, and the SD's (or MSP's) counterparty and its margin affiliates on the other. See 17 CFR 23.151.

[8] Commission Regulation 23.156(a)(1) sets forth the types of collateral that CSEs can post or collect as IM with covered counterparties, including cash funds, certain securities issued by the U.S. government or other sovereign entities, certain publicly traded debt or equity securities, securities issued by money market and similar funds, and gold. 17 CFR 23.156(a)(1).

[9] Although the scope of the eligible pooled investment funds described in Commission Regulation 23.156(a)(1)(ix) does not fully coincide with the regulatory definition of money market funds in Rule 2a–7 under the Investment Company Act (17 CFR 270.2a–7), for simplicity purposes, these funds will be referred to as ''money market and similar funds.''

[10] 17 CFR 23.156(a)(1)(ix)(A).

[11] 17 CFR 23.156(a)(1)(ix)(B).

[12] 17 CFR 23.156(a)(1)(ix)(C).

[13] Joint ISDA–SIFMA Report, Initial Margin for Non-Centrally Cleared Derivatives: Issues for 2019 and 2020, 3–4 (July 2018), *https://www.isda.org/a/D6fEE/ISDA-SIFMA-Initial-Margin-Phase-in-White-Paper-July-2018.pdf.*

[14] *See, e.g.,* Statement of Commissioner Caroline D. Pham Regarding Reporting and Information Requirements for Derivatives Clearing Organizations, U.S. Commodity Futures Trading

I encourage commenters to comment on whether the Commission's proposal sufficiently addresses the practical and operational issues, and whether it gives sufficient time for firms to implement and comply with a final rule.

[FR Doc. 2023–16572 Filed 8–7–23; 8:45 am]

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Commission (Nov. 10, 2022), *https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement111022b*.

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[EPA–R09–OAR–2023–0352; FRL–10399–01–R9]

RIN 2009–AA05

Federal Implementation Plan for Contingency Measures for the Fine Particulate Matter Standards; San Joaquin Valley, California

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed rule.

SUMMARY: The Environmental Protection Agency (EPA) is proposing to promulgate a Federal Implementation Plan (FIP) under the Clean Air Act (CAA) that consists of contingency measures for the 1997, 2006, and 2012 fine particulate matter ($PM_{2.5}$) national ambient air quality standards (NAAQS or "standards") for the San Joaquin Valley $PM_{2.5}$ nonattainment area. The contingency measures would apply to residential wood burning heaters and fireplaces and rural open areas. The proposed FIP, if finalized, would be implemented by the EPA, unless and until replaced through the EPA's approval of a contingency measure state implementation plan (SIP) submission.

DATES:

Comments: Comments must be received on or before September 22, 2023. Under the Paperwork Reduction Act (PRA), comments on the information collection provisions are best assured of consideration if the Office of Management and Budget (OMB) receives a copy of your comments on or before September 7, 2023.

Public Hearing: The EPA will hold a virtual public hearing on August 23, 2023. Please refer to the **SUPPLEMENTARY INFORMATION** section for additional information on the public hearing.

ADDRESSES: You may send comments, identified by Docket ID No. EPA–R09–OAR–2023–0352; via the Federal eRulemaking Portal: *https://www.regulations.gov* (our preferred method). Follow the online instructions for submitting comments.

Instructions: All submissions received must include the Docket ID No. for this rulemaking. Comments received may be posted without change to *https://www.regulations.gov,* including any personal information provided. For detailed instructions on sending comments and additional information on the rulemaking process, see the "Public Participation" heading of the **SUPPLEMENTARY INFORMATION** section of this document. Hand deliveries and couriers may be received by scheduled appointment only. For further information on EPA Docket Center services and the current status, please visit us online at *https://www.epa.gov/dockets.*

FOR FURTHER INFORMATION CONTACT: For questions regarding this proposed rule, please contact Rory Mays, Planning and Analysis Branch (AIR–2), Air and Radiation Division, EPA Region IX, (415) 972–3227. For questions regarding the virtual public hearing, please contact Kobi Cook, Communities and Partnerships Branch (AIR–4), Air and Radiation Division, EPA Region IX, (415) 972–3989. Both can be reached by emailing *SJVPublicMeetings@epa.gov.*

SUPPLEMENTARY INFORMATION: Throughout this document, "we," "us," and "our" refer to the EPA.

Public Participation

A. Written Comments

Submit your comments, identified by Docket ID No. EPA–R09–OAR–2023–0352 at *https://www.regulations.gov* (our preferred method), or the other methods identified in the **ADDRESSES** section. Once submitted, comments cannot be edited or removed from the docket. The EPA may publish any comment received to its public docket. Do not submit to the EPA's docket at *https://www.regulations.gov* any information you consider to be Confidential Business Information (CBI) or other information whose disclosure is restricted by statute. Multimedia submissions (audio, video, etc.) must be accompanied by a written comment. The written comment is considered the official comment and should include discussion of all points you wish to make. The EPA will generally not consider comments or comment contents located outside of the primary submission (*i.e.,* on the web, cloud, or other file sharing system). For additional submission methods, the full EPA public comment policy, information about CBI or multimedia submissions, and general guidance on making effective comments, please visit *https://www.epa.gov/dockets/commenting-epa-dockets.*

B. Participation in Virtual Public Hearing

The EPA will begin pre-registering speakers for the hearing no later than 1 business day after publication of this document in the **Federal Register**. To register to speak at the virtual hearing, please visit *https://www.epa.gov/sanjoaquinvalley* for online registration. The last day to pre-register to speak at the hearing will be August 21, 2023. The EPA will post a general agenda for the hearing that will list pre-registered speakers in approximate order at: *https://www.epa.gov/sanjoaquinvalley.*

The virtual public hearing will be held via teleconference on August 23, 2023. The virtual public hearing will convene at 4 p.m. Pacific Time (PT) and will conclude at 7 p.m. PT. The EPA may close the session 15 minutes after the last pre-registered speaker has testified if there are no additional speakers. For information or questions about the public hearing, please contact Kobi Cook, per the **FOR FURTHER INFORMATION CONTACT** section of this document. The EPA will announce further details at *https://www.epa.gov/sanjoaquinvalley.*

The EPA will make every effort to follow the schedule as closely as possible on the day of the hearing; however, please plan for the hearings to run either ahead of schedule or behind schedule. Each commenter will have 5 minutes to provide oral testimony. The EPA encourages commenters to provide the EPA with a copy of their oral testimony electronically (via email) by emailing it to *SJVPublicMeetings@epa.gov.* The EPA also recommends submitting the text of your oral comments as written comments to the rulemaking docket.

The EPA may ask clarifying questions during the oral presentations, but will not respond to the presentations at that time. Written statements and supporting information submitted during the comment period will be considered with the same weight as oral comments and supporting information presented at the public hearing.

Please note that any updates made to any aspect of the hearing will be posted online at *https://www.epa.gov/sanjoaquinvalley.* While the EPA expects the hearing to go forward as set forth above, please monitor our website or contact Kobi Cook, per the **FOR FURTHER INFORMATION CONTACT** section of this document, to determine if there are any updates. The EPA does not intend