

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 23

RIN Number 3038-AF36

Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap

Participants

AGENCY: Commodity Futures Trading Commission

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission (“Commission”) is amending the margin requirements for uncleared swaps applicable to swap dealers and major swap participants that are not subject to the margin rules of a prudential regulator. The amendment revises the definition of “margin affiliate” in the Commission’s regulations to provide that certain collective investment vehicles (“investment funds” or “funds”) that receive start-up capital from a sponsor entity (“seeded funds”) would be deemed not to have any margin affiliates or to constitute margin affiliates of another entity for the purposes of calculating certain thresholds that trigger the requirement to exchange initial margin for uncleared swaps (“Seeded Funds Amendment”). The Seeded Funds Amendment relieves swap dealers and major swap participants subject to the Commission’s uncleared swaps margin rules from the requirement to post and collect initial margin with certain eligible seeded funds for a period of up to three years from the date on which the eligible seeded fund’s asset manager begins making investments on behalf of the fund (“trading inception date”). The Commission is also eliminating a provision disqualifying securities issued by certain pooled investment funds (“money market and similar funds”) whose asset managers transfer fund assets through securities lending, securities borrowing, repurchase

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agreements, reverse repurchase agreements, and similar arrangements from being used as eligible initial margin collateral for uncleared swaps, thereby expanding the scope of assets that qualify as eligible collateral (“Eligible Collateral Amendment”). Additionally, the Commission is amending the haircut schedule for eligible margin collateral for uncleared swaps to address the haircuts applicable to money market and similar funds (“Haircut Schedule Amendment”).

DATES: The Final Rule is effective [INSERT 30 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

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I. Introduction

A. Statutory and Regulatory Background

Section 4s(e) of the Commodity Exchange Act (“CEA” or “Act”)¹ requires the Commission to adopt rules establishing minimum initial and variation margin requirements for all swaps² that are: (i) entered into by a swap dealer (“SD”)³ or major swap participant (“MSP”)⁴

¹ 7 U.S.C. 6s(e) (capital and margin requirements).

² 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.

³ CEA section 1a(49), 7 U.S.C. 1a(49) (swap dealer definition); Commission Regulation 1.3 (further definition of swap dealer).

⁴ CEA section 1a(32), 7 U.S.C. 1a(32) (major swap participant definition); Commission Regulation 1.3 (further definition of major swap participant).

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for which there is no prudential regulator⁵ (collectively, “covered swap entities” or “CSEs”);⁶ and (ii) not cleared by a registered derivatives clearing organization (“uncleared swaps”).⁷ To offset the greater risk to the SD or MSP and the financial system arising from the use of uncleared swaps, these margin requirements must: (i) help ensure the safety and soundness of the SD or MSP; and (ii) be appropriate for the risk associated with the uncleared swaps held by the SD or MSP.⁸ In 2016, the Commission promulgated Commission Regulations 23.150 through 23.161 (“CFTC Margin Rule”) to implement section 4s(e).⁹

The CFTC Margin Rule imposes initial margin (“IM”) requirements on uncleared swaps entered into by CSEs and certain specified counterparties.¹⁰ More specifically, Commission Regulation 23.152 requires CSEs to collect and post IM with each counterparty that is an SD,

⁵ 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.

⁶ 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).

⁷ 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.

⁸ CEA section 4s(e)(3)(A), 7 U.S.C. 6s(e)(3)(A).

⁹ *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).

¹⁰ 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 the swap is being closed out). Final Margin Rule, 81 FR 636 at 683.

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MSP, or financial end user (“FEU”) with material swaps exposure (“MSE”).¹¹ Commission Regulation 23.151 defines the term FEU by listing entities, persons, and arrangements whose business is financial in nature, including certain funds.¹²

Commission Regulation 23.161 establishes a phase-in schedule for compliance with the CFTC Margin Rule.¹³ Under the schedule, which commenced on September 1, 2016 and concluded on September 1, 2022, entities were 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, non-cleared security-based swaps, foreign exchange forwards, and foreign exchange swaps (“AANA”), and then successively those with lesser AANA.¹⁴ The AANA is calculated at a group level (*i.e.*, taking into consideration the AANA of the CSE combined with its margin affiliates,¹⁵ and the AANA of the counterparty

¹¹ 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.

¹² 17 CFR 23.151. Commission Regulation 23.151 contains 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 (“SEC”) under the Investment Company Act of 1940; (ii) private funds as defined in section 202(a) of the Investment Advisers Act of 1940; (iii) entities that would be investment companies under section 3 of the Investment Company Act of 1940 but for section 3(c)(5)(C); (iv) entities that are deemed not to be investment companies under section 3 of the Investment Company Act of 1940 pursuant to SEC Investment Company Act Rule 3a-7; (v) commodity pools; and (vi) 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.

¹³ 17 CFR 23.161.

¹⁴ *Id.*

¹⁵ Commission Regulation 23.151 provides that a company is a “margin affiliate” of another company if: (i) either company consolidates the other on financial statements 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 financial statements prepared in accordance with such principles or standards; or (iii) for a company that is not subject to such principles or standards, if consolidation would have occurred if the consolidation principles or standards in prong (i) or (ii) had applied. 17 CFR 23.151.

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combined with its margin affiliates). During the last phase of compliance, which started on September 1, 2022, CSEs and covered counterparties¹⁶ that had not come into 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 the phase-in approach, an investment fund with MSE comes within the scope of the IM requirements if it undertakes an uncleared swap with a CSE. The CSE and the fund, however, are not required to post and collect IM for their uncleared swaps until the IM threshold amount of \$50 million has been exceeded.¹⁷ The IM threshold amount is 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.

The CFTC Margin Rule provides that the IM requirements may be satisfied with only specified types of margin collateral. Commission Regulation 23.156(a)(1) lists the permitted collateral that CSEs may post or collect as IM with covered counterparties, including cash, 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.¹⁸

Under Commission Regulation 23.156(a)(1)(ix), the securities of money market and similar funds¹⁹ qualify as eligible collateral if the investments of such funds are limited to

¹⁶ The term “covered counterparty” is defined in Commission Regulation 23.151 as an FEU with MSE or a swap entity, including an SD or MSP, that enters into swaps with a CSE. 17 CFR 23.151.

¹⁷ 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) covered counterparty and its margin affiliates on the other. 17 CFR 23.151.

¹⁸ 17 CFR 23.156(a)(1).

¹⁹ 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). 17 CFR 23.156(b)(1)(ii). VM (or variation margin), as

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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 funds denominated in U.S. dollars;²⁰ 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 SDs subject to regulation by a prudential regulator, and immediately-available cash denominated in the same currency.²¹ 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”).²²

B. 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 the implementation of margin requirements for uncleared swaps, to identify challenges associated with forthcoming implementation phases, and to prepare a report with recommendations (“GMAC Subcommittee”).²³ The subcommittee issued a report with its recommendations in

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.

²⁰ 17 CFR 23.156(a)(1)(ix)(A).

²¹ 17 CFR 23.156(a)(1)(ix)(B).

²² 17 CFR 23.156(a)(1)(ix)(C).

²³ 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 uncleared 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>.

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.²⁴

Among other matters, 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. As a result of 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” or “seed period”). Such fund, referred to as a seeded fund, is considered a margin affiliate of the sponsor entity during the seeding period.²⁵ As such, the seeded fund is required to calculate AANA on an aggregate basis with the sponsor entity and the sponsor entity’s margin affiliates. Although the seeded 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, therefore, may come within the scope of the IM requirements. As such, a CSE that undertakes uncleared swaps with the seeded fund is 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-

²⁴ *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.

²⁵ The concept of a seeded fund refers to an investment fund capitalized by a sponsor as a separate entity to test specified investment strategies and establish a performance track record before attracting unaffiliated investors.

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IOSCO”) Framework for margin requirements for non-centrally cleared derivatives (“BCBS-IOSCO Framework”)²⁶ without further requiring seeded funds to be consolidated with the sponsor and to be treated as a margin affiliate of the sponsor.²⁷

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.”²⁸ The Report also stated that MMFs use repurchase or 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.²⁹ MMF asset managers, as fiduciaries, determine the types of investments and transactions that are in the best interest of the MMF and its investors.³⁰ 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 U.S. MMFs would qualify as eligible collateral.³¹

²⁶ 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.”

²⁷ Margin Subcommittee Report at pp. 7 and 29.

²⁸ *Id.* at p. 6.

²⁹ *Id.* at p. 27.

³⁰ *Id.*

³¹ *Id.* at p. 24.

II. Summary of the Proposal

On August 8, 2023, the Commission proposed to amend Commission Regulations 23.151 and 23.156 to provide a limited exemption to SDs and MSPs from the requirement to exchange IM with certain start-up investment funds and to eliminate a provision that disqualifies money market and similar funds engaging in repurchase or similar transactions from being eligible as IM collateral for uncleared swaps (“Proposal”).³² The Proposal also specifies the haircut to be applied to shares of money market and similar funds held as initial margin collateral for uncleared swaps by adding a footnote to the haircut schedule in Commission Regulation 23.156(a)(3).

The comment period for the Proposal closed on October 10, 2023. The Commission received 14 comment letters from various interested parties, including investor advocacy groups, trade associations, an asset management firm, and individual members of the public.³³ As more fully discussed below, the majority of commenters expressed support for the Proposal, generally noting that the proposed amendments represented appropriate revisions to Commission regulations. Commenters that opposed the Proposal generally expressed a concern that the proposed amendments would weaken margin requirements and undermine systemic stability in the derivatives markets. In consideration of the public feedback, the GMAC Subcommittee

³² *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 88 FR 53409 (Aug. 8, 2023).

³³ The following entities and individuals submitted comment letters: American Council of Life Insurers (“ACLI”); Better Markets, Inc. (“Better Markets”); Mr. Bill Harrington, Croatan Institute (“Harrington”); Mr. Chris Barnard (“Barnard”); Senator Elizabeth Warren (“Senator Warren”); Federated Hermes, Inc. (“Federated Hermes”); Investment Company Institute (“ICI”); Managed Funds Association (“MFA”); Mr. Paul Patrick Uy (“Uy”); the International Swap and Derivatives Association (“ISDA”), Securities Industry and Financial Markets Association (“SIFMA”), and the Asset Management Group of the Securities Industry and Financial Markets Association (“SIFMA AMG”) (collectively, “Associations” or “Associations Joint Letter”). The comment letters are available at <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7419>.

Four additional comment letters were either blank or did not include substantive comments on the Commission’s Proposal: comments from Andrew Robinson, Choochat Jumpathong, Curtis Higgins, and Natasha Delgado.

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recommendations, and the Commission’s experience administering the CFTC Margin Rule, the Commission is adopting the proposed amendments, subject to the changes discussed below.

A. Seeded Funds Amendment

1. *Proposal*

The Commission proposed to revise the definition of “margin affiliate” in Commission Regulation 23.151 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 up to three years from the eligible seeded fund’s trading inception date (“eligible seeded fund exception”). The Commission also proposed to define in Commission Regulation 23.151 the term “eligible seeded fund” to establish conditions that investment funds must meet to qualify for the eligible seeded fund exception.

Under the CFTC Margin Rule, a company is a “margin affiliate” of another company if, based on U.S. GAAP, IFRS, or other similar accounting standards, the financial results of both companies are required to be prepared and reported on financial statements on a consolidated basis, or the financial results of both companies are required to be prepared and reported on financial statements on a consolidated basis with a third party.³⁴ The proposed amendments to the definition of “margin affiliate” 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 up to three years after the fund’s trading inception date, notwithstanding the required consolidated financial reporting of the fund with another entity under applicable accounting standards.

³⁴ 17 CFR 23.151 (definition of “margin affiliate”).

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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 and financial reporting consolidation principles, in consideration of a concern that the proposed definition may have been over-inclusive.³⁵ The Commission noted that the accounting and financial reporting 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.³⁶ The Commission recognized, however, that financial reporting 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 ownership interest.³⁷ 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.³⁸ 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 the consolidation of the financial reporting 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.³⁹

As noted in the Proposal, after the adoption of the CFTC Margin Rule, SIFMA AMG (on behalf of its members that are asset managers) requested relief from the margin affiliate

³⁵ Final Margin Rule, 81 FR 636 at 646-647.

³⁶ *Id.* at 647.

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

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treatment, consistent with the subsequent arguments made in the Margin Subcommittee Report described above.⁴⁰ While acknowledging that a sponsor of a seeded investment fund has influence beyond that of a passive, unaffiliated investor, SIFMA AMG urged that a seeded fund not be consolidated with its 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.⁴¹ 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 capriciously at the desire of the fund sponsor.⁴² Further, the Margin Subcommittee Report noted that neither the sponsor, nor its consolidated entities, controls or has transparency into the management or trading of the seeded fund.⁴³ Moreover, the Report stated that, typically, the sponsor or affiliate of a seeded fund does not guarantee the obligations of the seeded fund nor participate in, or control the management of, the fund.⁴⁴ 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.⁴⁵

To address market participants' concerns, and based on its experience administering the CFTC Margin Rule, the Commission proposed the eligible seeded fund exception. The proposed

⁴⁰ Proposal at 53414 (referencing 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 p. 3 and Margin Subcommittee Report at p. 16).

⁴¹ SIFMA AMG 2016 Letter at p. 3.

⁴² *Id.*

⁴³ Proposal at 53415 and Margin Subcommittee Report at p. 16.

⁴⁴ Margin Subcommittee Report at pp. 6 and 16.

⁴⁵ *Id.* at p. 16.

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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 a period of up to 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 be relieved from the IM requirement after expiration of such period.⁴⁶ At the end of the three-year period, an eligible seeded 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 seeded fund for swaps entered into following the expiration of the three-year period if the fund and its margin affiliates, on a consolidated group basis, have MSE and the IM threshold amount for the fund and its margin affiliates has been exceeded.

As discussed in the Proposal, the proposed eligible seeded fund exception was 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.⁴⁷ To limit the relief to only such funds, the proposed treatment was applicable only to seeded 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. The Commission further noted that notwithstanding the proposed eligible

⁴⁶ The Commission noted, 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.

⁴⁷ Proposal at 53413.

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seeded fund exception, CSEs would still be required to include 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, argued that absent relief, seeded funds experience a performance drag given that a portion of their investment assets are committed to, and segregated as, IM and 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 seeded funds to attract new investors may be compromised as a result.⁴⁸

In its Report, the GMAC Margin Subcommittee discussed the costs that seeded funds incur from being consolidated with their sponsor entities and 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 23.157.⁴⁹ The seeded funds are also required to engage in negotiation of complex margin documentation and develop compliance infrastructures to handle the exchange of IM.⁵⁰ The Report further observed that, given their typically small size and limited swaps, 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.⁵¹

⁴⁸ Margin Subcommittee Report at p. 32.

⁴⁹ 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.

⁵⁰ Margin Subcommittee Report at p. 32.

⁵¹ *Id.*

The Margin Subcommittee Report also stated that although seeded funds may be consolidated with other entities for financial statement reporting purposes, 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 group-wide \$50 million IM threshold amount above which IM for uncleared swaps must be exchanged. 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 wall issues, such as confidentiality requirements, an insurance company that sponsors a seeded fund would not share information about the fund's trading activity with an affiliate engaging in swap transactions for purposes of hedging general insurance risk.⁵²

Finally, the Report stated that seeded funds that do not otherwise hold assets qualifying as eligible IM collateral under Commission Regulation 23.156⁵³ 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.⁵⁴

In proposing the eligible seeded fund exception, the Commission noted that the exception is consistent with the approach in other jurisdictions such as Australia, Canada, and the EU, which have adopted provisions that permit investment funds to be treated as distinct, separate

⁵² Margin Subcommittee Report at p. 33.

⁵³ *Id.*

⁵⁴ *Id.* at p. 31.

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entities for purposes of calculating the relevant IM thresholds, subject to conditions similar to those proposed by the Commission.⁵⁵ As discussed in the Proposal, the proposed approach is also consistent with the BCBS-IOSCO Framework, which provides that an investment fund should be treated as a separate legal entity when applying the IM threshold amount provided that it is a distinct legal entity that is not collateralized or otherwise guaranteed or supported by other investment funds or the investment advisor in the event of the fund's insolvency or bankruptcy.⁵⁶ In addition, both the BCBS-IOSCO Framework and the frameworks of the jurisdictions whose rules the Commission considered in connection with the Proposal provide that investment funds are to be considered distinct legal entities for purposes of the calculation of IM thresholds on a permanent basis, and not for a temporary start-up period.

The Commission recognized, however, that the proposed amendments are a departure from the approach adopted by the prudential regulators, 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

⁵⁵ Margin Subcommittee Report at p. 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/ft-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.

⁵⁶ BCBS-IOSCO Framework, Footnote 10, *supra* note 25. See also Proposal at 53412-53413.

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provide significant support to, or may be materially subject to the risks of losses of, another entity.⁵⁷

The Commission also proposed to amend Commission Regulation 23.151 by adding a definition for the term “eligible seeded fund.” “Eligible seeded fund” was proposed to be defined as a collective investment vehicle that 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 proposed “eligible seeded fund” definition, in respect of any of the seeded fund’s obligations, a seeded 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 seeded fund’s asset manager. These proposed conditions were designed to ensure that the sponsor entity does not retain a level of influence or exposure that is materially above that of other minority or passive investors and that the seeded fund follows a genuine plan to emerge from the seeding phase by attracting unaffiliated investors.

⁵⁷ See Prudential Regulators Margin Rule at 74859-60.

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

Furthermore, the Proposal was 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. To target funds that are “seeded” by parent or affiliated entities that have MSE and thus cause the seeded funds to come within the scope of the IM requirements, the proposed definition of “eligible seeded fund” required 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” provided that the seeded fund must not be a securitization vehicle. This condition was designed to further limit the proposed treatment of seeded funds only to funds subject to the Margin Subcommittee Report’s recommendation.

2. Comments

The Commission received eight substantive comments addressing the proposed eligible seeded fund exception.⁵⁸ Four comment letters supported the Proposal,⁵⁹ and four letters opposed it.⁶⁰

⁵⁸ ACLI, Associations Joint Letter, Better Markets, Harrington, ICI, MFA, Senator Warren, Uy.

⁵⁹ ACLI at p. 1; Associations Joint Letter at pp. 1-11; ICI at pp. 2-5; and MFA at p. 1.

⁶⁰ Senator Warren at pp. 1-2; Better Markets at p. 2; Uy; and Harrington.

Comments supportive of the Proposal noted that, among other benefits, the proposed amendments would place U.S. seeded funds on a better competitive footing relative to non-U.S. seeded funds.⁶¹ More generally, commenters supported the Commission's efforts to more closely align the CFTC Margin Rule with the BCBS-IOSCO Framework and the margin framework of other global jurisdictions.⁶² ICI and ACLI further stated, consistent with arguments advanced by the GMAC Subcommittee, that seeded funds pose limited risk to swap counterparties given the models notional value of their swaps and of their capitalization level.⁶³ MFA similarly noted that the proposed changes were consistent with the CFTC Margin Rule's approach of imposing margin requirements commensurate with risk of uncleared swaps.⁶⁴ To address the Commission's concerns regarding potential systemic risk resulting from uncollateralized swap exposures, commenters noted that under the Proposal, CSEs and their eligible seeded fund counterparties would remain subject to the requirement to exchange VM.⁶⁵

In support of the Proposal, ICI described the utility of seeded funds as a tool to implement and test new investment strategies prior to making them accessible to the public.⁶⁶ ICI argued that requiring a seeded fund to exchange IM with its counterparty (typically a CSE) is not only unnecessary to accomplish the regulatory objectives underlying the uncleared swaps margin requirements, but also undermines the ability to use seeded funds as a means for innovation in, and development of, new regulated fund products.⁶⁷ ICI and ACLI also discussed

⁶¹ ICI at p. 3, MFA at p.1.

⁶² MFA at p. 1.

⁶³ ICI at p. 4; ACLI at pp. 3, 6, Margin Subcommittee Report at p. 31.

⁶⁴ MFA at p. 2.

⁶⁵ ACLI at pp. 7-8, 10.

⁶⁶ ICI at p. 3.

⁶⁷ *Id.*

the regulatory framework and safeguards supporting an argument that seeded funds should be treated separately from the corporate group for purposes of calculating the IM compliance thresholds.⁶⁸ In this regard, commenters noted that seeded funds must operate in accordance with the regulatory regime administered by the SEC under the Investment Company Act of 1940 (“1940 Act”) and other federal securities laws. Among other requirements, commenters noted that funds registered as management companies are subject to oversight by an independent board of directors, conflict of interest protections through prohibitions on affiliated transactions, and strict restrictions on leverage.⁶⁹ Further, ICI pointed out that the manager of the seeded fund is a fiduciary that must act in the best interest of the fund at all times and is legally obligated to manage the fund’s assets in accordance with a specified investment strategy, policies and limitations.⁷⁰ ACLI asserted that unregistered funds relying on an exemption from registration under Section 3(c)(1) or 3(c)(7) of the 1940 Act present similar features.⁷¹ Commenters also emphasized that outside of the seed capital, seeded funds are not guaranteed or supported by other funds, the fund manager, or other sponsors.⁷²

In addition to expressing general support, commenters recommended several changes to the Proposal. ISDA, SIFMA, SIFMA AMG, and ACLI sought revisions to the condition in the proposed definition of “eligible seeded fund” that none of the sponsor entity’s margin affiliates controls or has transparency into the management or trading of the fund.⁷³ Commenters argued that the condition is overly broad and would make it impossible for many genuinely independent

⁶⁸ ACLI at pp. 4-5; ICI at pp. 3-4.

⁶⁹ ICI at pp. 3-4 (referencing Sections 10(a), 17(a), and 18 of the 1940 Act).

⁷⁰ ICI at p. 4.

⁷¹ ACLI at p. 5.

⁷² ICI at p. 4; ACLI at p. 5.

⁷³ Associations Joint Letter at pp. 2, 5-6; ACLI at pp. 5-6.

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seeded funds whose asset manager is part of the sponsor's corporate group to rely on the seeded funds exception. ISDA, SIFMA, and SIFMA AMG noted that many seeded funds are operated by functionally independent asset managers that have the same ultimate parent as the sponsor of such seeded funds, and accordingly, are subject to accounting consolidation with the sponsor of the seeded funds.⁷⁴ ACLI similarly explained that insurance companies typically seed funds managed by their affiliated asset managers.⁷⁵ ACLI asserted that "the trading decisions of those affiliated asset managers are generally independent of the sponsoring entity and subject to the asset manager's investment discretion, a written investment strategy, and an independent fiduciary duty to the fund."⁷⁶

Commenters also criticized the proposed condition that "[o]ne or more of the seeded fund's margin affiliates is required to post and collect initial margin pursuant to § 23.152."⁷⁷ Commenters argued that this requirement would effectively prevent seeded funds without an SD or MSP affiliate from relying on the seeded funds exception because the CFTC Margin Rule only directly obligates CSEs to post IM to, and to collect IM from, counterparties.⁷⁸ Another commenter raised a similar issue and asked the Commission to clarify that the proposed condition does not require a seeded fund to have a margin affiliate that is a CSE.⁷⁹

ICI, ISDA, SIFMA, and SIFMA AMG also expressed concerns that the proposed condition, even if revised to clarify that the condition does not require the seeded fund to have a

⁷⁴ Associations Joint Letter at p. 6.

⁷⁵ ACLI at p. 6.

⁷⁶ *Id.*

⁷⁷ Proposal at 53427.

⁷⁸ Associations Joint Letter at p. 6.

⁷⁹ ACLI at p. 4.

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margin affiliate that is a CSE, would in practice lead to disparate treatment.⁸⁰ In this regard, ISDA, SIFMA, and SIFMA AMG noted that a revised condition would still create inequity between (i) seeded funds whose affiliates are in-scope of the Commission's margin rules and (ii) seeded funds whose affiliates are not in-scope of the Commission's margin rule and are complying with prudential regulators' margin rules. In their comment letter, ISDA, SIFMA, and SIFMA AMG noted that it is possible for a fund group to have swaps whose notional values are required to be counted towards the MSE calculation with counterparties who are not subject to the CFTC Margin Rule, including SDs subject to, and complying with, the prudential regulators' margin rules.⁸¹ This creates an inequity as, pursuant to the terms of the proposed condition, at least one of seeded fund's margin affiliates must be subject to the margin rules of the Commission. Commenters also asserted that the condition is not necessary to meet the regulatory objective of the Proposal because the other proposed conditions would ensure that targeted seeded funds are the only eligible funds to take advantage of this exception.⁸²

Commenters also recommended that the Commission revise the Proposal to eliminate the requirement that the eligible seeded fund's sponsor entity and other margin affiliates 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.⁸³

Commenters noted that as a result of the requirement, the seeded fund would have to share

⁸⁰ ICI at pp. 4-5; Associations Joint Letter at p. 7.

⁸¹ Associations Joint Letter at p. 7.

⁸² Associations Joint Letter at p. 7.

⁸³ Under the Proposal, the eligible seeded fund exception would apply only for purposes of calculating MSE and the IM threshold amount of the eligible seeded fund. Proposal at 53413. Commenters recommended that the proposed exception be revised such that eligible seeded funds are not only deemed to not have margin affiliates but are also deemed not to constitute margin affiliates of any other entity, during the seeding period. ACLI at p. 3, Associations Letter at pp. 7-11, ICI at p. 5.

information about its uncleared swaps, uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps with such entities to allow them to determine: (i) whether they have MSE and (ii) if they have MSE, the amount of IM that they would hypothetically post, for purposes of determining whether the IM threshold amount of its margin affiliates has been exceeded.⁸⁴ The commenters argued that the challenges associated with the threshold monitoring and the requisite information sharing between the seeded funds and their affiliated entities would continue to prevent many seeded funds from accessing the uncleared swaps market or incentivize fund groups to set up seeded funds offshore.⁸⁵ ISDA, SIFMA, and SIFMA AMG asserted that if the requirement was adopted as proposed, the margin affiliates that must take into account the fund's exposure would become economically responsible for the seeded fund.⁸⁶ In support of their argument, the commenters discussed a situation where entities in a sponsor group have uncleared swaps with a CSE and no uncleared swaps with the CSE's margin affiliates, and the sponsor's group would not have breached the IM threshold amount but for the exposure of the eligible seeded funds.⁸⁷ In such case, the commenters argued, the CSE could become obligated to collect IM from the sponsor and its margin affiliates that are not eligible seeded funds even though the CSE does not have sufficient credit exposure from the sponsor and those margin affiliates to generate an IM amount that is greater than the IM threshold.⁸⁸ Further, the eligible seeded funds' IM exposure amount would need to be included in the IM threshold amount of the sponsor and the sponsor's IM documentation would need to be amended to cover

⁸⁴ Associations Joint Letter at p. 7.

⁸⁵ *Id.* at p. 8.

⁸⁶ *Id.* at p. 9.

⁸⁷ *Id.*

⁸⁸ *Id.*

the eligible seeded funds. ACLI similarly argued that “[r]equiring members of the seeded fund’s corporate group to deduct the funds’ IM from their shared IM threshold would require significant operational support, sharing of information across affiliates in ways that are difficult to achieve, and frequent amendments to trading documents to account for funds’ trading behavior, which is outside the control of the other corporate entities in the group.”⁸⁹ In response to the Commission’s concerns that not including the seeded fund’s exposure in the sponsor’s MSE calculation and IM threshold amount may incentivize the sponsor to create seeded funds merely to reduce its own exposure and circumvent the applicability of the IM requirements, ACLI argued that there are contractual, structural, fiduciary, financial, and regulatory safeguards that would prevent the limited seeded fund exception from creating opportunities for the fund’s sponsor to avoid or evade its requirements in any material respect.⁹⁰ ACLI recognized that many of these safeguards are reflected in the proposed definition of “eligible seeded fund.”⁹¹ ICI also stated its belief that it would not be feasible for the proposed exception to be used to circumvent the applicability of the IM requirements, “given the established and specific purposes for seeded funds” and “the significant regulatory framework that applies to them.”⁹² In support of their argument in favor of deeming eligible seeded funds not to constitute margin affiliates of any other entity, commenters noted that such approach would be consistent not only with the Margin Subcommittee’s recommendation – which itself is based on the BCBS-IOSCO Framework – but

⁸⁹ ACLI at p. 3.

⁹⁰ *Id.* at p. 9.

⁹¹ *Id.* at p. 5. ACLI highlighted that seeded funds are: (i) separate legal entities, created for a bona fide business and economic purpose; (ii) typically overseen by an independent board (or equivalent); (iii) managed by an investment advisor having fiduciary duties to the entity in accordance with specified, written, investment program; and (iv) not collateralized by or otherwise supported by the fund sponsor or any other entity beyond the initial seed capital contribution.

⁹² ICI at p. 5.

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also harmonize the CFTC Margin Rule with the margin rules adopted by regulators in other jurisdictions.⁹³ ISDA, SIFMA, and SIFMA AMG referred to the margin rules in the EU and the United Kingdom (“UK”), which provide that investment funds “shall be considered distinct entities and treated separately when applying” the thresholds based on IM amount, and the calculation of AANA when “the funds are distinct segregated pools of assets for the purposes of the fund’s insolvency or bankruptcy” and “the segregated pools of assets are not collateralized, guaranteed, or otherwise financially supported by other investment funds or their managers.”⁹⁴ Commenters also asserted that the approach would be consistent with the Volcker Rule, which generally prohibits banking entities from investing in “covered funds” but allows such entities to make seed investments and retain de minimis investments in covered funds, provided that any seed investment is reduced to a de minimis (3 percent) per fund amount after a seeding period that can reach up to three years.⁹⁵ In this regard, ISDA, SIFMA, and SIFMA AMG noted that they were not aware of any concerns raised by the Commission or the banking or market regulators that market participants are creating seeded funds to evade the Volcker Rule or foreign uncleared swaps margin rules.⁹⁶

Finally, ACLI argued that eligible seeded funds should not be subject to an inflexible requirement of a written plan for reducing the sponsor’s ownership interest, as proposed in condition (5) of the “eligible seeded fund” definition.⁹⁷ ACLI asserted that there are already

⁹³ Associations Joint Letter at p. 9; ICI at p. 3; MFA at pp. 1-2; and ACLI at p. 3.

⁹⁴ Associations Joint Letter at p. 10 (referencing Articles 28(3), 29(3), and 29(2) of Commission Delegated Regulation No. 2016/2251 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 (the “EMIR RTS”)).

⁹⁵ Associations Joint Letter at p. 10; ICI at p. 5 fn. 18 (both referring to section 619 of the Dodd-Frank Act, commonly known as the “Volcker Rule”).

⁹⁶ Associations Joint Letter at p. 11.

⁹⁷ ACLI at p. 4.

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sufficient incentives for the sponsor of a seeded fund to divest its ownership interest over the near term that make this additional requirement burdensome and unnecessary.⁹⁸ In this connection, ACLI noted that the well understood purpose of a seeded fund is for it to ultimately become a non-seeded fund that is funded predominantly if not exclusively by external investors.⁹⁹ ACLI also discussed the administrative and financial burdens that seeded funds represent for the sponsor, including accounting consolidation compliance and capital charges on the equity ownership interest.¹⁰⁰ Finally, ACLI argued that adherence to a written plan could undermine the needed flexibility to manage divestment in a way that would not impact the fund's net asset value ("NAV") or trigger NAV-based early termination events.¹⁰¹

Commenters that opposed the Proposal, including Better Markets and Senator Warren, expressed concern over any relaxation of the IM requirements.¹⁰² Better Markets argued that the Proposal conflicts with the statutory mandate in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that the Commission impose IM requirements on "all" non-cleared derivatives.¹⁰³ Better Markets asserted that the interpretation of the term "all" precludes a reading of the statute that would allow exclusions from the mandatory IM requirement for "some" non-cleared derivatives.¹⁰⁴ Better Markets and Senator Warren also highlighted the potential lack of consistency within U.S. regulatory regimes, pointing to the

⁹⁸ ACLI at p. 11.

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² Better Markets at pp. 2, 6-7; Senator Warren; Uy; Harrington at pp. 24-27

¹⁰³ Better Markets at pp. 6-7.

¹⁰⁴ *Id.* at p. 7.

Proposal's failure to align with the prudential regulators' definition of margin affiliate.¹⁰⁵ Better Markets argued that the misalignment carries the potential to sow confusion and operational difficulties for market participants.¹⁰⁶ Finally, another commenter expressed concern that the Proposal would incentivize parties to engage in high-risk transactions with insufficient collateralization.¹⁰⁷ Another commenter, Harrington, generally opposed the Proposal, arguing that it would create systemic exposures and is harmful to the public.¹⁰⁸

3. *Discussion*

The Commission has considered the comments and is adopting the Proposal, subject to certain revisions discussed below.

a. Commission Regulation 23.151 – Amendments to the Definition of “Margin Affiliate”

The Commission is adopting the proposed amendments to the definition of “margin affiliate” in Commission Regulation 23.151 to include an “eligible seeded fund exception.” The definition of “margin affiliate” will thus provide that for a period of up to three years from the fund's trading inception date, an eligible seeded fund will be deemed not to have any margin affiliates or to constitute a margin affiliate of another entity. The Commission notes, however, that notwithstanding the eligible seeded fund exception, a CSE will still be required to count the notional value of uncleared swaps, non-cleared security-based swaps, foreign exchange forwards, and foreign exchange swaps that the CSE undertakes with a counterparty that is an eligible seeded fund for purposes of calculating the CSE's own AANA.

¹⁰⁵ Better Markets at pp. 7-8; Senator Warren at p. 2.

¹⁰⁶ Better Markets at p. 8.

¹⁰⁷ Uy.

¹⁰⁸ Harrington at pp. 24-27.

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After considering the public comments, the Commission continues to believe that the Seeded Funds Amendment will 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 consolidation that exist in other jurisdictions.¹⁰⁹ While adopting an approach that is consistent with the treatment of investment funds in other jurisdictions, the Commission is including additional safeguards, including a maximum three-year limit on the availability of the "eligible seeded fund exception," to more narrowly tailor the relief to start-up investment funds, consistent with the Margin Subcommittee Report's recommendations.

Further, the Commission believes that adopting the Seeded Funds Amendment would support the CFTC Margin Rule's objective of imposing margin requirements that are commensurate with the risk of uncleared swaps entered into by CSEs.¹¹⁰ In this connection, the Commission continues to believe, as discussed in the Proposal and as asserted by the GMAC Subcommittee 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 an individual fund's capitalization does not exceed \$50-100 million and the aggregate notional exposure of the swaps entered into by the fund is limited.¹¹¹ The Commission's preliminary risk assessment is supported by commenters who asserted that seeded funds do not pose systemic risk during the seeding period, as they tend to be small.¹¹² As stated in the Proposal, given the

¹⁰⁹ Proposal at 53412.

¹¹⁰ 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).

¹¹¹ Proposal at 53413.

¹¹² ACLI at p. 6; ICI at p.4.

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seeded funds' modest size and limited individual swaps activity, the Commission 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.¹¹³

As noted in section III.A.2, some commenters expressed concerns with the Proposal's compliance with the Dodd-Frank Act amendments to the CEA.¹¹⁴ Better Markets criticized the Commission for exceeding its discretionary authority under the Dodd-Frank Act by providing an exception to the application of IM requirements.¹¹⁵ Additionally, a commenter raised concerns about the risk of transactions occurring with insufficient collateralization.¹¹⁶

The Commission recognizes the risk-management and systemic stability benefits of the margin requirements mandated by the CEA but believes that a limited, risk-based exception to the IM requirements is not inconsistent with the CEA mandate. Existing exemptions from the margin requirements confirm Congress's intent to establish a risk-based framework for the margin requirements.¹¹⁷ The Commission has also used its discretionary authority in the past to

¹¹³ Proposal at 53413 (citing the Margin Subcommittee Report's discussion of the results of an informal sampling conducted in 2018 among the members of SIFMA AMG and ACLI, which found that of the 33 funds identified by the respondents as exceeding the thresholds for IM compliance due to their derivatives notional exposures being consolidated with entities with MSE, none would be within the scope of the IM requirements absent consolidation with their sponsor entity, given that the average gross notional exposure for each seeded fund was \$32 million).

¹¹⁴ Better Markets at pp. 2, 6-7; Senator Warren at p. 1.

¹¹⁵ Better Markets at p. 6.

¹¹⁶ Uy.

¹¹⁷ On January 12, 2015, the Terrorism Risk Insurance Program Reauthorization Act of 2015 ("TRIPRA") amended the Dodd-Frank Act to exempt certain transactions of certain commercial end users and others from the Commission's capital and margin requirements. Pub. L. 114-1, 129 Stat. 3. Specifically, section 302 of Title III of TRIPRA amended sections 731 and 764 of the Dodd-Frank Act to provide that the Commission's rules on margin requirements under those sections shall not apply to a swap in which a counterparty: (1) qualifies for an exception under section 2(h)(7)(A) of the CEA (commercial end user exception); (2) qualifies for an exemption issued under section 4(c)(1) of the CEA for cooperative entities as defined in such exemption; or (3) satisfies the criteria in section 2(h)(7)(D) of the CEA (treasury affiliate exemption).

establish risk-based parameters for determining the applicability of the margin requirements, including by setting forth IM compliance thresholds.¹¹⁸

The Commission notes that the eligible seeded funds exception incorporates structural and regulatory safeguards, further discussed below, designed to provide only a limited, narrowly tailored relief. The Commission also continues to believe that existing safeguards already present (and not being amended) in the CEA and Commission regulations mitigate the increase in uncollateralized credit risk resulting from swap transactions between CSEs and seeded funds that are relieved from the IM requirements. In this regard, the Commission emphasizes that uncleared swap transactions between CSEs and eligible seeded funds remain subject to the VM requirements, which requires a CSE to settle with its counterparties the cumulative mark-to-market change in the value of swaps on a daily basis.¹¹⁹ The daily exchange of VM prevents losses from accruing on open swap positions of the CSE and swap counterparties beyond the minimum transfer amount applicable to the transaction, thereby mitigating the magnitude of the potential loss in the event of a default.¹²⁰ 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 and Commission Regulation 23.600 requires that CSEs, in establishing the risk

¹¹⁸ See e.g., Commission Regulation 23.151, which provides a threshold of \$8 billion before a SD is within scope of the CFTC Margin Rule and further provides CSEs and covered counterparties that are in-scope for the margin requirements with a \$50 million threshold before IM must be exchanged.

¹¹⁹ 17 CFR 23.153.

¹²⁰ See definition of “variation margin” in Commission Regulation 23.151 (providing that variation margin means collateral provided by a party to its counterparty to meet the performance of its obligation under one or more uncleared swaps between the parties as a result of a change in value of such obligation since the trade was executed or the last time such collateral was provided). 17 CFR 23.151. “Minimum transfer amount” is defined in Commission Regulation 23.151 as a combined initial and variation margin amount under which no actual transfer amount is required. The minimum transfer amount is \$500,000. 17 CFR 23.151. A CSE and a counterparty that is a swap entity or an FEU may agree to have separate minimum transfer amount for IM and VM (to be reflected in the margin documentation). 17 CFR 23.158(a).

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management program to monitor and manage risks associated with their swaps activities, must account for credit risk and must set risk tolerance limits.¹²¹

The Commission is also adopting, as proposed, a maximum three-year limit to the availability of the eligible seeded fund exception to each individual seeded fund.¹²² The exception is applicable only for a period of up to three years from an eligible seeded fund's trading inception date. At the expiration of the three-year period, a fund that meets the accounting standards for consolidation due to a sponsor entity holding an equity stake in the fund, will be deemed to have margin affiliates. As a result, a CSE would be required to exchange IM with the fund for any swaps entered into following the expiration of the three-year period if, on a consolidated basis with its margin affiliates, the fund has MSE and the IM threshold amount has been exceeded. In addition, if the fund's AANA at any point during the three-year period from the fund's trading inception date, calculated on an individual entity basis, exceeds the MSE threshold and the fund, individually with its CSE counterparty and the CSE's margin affiliates, crosses the IM threshold amount, the CSE would be required to post IM to, and collect IM from, the fund for swaps entered into following the fund's exceeding of the MSE and IM thresholds.

The three-year limit is designed to cover the period during which the fund is establishing a performance track record and attracting unaffiliated investors. Market participants have noted that after three years, investment funds have typically established a sufficient performance record to attract third-party investors and are no longer subject to consolidation with their sponsor entity

¹²¹ 7 U.S.C. 6s(j); 17 CFR 23.600.

¹²² Proposal at 53413.

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for AANA calculation purposes.¹²³ The Seeded Funds Amendment would thus advance responsible financial innovation by promoting the creation of new funds by allowing eligible seeded funds to test the viability of investment strategies without having to commit their relatively limited capital to meet IM requirements.¹²⁴ Following the expiration of the three-year period, a seeded fund that has margin affiliates that already have AANA with a counterparty CSE and its margin affiliates that exceeds the MSE amount is required to exchange IM with the CSE for any of the fund's swap entered into commencing immediately after the end of the three-year period, subject to the fund's and the fund's margin affiliates collective IM threshold amount.¹²⁵

In addition, a fund and its margin affiliates that collectively do not have AANA with a CSE and its margin affiliates that exceeds the MSE at the end of the fund's three-year seeding period must add the notional amount of each swap entered into with the CSE that is open at the end of the three-year seed period to its group's MSE calculation in accordance with Commission Regulation 23.151 (definition of "material swaps exposure").¹²⁶

Furthermore, a seeded fund and its margin affiliates are subject to "change in status" requirements set forth in Commission Regulation 23.161(c).¹²⁷ Thus, for example, pursuant to

¹²³ Margin Subcommittee Report at 30. 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," which also recognize the concept of "seeding period" with a maximum duration of three years. 17 CFR 255.12.

¹²⁴ ICI at p. 4.

¹²⁵ Swaps between the CSE and the fund that were entered into prior to the termination of the three-year seed period are not subject to IM requirements after the three-year period.

¹²⁶ 17 CFR 23.151. In accordance with Commission Regulation 23.151, MSE is determined as of September 1 of any year based on the AANA for March, April, and May of that year. Therefore, if a seeded fund's three-year exemption period terminates prior to September 1, the fund and its margin affiliates MSE calculation performed on September 1 must include the notional value of the fund's and its margin affiliates' swaps that are open as of the previous March, April, and May month-end dates.

¹²⁷ 17 CFR 23.161(c).

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the MSE definition in Commission Regulation 23.151 and the “change in status” provision of Commission Regulation 23.161, if a seeded fund’s margin affiliates are collectively below the MSE threshold of \$8 billion AANA as of the last day of March, April, and May of 2025, a CSE that engaged in swaps with the fund’s margin affiliates was not required to exchange IM with the margin affiliates commencing on September 1, 2025. If, however, the seeded fund’s three-year exemption period expired on or after June 30, 2025, the MSE of the seeded fund and its margin affiliates would be based on the collective AANA computed based on the notional value of the uncleared swaps, non-cleared security-based swaps, foreign exchange forwards, and foreign exchange swaps of the former seeded fund that were entered at any point in time and remain open on the calculation dates of March, April, and May 2026. If, as a result of the collective calculation, the former seeded fund and its margin affiliates change their status with respect to the margin requirements (*e.g.*, the group collectively has MSE of more than \$8 billion in AANA on September 1, 2026 and the former seeded fund’s and its margin affiliates status therefore changes from FEUs without MSE to FEUs with MSE), the fund’s CSE counterparty will be required to comply with the stricter margin requirements for any uncleared swaps entered into with the fund and its margin affiliates commencing on September 1, 2026 as provided in Commission Regulation 23.161(c).¹²⁸

The Commission has also determined not to require the eligible seeded fund’s sponsor entity or other affiliates to include the notional value of the seeded fund’s uncleared swaps, non-cleared security-based swaps, foreign exchange forwards, and foreign exchange swaps or the exposure of the seeded fund’s uncleared swaps in the calculation of the sponsor entity’s or

¹²⁸ 17 CFR 23.161(c). To further clarify, a CSE is not required to post or collect IM for swaps entered into with the fund and its margin affiliates prior to the calculation date of September 1.

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affiliates' MSE and IM threshold amounts, respectively, during the three-year seed period. To that effect, the Commission is not adopting the proposed provision specifying that the eligible seeded fund exception would apply "only for purposes of calculating the fund's material swaps exposure and the initial margin threshold amount." For the avoidance of doubt, the Commission is also specifying that during the three-year seeding period, an eligible seeded fund would not be deemed "to constitute a margin affiliate of another entity." In reaching these decisions, the Commission considered commenters' concerns about the challenges that sponsor entities and other affiliates would encounter if they were required to include the notional value of the relevant financial products to determine whether they have MSE and to deduct the eligible seeded fund's IM from the shared IM threshold amount.¹²⁹ As described by commenters, these challenges include operational costs, difficulties around information sharing across affiliates, and burdens associated with frequent amendments of IM documentation to account for the funds' trading behavior.¹³⁰ Commenters asserted that the challenges are particularly salient in the context of calculating the IM threshold, because to determine whether the eligible seeded fund's sponsor entity and affiliates have breached the IM threshold, the IM amount that the seeded fund would have to collect or post must be determined on a real-time basis using a model-based or standardized approach.¹³¹ Commenters further argued that even if margin affiliates were to rely on their CSE counterparties for those calculations, it is likely that CSEs would determine the cost-and-benefit analysis would not make it economical to enter into swaps with the relevant margin affiliates.¹³² Commenters concluded that if the Commission retains the requirement that

¹²⁹ ACLI at pp. 3, 6-7; Associations Joint Letter at pp. 7-8.

¹³⁰ ACLI at pp. 3, 6-7; Associations Joint Letter at pp. 7-8.

¹³¹ Associations Joint Letter at p. 8.

¹³² *Id.*

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an eligible seed fund be treated as a margin affiliate of its sponsor group for the calculation of MSE and the IM threshold, the Proposal’s objective to “prevent[] potential reductions in liquidity or trading disruptions” would not be achieved.¹³³

The Commission also considered the structural, fiduciary, and regulatory safeguards that preclude sponsors from using seeded funds to avoid or evade the IM requirements. As stated in the Proposal, the requirement for the sponsor and other affiliates to include an eligible seeded fund’s exposure in the calculation of their MSE and IM threshold amount was proposed to prevent the eligible seeded fund exception from serving 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.¹³⁴ After considering public comments, however, the Commission is satisfied that other safeguards exist to prevent such result. Some of the safeguards, including the requirement that seeded funds be separate legal entities created for a bona fide business and economic purpose, are built into the definition of “eligible seeded fund” discussed below. Other features contributing to the funds’ independence result from the regulatory framework applicable to investment funds under the 1940 Act. Seeded funds that are registered management companies under the 1940 Act are overseen by an independent board of directors and managed by a registered investment adviser that has fiduciary duties to the fund.¹³⁵ In addition, investment funds relying on an exemption from SEC registration as investment companies under Section 3(c)(1) or 3(c)(7) of the 1940 Act are private funds subject to mandatory criteria intended to limit participants to sophisticated and institutional investors. For example, Section

¹³³ Associations Joint Letter at p. 9.

¹³⁴ Proposal at 53413.

¹³⁵ Section 10(a) of the 1940 Act, 15 U.S.C. 80b-1 et seq.; SEC, Commission Interpretation Regarding the Standard of Conduct for Investment Advisers, 84 FR 33669 (July 12, 2019).

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3(c)(1) funds are generally limited to no more than 100 beneficial owners that meet “accredited investor” standards.¹³⁶ Section 3(c)(7) funds are generally limited to investors that are “qualified purchasers.”¹³⁷ Furthermore, both Section 3(c)(1) and Section 3(c)(7) funds are subject to strict solicitation and marketing restrictions or requirements with respect to the public offering of their securities.¹³⁸ The Commission believes that with such governance, offering, and investor participation limitations, the risk that sponsoring entities would establish multiple investment funds solely to avoid initial margin requirements on swaps for a limited period of three years, or earlier if a fund exceeds the AANA and initial margin threshold amount, is impractical as it would involve a sponsor and funds expending excessive resources on redundant legal, operational, and administrative costs.

One commenter indicated that most seeded funds operate as pooled investment vehicles and rely on one of two de minimis usage exemptions from registration as a commodity pool operator under Commission Regulation 4.5 (with respect to registered investment funds) or Commission Regulation 4.13(a)(3) (with respect to unregistered investment funds).¹³⁹ If a seeded fund relying on this exemption exceeds one of the de minimis thresholds, the fund operator would be required to register with the Commission.¹⁴⁰ Registration would trigger

¹³⁶ 15 U.S.C. 80a-3(a)(1). An “accredited investor” includes a natural person with a net worth of more than \$1 million (not including a primary residence) and annual income of over \$200,000 (or \$300,000 jointly with a spouse or spouse equivalent), and includes non-natural persons with more than \$5 million in total assets. 17 CFR 230.501(a).

¹³⁷ 15 U.S.C. 80a-3(a)(1) and (7). A “qualified purchaser” is an investor that meets certain financial and sophistication standards including, for example, an individual that owns \$5 million or more in investments or an entity that owns and invests on a discretionary basis at least \$25 million in investments.

¹³⁸ 17 CFR 230.506.

¹³⁹ 17 CFR 4.5 and 4.13(a)(3); ACLI at p. 5

¹⁴⁰ 17 CFR 4.5(c)(2)(iii) and 4.13(a)(3)(ii) (exempted registrants under either section have the option to select an aggregate initial margin test or a net notional test).

additional oversight from the Commission and allow for “greater capabilities to ensure that the seeded fund is not being used to evade the requirements of the [CFTC Margin Rule].”¹⁴¹

Finally, regarding the comment that a misalignment with the prudential regulators’ definition of margin affiliate may cause confusion and operational difficulties for market participants,¹⁴² the Commission notes that market participant representatives supported the Commission’s adoption of the Proposal even in the absence of a parallel action by the prudential regulators.¹⁴³ According to commenters, the burden on market participants to make documentation and operational changes to accommodate different requirements under two U.S. regimes would not be significant because current documentation and systems can continue to be used in connection with prudentially regulated SDs.¹⁴⁴

b. Commission Regulation 23.151 – Definition of “Eligible Seeded Fund”

The Commission proposed to define the term “eligible seeded fund” in Commission Regulation 23.151 as a collective investment vehicle that received all or part of its start-up capital from a parent and/or affiliate (each, a sponsor entity) and that meets certain specified conditions. The Commission’s proposed conditions to the “eligible seeded fund” definition were as follows: (1) the seeded fund must be a distinct legal entity from each sponsor entity; (2) one or more of the seeded fund’s margin affiliates must post and collect IM with a counterparty pursuant to Commission Regulation 23.152; (3) the seeded fund must be managed 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 assets manager must have independence in

¹⁴¹ ACLI at p. 5.

¹⁴² Better Markets at p. 8.

¹⁴³ ACLI at p. 11; Associations Joint Letter at pp. 4, 16-17.

¹⁴⁴ Associations Joint Letter at p. 16.

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carrying out its management responsibilities and in exercising its investment discretion, and, to the extent applicable, must have 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 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 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 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 vehicle, or the seeded fund's asset manager; (7) the seeded fund must not have received any of its assets, directly or indirectly, from an eligible seeded fund that has [previously relied on the eligible seeded fund exception]; and, (8) the seeded fund must not be a securitization vehicle. After considering the comments received, the Commission is adopting the term "eligible seeded fund" as proposed, subject to the revisions discussed below. The Commission did not receive comments regarding proposed conditions (1) and (3) and is adopting the conditions as proposed. As such, an "eligible seeded fund" must be a distinct legal entity from each sponsor entity and must be 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.

The Commission is also adopting condition (4) of the proposed definition subject to limited revisions. Proposed condition (4) required "[t]he seeded fund's asset manager [to have] independence in carrying out its management responsibilities and in exercising its investment discretion, and, to the extent applicable, [have] independent fiduciary duty to other investors in

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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." The Commission is revising the final condition to require "[t]he seeded fund's asset manager [to have] independence in carrying out its management responsibilities and in exercising its investment discretion, and, to the extent applicable, [have] independent fiduciary duty to the fund and other investors in the fund, such that no sponsor entity or any of the sponsor entity's margin affiliates, except for the fund's asset manager in the exercise of its management responsibilities, controls or has transparency into the management or trading of the seeded fund." The Commission is revising condition (4) by adding the provision "except for the fund's asset manager in the exercise of its management responsibilities" to address commenters' concerns that the condition would otherwise make it impossible for many genuinely independent seeded funds operated by an independent asset manager that has the same ultimate parent as the sponsor to rely on the exception.¹⁴⁵ The "eligible seeded fund" definition would thus allow seeded funds to have sponsor-affiliated asset managers while ensuring the fund's independence. The Commission is also adding the words "to fund," after "independent fiduciary duty," in recognition that the asset manager's fiduciary duty applies with respect to the fund and only indirectly with respect to other investors in the fund.

The Commission is not adopting condition (2) of the proposed "eligible seeded fund" definition, which provided that "one or more of the seeded fund's margin affiliates [must be] required to post and collect [IM] pursuant to § 23.152." Consistent with the Margin Subcommittee Report, the Commission proposed condition (2) to target seeded funds that become subject to the requirement to exchange IM due to the seeded funds' affiliation with

¹⁴⁵ Associations Joint Letter at pp. 5-6; ACLI at p. 4.

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entities that are already required to post and collect IM with CSEs. The Commission, however, did not intend for the eligible seeded fund exception to be applicable only to funds that have a CSE in the corporate group. Rather, the Commission's intent was to designate as "eligible" seeded funds only those seeded funds that are "seeded" by parent entities that have MSE and thus cause the seeded fund to come within the scope of the IM requirements. The Commission recognizes commenters' concerns, however, that the proposed condition may lead to disparate treatment between seeded funds depending on the composition of their corporate group as discussed in Section II.A.2 above.¹⁴⁶ The Commission also believes, as further discussed below, that the other conditions in the adopted definition of "eligible seeded fund" would be sufficient to ensure that only the bona fide seeded funds discussed in the Margin Subcommittee Report would benefit from the exception.

The Commission is not adopting proposed condition (5), which would require that the seeded fund's investment strategy 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 from inception.¹⁴⁷ The Commission concurs with commenters that there are sufficient regulatory and market incentives for the sponsor entity to reduce its ownership stake in a seeded fund, including the three-year limit on the eligible seeded fund exception, the risk-based capital charges on the equity interest in seeded funds to which a sponsor may be subject, and the goal of the asset manager to implement a successful investment strategy that attracts third party

¹⁴⁶ Associations Joint Letter at 7.

¹⁴⁷ *Id.*

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investments.¹⁴⁸ The Commission is also convinced by the argument that divestment must be flexible and managed so as to not materially impact the fund's NAV.¹⁴⁹

The Commission is adopting remaining conditions (6), (7), and (8) of the proposed eligible seeded fund definition as proposed.¹⁵⁰ Proposed condition (6) provided that an eligible seeded 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 vehicle, or the seeded fund's asset manager, in respect of any of the seeded fund's obligations. Proposed condition (7) provided that the seeded fund must not have received any of its assets, directly or indirectly, from an eligible seeded fund that has relied on the eligible seeded fund exception. Finally, proposed condition (8) provided that the seeded fund must not be a securitization vehicle.¹⁵¹

The condition imposing financial independence of the fund (condition (4) of the final definition), along with the requirements related to the fund's legal, structural, and practical independence (conditions (1), (2), and (3) of the final definition), correspond to features that commenters consistently highlighted as justifying a separate treatment of seeded funds. As discussed in the Proposal, these conditions seek 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 is warranted.¹⁵² Conditions (1), (2), and (3) also seek to ensure that

¹⁴⁸ ACLI at pp. 10-11.

¹⁴⁹ ACLI at p. 11.

¹⁵⁰ Proposal at 53427.

¹⁵¹ *Id.*

¹⁵² Proposal at 53415.

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funds that qualify as eligible seeded funds 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.

In particular, the 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 has independent fiduciary duties to the fund and, to the extent applicable, 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 condition that the fund's assets are managed by an independent investment manager in accordance with a specified, written investment strategy aims to reserve the benefit of the eligible seeded fund exception to seeded funds that have a genuine economic purpose and intentions to emerge from the seeding phase as a viable collective investment vehicle.¹⁵³

In addition, the financial independence condition seeks to account for the potential risk that the seeded fund's uncollateralized exposure may lead the sponsor entity or the asset manager to incur risks, increasing the potential for contagion and systemic risk. In proposing the

¹⁵³ Proposal at 53413. In this connection, the Commission also noted in the Proposal that 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). The 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 adopting identical conditions, the Commission is incorporating several requirements to achieve the same purpose as appropriate in the context of the CFTC Margin Rule, including the requirement that an eligible seeded fund be managed pursuant to a specified written investment strategy.

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condition, the Commission recognized 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 eligible seeded fund exception.¹⁵⁴ As discussed in the Proposal, the Commission was also concerned that 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.¹⁵⁵ The Commission believes that condition (4) of the final eligible seeded fund definition, which seeks to ensure the fund's genuine independence, serves as an effective safeguard against financial contagion. In addition, the Commission believes that financial distress at a seeded fund that, by its nature, is in its initial stages of investment, would not cause significant reputational harm to the sponsor or asset manager, as many seeded funds that fail to develop successful trading strategies never reach the public markets.

Further, condition (5) that the seeded fund has not received, directly or indirectly, any of its assets from an eligible seeded fund seeks to ensure that the three-year period of the eligible seeded fund exception is not reinstated as a result of rollovers of fund assets or similar activities.¹⁵⁶

Finally, condition (6), which excludes securitization vehicles from the eligible seeded fund exception, is designed to further limit the proposed treatment of seeded funds only to funds subject to the Margin Subcommittee Report's recommendation.¹⁵⁷ The Commission maintains,

¹⁵⁴ Proposal at 53415.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.* at 53422.

¹⁵⁷ *Id.* at 53414.

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as was noted in the adopting release for the CFTC Margin Rule, that there are sufficient reasons to keep securitization vehicles within the scope of the IM requirements.¹⁵⁸

These conditions collectively seek to achieve the goals of the Proposal, namely, to address challenges confronted by seeded funds, while providing appropriate safeguards to ensure that the eligible seeded fund exception remains narrowly tailored.¹⁵⁹

B. Eligible Collateral Amendment – Elimination of the Asset Transfer Restriction

1. Proposal

The Commission proposed to amend Commission Regulation 23.156(a)(1)(ix) to eliminate the requirement that only shares of funds that prohibit the transfer of fund assets through repurchase or similar arrangements that involve the funds having the right to acquire the same or similar assets from the transferees (the asset transfer restriction) qualify as eligible margin collateral. In adopting the CFTC Margin Rule, the Commission added redeemable shares 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.¹⁶⁰ The Commission explained that the addition of money market and similar fund share to the list of eligible

¹⁵⁸ As noted in the Proposal, despite receiving multiple comments from industry representatives to exclude securitization vehicles from the definition of FEU, and recommendations subsequent to the adoption of the CFTC Margin 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. Proposal at 53414, Final Margin Rule, 81 FR 636 at 683. The Commission continues to believe that it is not prudent to extend the eligible seeded fund exception to securitization vehicles.

¹⁵⁹ The Commission will also rely on tools that already exist under the CEA and the Commission regulations to address evasion concerns. Specifically, 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. Further, 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.

¹⁶⁰ Final Margin Rule, 81 FR 636 at 666.

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collateral would provide flexibility while maintaining a level of safety, noting that to qualify, such fund shares would need to meet the conditions in Commission Regulation 23.156(a)(1)(ix).

Commission Regulation 23.156(a)(1)(ix) limits eligible money market and similar funds to funds investing in: (i) 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 denominated in U.S. dollars; or (ii) securities denominated in a common currency and issued, or fully guaranteed, 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 SDs subject to regulation by a prudential regulator, and immediately-available cash funds denominated in the same currency.¹⁶¹ Eligible money market and similar funds are also subject to the asset transfer restriction in paragraph (C) of Commission Regulation 23.156(a)(1)(ix), which has the effect of disqualifying shares of money market and similar funds where the funds have the authority to transfer fund assets through repurchase or similar arrangements.¹⁶² As discussed above, market participants, and the GMAC Margin Subcommittee, have requested the Commission to eliminate the asset transfer restriction in paragraph (C), noting that it disqualifies the securities of most money market and similar funds and, therefore, significantly restricts the ability of CSEs and covered counterparties to use such forms of collateral.¹⁶³

MMFs are regulated, short-term investment vehicles that are subject to government regulations and oversight in the jurisdiction where the MMF is organized. In the United States,

¹⁶¹ The terms “money market and similar funds” and “MMFs” used in referencing eligible initial margin collateral under Commission Regulation 23.156(a)(1)(ix) includes both money market funds investing in U.S. government securities consistent with Regulation 23.156(a)(1)(ix)(A) and funds investing in securities issued by the European Central Bank or certain foreign sovereigns consistent with Regulation 23.156(a)(1)(ix)(B), unless the context specifies otherwise.

¹⁶² *Id.*

¹⁶³ Margin Subcommittee Report at 23.

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MMFs are subject to SEC regulations, such as SEC Rule 2a-7.¹⁶⁴ SEC Rule 2a-7 imposes several liquidity requirements, including (i) a general liquidity requirement;¹⁶⁵ (ii) restrictions on acquiring illiquid securities;¹⁶⁶ (iii) a minimum daily liquid asset requirement;¹⁶⁷ and (iv) a weekly liquid assets requirement.¹⁶⁸ These liquidity requirements are designed to ensure that a fund is able to accommodate investor redemptions, especially during times of market turmoil. SEC Rule 2a-7 also imposes diversification requirements, which restrict a fund from investing more than a certain percentage of its assets into the same entity.¹⁶⁹ The diversification requirements are designed to prevent a fund's overexposure to a single issuer.

In the European Union, MMFs are subject to European Union regulations and are supervised by the applicable authority in the EU Member State where the MMF is organized (*i.e.*, “national competent authority”).¹⁷⁰ The EU MMF Regulation imposes on MMFs a

¹⁶⁴ 17 CFR 270.2a-7.

¹⁶⁵ 17 CFR 270.2a-7(d)(4) requires a money market fund to hold securities that are sufficiently liquid to meet reasonably foreseeable shareholder redemptions.

¹⁶⁶ 17 CFR 270.2a-7(d)(4)(i) restricts a money market fund from investing more than 5% of its total assets in illiquid securities. An illiquid security is defined in 17 CFR 270.2a-7(a)(18) as a security that cannot be sold or disposed of in the ordinary course of business within seven calendar days at approximately the value ascribed to it by the fund.

¹⁶⁷ 17 CFR 270.2a-7(d)(4)(iii) restricts an MMF from acquiring any security (other than a daily liquid asset) if, immediately after the acquisition, the fund would have invested less than 25% of its total assets in daily liquid assets. A daily liquid asset is an asset that can be converted into cash within one business day.

¹⁶⁸ 17 CFR 270.2a-7(d)(4)(iii) restricts an MMF from acquiring any security (other than a weekly liquid asset) if, immediately after the acquisition, the fund would have invested less than 50% of its total assets in weekly liquid assets. A weekly liquid asset is an asset that can be converted into cash within five business days or securities issued by US government instrumentalities with a remaining maturity date of 60 days or less.

¹⁶⁹ 17 CFR 270.2a-7(d)(3)(i) contains the following diversification restrictions: (i) a non-single state fund may not invest more than 5% of its total assets in securities issued by the same entity (which is subject to a temporary safe harbor); and (ii) a single state fund may not invest more than 5% of 75% of its total assets in securities issued by the same entity (which is subject to a permanent safe harbor).

¹⁷⁰ See Regulation 2017/1131, of the European Parliament and of the Council of 14 June 2017 on Money Market Funds (the “EU MMF Regulation”). Competent authorities cooperate and share information with the European Securities and Markets Authority (“ESMA”) to carry out their respective responsibilities. EU MMF Regulation, art 43.

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minimum daily liquid asset requirement and a weekly liquid asset requirement.¹⁷¹ Similar to the U.S. requirements, these liquidity requirements are designed to ensure that a fund is able to accommodate investor redemptions.¹⁷² The EU MMF Regulation also imposes diversification requirements that, similar to the SEC rules, restrict MMFs from investing more than a certain percentage of their assets into a single issuer;¹⁷³ these rules are designed to limit an MMF's exposure to the credit risk of any single issuer.¹⁷⁴

Additionally, the MMFs that qualify as eligible IM collateral under Commission Regulation 23.156 invest in high quality underlying instruments, including securities issued or unconditionally guaranteed as to the timely payment of principal and interest by the U.S. Department of the Treasury or the European Central Bank 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 futures commission merchants ("FCMs") to invest customer funds in MMFs without an asset transfer restriction.¹⁷⁵

Based on its experience implementing the margin requirements since their adoption in 2016 and for the reasons described in the Proposal, the Commission proposed the elimination of

¹⁷¹ EU MMF Regulation, art. 24(1)(c) and (e). EU Money Market funds must invest a certain percentage of their assets in daily assets (either 7.5% or 10%, depending on the type of money market fund) and in weekly assets (either 15% or 30%, depending on the type of money market fund). If the assets of an MMF falls below one of its relevant thresholds, when a fund acquires a new security, it must be a type of security that would help the fund return to compliance with the liquidity requirements.

¹⁷² EU MMF Regulation, recitals (4), (37), and (38).

¹⁷³ EU MMF Regulation, art. 17 restricts EU Money Market funds from investing more than a certain percentage of its assets in the same entity (either 5%, 10%, or 20%, depending on the type of money market fund and the type of asset that is purchased).

¹⁷⁴ EU MMF Regulation, recitals (10), (25), and (28).

¹⁷⁵ Margin Subcommittee Report at 26. Commission Regulation 1.25 permits an FCM to invest customer excess funds in accounts held for futures, foreign futures, and cleared swap transactions in shares of U.S. government MMFs that invest a minimum of 99.5 percent of their total assets in cash, U.S. government securities, and/or repurchase agreements that are fully collateralized. (17 CFR 1.25(a)(1)(iv)).

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the restriction in paragraph (C) of Commission Regulation 23.156(a)(1)(ix).¹⁷⁶ The elimination of the asset transfer restriction would allow for a greater number of money market and similar fund securities to qualify as eligible IM collateral.¹⁷⁷ The Commission preliminarily considered the Proposal consistent with the Commission’s intent in identifying certain fund securities as eligible collateral when it adopted the CFTC Margin Rule. As discussed in the Proposal, 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.”¹⁷⁸ 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.¹⁷⁹ The GMAC Subcommittee stated that, given the widespread use of repurchase or similar arrangements by MMFs, only a few of the MMFs currently available to institutional clients satisfy the asset transfer restriction in paragraph (C).¹⁸⁰ As a result, unless the asset transfer restriction is eliminated, this form of margin collateral would be of very limited availability to swap counterparties, contrary to the intent of the Commission.

¹⁷⁶ Proposal at 53416-53418.

¹⁷⁷ 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).

¹⁷⁸ Final Margin Rule, 81 FR 636 at 666.

¹⁷⁹ Margin Subcommittee Report at 27.

¹⁸⁰ *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)). By comparison, as of January 2026, there were 72 “Treasury” MMFs, whose shares could potentially qualify as eligible collateral absent the asset transfer restriction, provided the funds meet the remaining requirements in Commission Regulation 23.156(a)(1)(ix). See Money Market Fund Statistics, January 2026 Supporting Data, available at the SEC’s website here: <https://www.sec.gov/data-research/investment-management-data/money-market-fund-statistics>.

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As part of its rationale for issuing the Proposal, the Commission noted that expanding the scope of eligible money market and similar fund securities may lead to more efficient collateral management practices.¹⁸¹ With respect to the use of MMF securities as IM collateral, the Commission referenced the Margin Subcommittee Report's statement 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.¹⁸² The Commission noted that 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.¹⁸³

As noted in the Proposal, the Report also 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.¹⁸⁴ Finally, according to the Report, the sweep of cash into MMF securities helps market participants mitigate the risk of custodian

¹⁸¹ Proposal at 53417.

¹⁸² 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).

¹⁸³ Final Margin Rule, 81 FR 636 at 671.

¹⁸⁴ Proposal at 53417; Margin Subcommittee Report at 27.

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insolvency as non-cash assets would not be consolidated with the custodian's balance sheet or estate from a supplemental leverage ratio¹⁸⁵ or bankruptcy perspective.¹⁸⁶

In issuing the Proposal, the Commission stated that 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.¹⁸⁷ In this regard, the Commission noted that the removal of the asset transfer restriction could lead to an increased use of MMF securities as margin collateral.¹⁸⁸ The Commission acknowledged the risk of concentration of collateral in particular assets and reiterated, as stated in the preamble to the CFTC Margin Rule, that CSEs should take concentration into account and prudently manage their margin collateral.¹⁸⁹ For the same reasons, the Commission stated 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 also discussed how its understanding of the rationale for the asset transfer restriction has evolved since the adoption of the CFTC Margin Rule.¹⁹⁰ As noted in the Proposal, the Commission explained in the preamble to the CFTC Margin Rule that the

¹⁸⁵The 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).

¹⁸⁶ Proposal at 53417; Margin Subcommittee Report at 26-27.

¹⁸⁷ 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.

¹⁸⁸ Proposal at 53417.

¹⁸⁹ Final Margin Rule, 81 FR 636 at 666.

¹⁹⁰ Proposal at 53417.

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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 came to the preliminary conclusion that although these rules are similar in that they aim to mitigate loss, their objectives are distinguishable.¹⁹¹

As discussed in the Proposal, 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.¹⁹² In this context, the prohibition in Commission Regulation 23.157(c)(1) against rehypothecation, rep pledging, 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.¹⁹³ 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

¹⁹¹ *Id.*

¹⁹² Final Margin Rule, 81 FR 636 at 670; Proposal at 53417.

¹⁹³ 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.

other counterparty as collateral for additional swaps, resulting in rehypothecation chains and embedded leverage throughout the financial system.¹⁹⁴

In contrast, as discussed in the Proposal, Commission Regulation 23.156(a) aims to identify assets as eligible collateral that are liquid, and, with appropriate haircuts, will hold their value in times of financial stress.¹⁹⁵ Paragraph (C) of Commission Regulation 23.156(a)(1)(ix), as adopted in the Final Margin Rule, was thus contemplated to ensure 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) disqualified 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.¹⁹⁶ In explaining this rationale, the Proposal discussed the potential risks associated with a money market or similar fund being left with assets that cannot be easily resold as a result of a failure by a counterparty under a repurchase arrangement. The Commission, however, noted that the potential risk of a failed repurchase or similar arrangement may be mitigated by the standard industry practice of applying haircuts to non-cash collateral in repurchase or similar

¹⁹⁴ Final Margin Rule, 81 FR 636 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).

¹⁹⁵ Final Margin Rule, 81 FR 636 at 665; Proposal at 53417.

¹⁹⁶ Proposal at 53417-53418 (discussing the example of a counterparty to a money market or similar fund that does not fulfill its obligations under a repurchase or similar arrangement, thus leaving the fund 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). *See also*, Proposal at 53418 (noting that the inability to liquidate assets that a money market or 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 agreement, 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).

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arrangements to compensate for the risk that the value of the collateral may decline over the term of the arrangement.¹⁹⁷

The Commission further noted that 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.¹⁹⁸ Hence, the risk of loss would be mitigated. As the Commission reasoned, 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.¹⁹⁹

While acknowledging the concerns associated with repurchase or similar arrangements, the Commission preliminarily considered 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 or similar arrangements are not restricted for the purpose of qualifying money market and similar fund securities as eligible collateral. In that regard, the Commission stated that, based on its experience administering the CFTC Margin Rule, it preliminarily believed that risks associated with repurchase or similar arrangements would be adequately addressed even in the absence of the asset transfer restriction by safeguards already present in the CFTC regulations, which, in the Commission's view, can

¹⁹⁷ Proposal at 53418, note 83 (referencing 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).

¹⁹⁸ Proposal at 53418.

¹⁹⁹ Proposal at 53418. As noted in the Proposal, that counterparty might, of course, experience some loss as the retained assets might not fully compensate such party for the unreturned assets.

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achieve the desired level of safety with respect to fund securities without restricting a fund's ability to undertake transactions in repurchase or similar arrangements.²⁰⁰

Among the safeguards, the Commission referenced Commission Regulation 23.156(a)(1)(ix)(A) and (B), which 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 stated that, in its preliminary view, 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.²⁰¹ The Commission further noted 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.²⁰² As such, the Commission noted, 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).²⁰³

The Commission further discussed Commission Regulation 23.156(c), which 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 23.161.²⁰⁴ Thus, the Commission stated, even if the value or liquidity of pledged money market and similar fund securities may be

²⁰⁰ Proposal at 53418.

²⁰¹ Proposal at 53418; Final Margin Rule, 81 FR 636 at 665.

²⁰² Proposal at 53418.

²⁰³ *Id.*

²⁰⁴ *Id.* (referencing 17 CFR 23.156(c)).

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.²⁰⁵

Finally, the Commission referenced section 4s(j)(2) of the CEA, which requires CSEs to adopt a robust and professional risk management system that is adequate for the management of their swap activities,²⁰⁶ and Commission Regulation 23.600, which 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, the Commission highlighted the requirement in Commission Regulation 23.600(c)(4) that 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 that 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.²⁰⁷

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 preliminarily concluded that it is appropriate to eliminate the asset transfer restriction.²⁰⁸ The Commission also noted that the elimination of the restriction would bring the CFTC's treatment of money market and similar fund securities as eligible collateral more in line

²⁰⁵ *Id.*

²⁰⁶ *Id.* (referencing 7 U.S.C. 6s(j)).

²⁰⁷ *Id.* (referencing 17 CFR 23.600).

²⁰⁸ Proposal at 53418.

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.²⁰⁹

2. *Comments*

The Commission received seven substantive comments addressing the asset transfer restriction. Five comment letters supported the Proposal,²¹⁰ while two letters opposed it.²¹¹

Comments supportive of the Proposal noted that, among other benefits, the proposed amendments would greatly expand the potential universe of MMFs that would be considered eligible collateral, without significantly increasing risk.²¹² Commenters stated that MMFs regularly engage in transactions in repurchase or similar arrangements involving U.S. Treasury securities as an important means to invest their excess cash on a secure, short-term basis and that the asset transfer restriction significantly and unnecessarily limits the ability to utilize government MMFs and other similar fund securities as eligible IM.²¹³

Further, ICI asserted that any additional risks associated with transactions in repurchase or similar arrangements would be addressed notwithstanding the elimination of the asset transfer

²⁰⁹ *Id.*

²¹⁰ Federated Hermes at p. 1; ICI at p. 5; Associations Joint Letter at p. 3; Barnard at p. 2; and MFA at p. 3.

²¹¹ Better Markets at pp. 1-2; Senator Warren at p. 3.

²¹² ICI at pp. 5-7 (noting, among other comments, that ICI estimates that eliminating the asset transfer restriction would significantly increase the scope of eligible collateral from 21 to 45 MMFs); Associations Joint Letter at pp. 3-4; Barnard at p. 2; MFA at pp. 3-4; and Federated Hermes at p. 2.

²¹³ ICI at pp. 5-6.

restriction.²¹⁴ In this regard, ICI noted that among the various types of MMFs,²¹⁵ only certain government MMFs would continue to qualify as eligible collateral.²¹⁶ Other types of MMFs, such as prime MMF that invest in a broader variety of instruments, including privately-issued short-term securities, would continue to be excluded.²¹⁷ ICI highlighted that prime MMFs, not eligible government MMFs, have raised financial stability concerns in the past.²¹⁸ In support of eliminating the asset transfer restriction, several commenters also referred to existing safeguards in the SEC rules under the Investment Company Act of 1940, including SEC Rule 2a-7 (mandating that government MMFs invest 99.5 percent or more of their total assets in cash, government securities, and/or repurchase agreements that are collateralized fully and evaluate the creditworthiness of the repurchase agreement counterparty) and SEC Rule 5b-3 (defining the “collateralized fully” requirement).²¹⁹ Commenters asserted that as a result of the requirements imposed by these rules, the vast majority of repurchase transactions in which government MMFs engage are overcollateralized and entered into with counterparties posing minimal credit risk due to credit risk determinations made with respect to the counterparty.²²⁰ ICI and Federated Hermes emphasized that the characteristics of government MMFs and the manner in which they conduct

²¹⁴ ICI at pp. 7-8.

²¹⁵ Only MMFs that primarily invest in securities issued or guaranteed by the U.S. government (government MMFs) or similar funds that invest in securities issued or unconditionally guaranteed by certain other sovereign entities are addressed in this Final Rule. MMFs that primarily invest in short-term corporate debt (prime MMFs) and other types of MMFs are not relevant to the Eligible Collateral Amendment.

²¹⁶ ICI at p. 7-8.

²¹⁷ ICI at p. 8 (noting that the Reserve Primary Fund, a prime MMF – whose shares fell from a net asset value of \$1.00 to \$.97 in September 2008 – held a range of privately-issued debt in its portfolio, including commercial paper issued by Lehman Brothers).

²¹⁸ ICI at p. 8 (noting that government MMF received substantial inflows during the COVID-19 pandemic, during which prime MMFs experienced purported stress).

²¹⁹ Federated Hermes at p. 2; ICI at pp. 6-7; Associations Joint Letter at pp. 13-14.

²²⁰ Federated Hermes at p. 2; ICI at pp. 6-7; Associations Joint Letter at pp. 13-14.

repurchase transactions would mitigate the risk of settlement failure in a repurchase transaction.²²¹

The Associations Joint Letter and ICI further explained that MMFs generally act as “buyers” that provide cash to other market participants with cash borrowing needs (“sellers”) in exchange for U.S. Treasury securities, with an agreement by the fund to sell (or the seller to buy) back those securities after a specified period, typically overnight.²²² The Associations Joint Letter asserted that this arrangement protects MMFs from custodian insolvency risk which arises where custodians hold cash in deposit accounts.

In general, commenters recommended that the Commission eliminate the asset transfer restriction without imposing any additional requirements such as restrictions on the nature of the repurchase or similar arrangements in which MMFs engage, a percentage cap on repurchase or similar arrangements, or additional haircuts.²²³ Commenters argued that such additional requirements would undermine the elimination of the restriction by significantly and unnecessarily limiting the scope of MMFs and other similar funds that qualify as eligible collateral.²²⁴ The Associations Joint Letter further rejected the idea that the Commission should impose a clearing requirement for transactions involving repurchase or similar arrangements.²²⁵ The Associations Joint Letter noted that the U.S. Treasury securities clearing market is in a state

²²¹ ICI at p. 6; Federated Hermes at pp. 2-3.

²²² Associations Joint Letter at p. 13; ICI at p. 6.

²²³ ICI at pp. 6-8; Federated Hermes at pp. 2-3; and Associations Joint Letter at pp. 12-15.

²²⁴ ICI at p. 7.

²²⁵ Associations Joint Letter at pp. 14-15.

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of transition, citing the SEC's reform of the U.S. Treasury market, and recommended the Commission wait until the SEC's reform is finalized.²²⁶

Some commenters criticized the proposal arguing that the Commission should not allow SDs to use MMFs as collateral and expressing general concern over MMFs and their performance during the 2020 COVID-19 pandemic.²²⁷ Senator Warren noted that the Federal Reserve had to step in and use taxpayer-backed bailouts to assist MMFs during the pandemic.²²⁸ Better Markets argued that MMFs are unstable and instead capitalize on profits during favorable market conditions and externalize losses to the public during times of market stress.²²⁹ Additionally, according to Better Markets, MMFs lack mandatory capital buffers or government insurance which makes them unsuitable for margin collateral.²³⁰ Better Markets asserted that both in 2008 and 2020, the government had to intervene with trillions of dollars in taxpayer-funded guarantees and liquidity assistance to prevent MMFs from collapsing.²³¹ Finally, Better Markets asserted that the Commission should refrain from lifting the asset transfer restriction, a move that could significantly elevate the use of MMFs as eligible non-cash collateral.²³²

Conversely, ICI argued that government MMFs actually saw substantial inflows during the 2020 COVID-19 pandemic, showing that government MMFs continued to serve as a liquidity

²²⁶ Associations Joint Letter at p. 14 (referring to the SEC's proposal in Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule with Respect to U.S. Treasury Securities, 87 FR 64610 (Oct. 25, 2022) ("Treasury Clearing Rule"). The SEC adopted the proposal in a final rule published on January 16, 2024, *see* 89 FR 2714 (Jan. 16, 2024). On February 25, 2025, the SEC extended the compliance date of the new requirements for eligible repo market transactions to June 30, 2027.

²²⁷ Senator Warren at pp. 2-3; Better Markets pp. 8-9.

²²⁸ Senator Warren at pp. 2-3.

²²⁹ Better Markets at pp. 8-9.

²³⁰ *Id.*

²³¹ *Id.*

²³² *Id.*

vehicle of choice for investors.²³³ Similarly, ISDA, SIFMA, and SIFMA AMG noted that the MMFs most impacted by “runnability” and “breaking the buck” in past crises were those that invested in a broader range of assets and accordingly would not be eligible collateral under the CFTC Margin Rule regardless of whether there is an asset transfer restriction or other restrictions on the MMF’s use of repos.²³⁴

3. Discussion

The Commission has considered the comments and continues to believe that the elimination of the asset transfer restriction will lead to more efficient collateral management practices by allowing for a greater number of money market and similar fund securities to qualify as eligible IM collateral. For the reasons stated in the Proposal, the Commission, therefore, is amending Commission Regulation 23.156(a)(1)(ix) to eliminate the asset transfer restriction as proposed.

The Commission understands that the asset transfer restriction continues to be a significant impediment to the use of MMF and similar funds’ securities as IM collateral. Data from the Office of Financial Research indicates that U.S. MMFs actively engage in U.S. Treasury securities repurchase transactions, which, absent amendment, renders such funds ineligible as collateral under Commission Regulation 23.156(a)(1)(ix).²³⁵

The Commission acknowledges commenter concerns that, in the past, government support has helped to stabilize the MMF market. As noted by some commenters, however, the

²³³ ICI at p. 8.

²³⁴ Associations Joint Letter at p. 13.

²³⁵ Current data from the Office of Financial Research indicates that U.S. MMFs continue to take part in Treasury repo transactions, accounting for approximately \$1.7 trillion dollars in October 2025. *See U.S. MMFs’ Investments in the Repo Market*, Office of Financial Research, available at: <https://www.financialresearch.gov/money-market-funds/us-mmfs-investments-in-the-repo-market/>.

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SEC has adopted amendments to the regulations governing MMFs to address the structural weaknesses in the MMF market.²³⁶ In addition, prime MMFs, which are generally the type of funds that in the past have experienced decrease in value during periods of stress, remain ineligible under Commission Regulation 23.156(a)(1)(ix).²³⁷ Government MMFs, on the other hand, have high liquidity and low volatility.²³⁸ The Commission agrees that prime MMFs should not be included in the list of eligible collateral, but believes that disqualifying all MMFs engaging in repurchase or similar arrangements from the list of eligible collateral could unduly restrict market participants' use of fund securities as IM under the CFTC Margin Rule framework. Commission Regulation 23.156(a)(1)(ix), therefore, will continue to only allow certain types of government MMFs and similar funds to qualify as eligible collateral, including after the elimination of the asset transfer restriction; prime MMFs will continue to be excluded as eligible collateral.

In consideration of the comments received, the Commission is not adopting any additional restrictions – such as limits on the nature or volume of repurchase and similar arrangements or additional haircut – on the ability of eligible money market and similar funds to engage in repurchase or similar arrangements. The Commission agrees that additional conditions would be unnecessary, burdensome, and potentially counterproductive given the existing regulatory frameworks governing the investment funds whose securities are eligible to serve as IM collateral. Given the ongoing implementation of the SEC's clearing requirements

²³⁶ *Money Market Fund Reforms; Form PF Reporting Requirements for Large Liquidity Fund Advisers; Technical Amendments to Form N-CSR and Form N-1A*, 88 FR 51404 (August 3, 2023).

²³⁷ 17 CFR 23.156(a)(1)(ix).

²³⁸ See SEC, Statistics & Data Visualizations, available at: <https://www.sec.gov/data-research/statistics-data-visualizations/money-market-fund-statistics/money-market-funds-liquidity>.

for transactions in U.S. Treasury securities,²³⁹ the Commission has also determined not to condition the collateral eligibility of an investment fund on the requirement that the fund's repurchase or similar arrangements be cleared.

C. Commission Regulation 23.156(a)(3) – Haircut Schedule Amendment

1. *Proposal*

The Commission proposed amending the eligible margin collateral haircut schedule contained in Commission Regulation 23.156(a)(3)(i)(B) to add a footnote specifying the haircut required on shares of money market and similar funds that was inadvertently omitted when the rule was originally promulgated.²⁴⁰

Commission Regulation 23.156(a)(3) sets forth percentage discounts to be applied to the market value of eligible non-cash margin collateral collected or posted to satisfy IM requirements that vary according to asset class (“haircut requirements”). The haircut requirements are intended to address the possibility that the value of non-cash eligible collateral may decline between a CSE's or its counterparty's default and the close out of the swap positions by the CSE or the CSE's counterparty, as applicable.

Although the Commission intended to align the CFTC 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.²⁴¹ The Commission proposed an amendment to Commission Regulation 23.156(a)(3) to incorporate

²³⁹ On February 25, 2025, the SEC extended the compliance date of the new requirements for eligible repo market transactions in U.S. Treasury securities described in the Treasury Clearing Rule to June 30, 2027.

²⁴⁰ 17 CFR 23.156(a)(3)(i)(B).

²⁴¹ Prudential Regulators Margin Rule at 74910.

the omitted footnote.²⁴² The proposed footnote, consistent with the footnote in the Prudential Regulators Margin Rule, describes the haircut applicable to the securities of money market and similar funds.²⁴³ The Proposal provided that 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.²⁴⁴ As proposed, 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.²⁴⁵

The Proposal sought public comment on the proposed footnote, and on alternative methods to calculate the applicable haircut.²⁴⁶ Specifically, the Proposal requested comment on whether utilizing a fixed percentage haircut (similar to the percentages applicable to other assets that qualify as eligible collateral under the haircut schedule) would be less complex to administer than applying a dynamic formula.²⁴⁷

2. *Comments*

The Commission received two substantive comments addressing the amendment to the haircut schedule.²⁴⁸ Both comment letters recognized the Commission's effort to align the margin rules for uncleared swaps with the Prudential Regulators Margin Rule.²⁴⁹ The

²⁴² Proposal at 53419.

²⁴³ *Id.*

²⁴⁴ *Id.*

²⁴⁵ *Id.*

²⁴⁶ *Id.*

²⁴⁷ *Id.*

²⁴⁸ Associations Joint Letter; ICI. ICI and SIFMA AMG later elaborated on their original comments on the appropriate haircut by submitting a supplemental comment letter ("ICI/SIFMA AMG Letter").

²⁴⁹ ICI at pp. 8-9; Associations Joint Letter at p. 15.

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Associations Joint Letter appreciated the Commission's effort to harmonize margin rules within the U.S.²⁵⁰ and ICI stated that the amendment to the haircut schedule in the Proposal would harmonize the CFTC's approach with the Prudential Regulators Margin Rule.²⁵¹ Both comment letters, however, also highlighted the challenges in applying a weighted average discount on all fund assets and recommended that the Commission adopt a standard discount percentage for the haircut footnote.²⁵² The Associations Joint Letter stated that applying a weighted average discount is "overly cumbersome," "unduly burdensome in practice and contribute[s] to the fact that market participants . . . generally do not pledge MMF securities as collateral."²⁵³ ICI stated that the approach would impose a "host of practical challenges."²⁵⁴ Both comment letters stated that, because portfolio information might not be available on a real-time basis or in a timely manner, it would be difficult for market participants to perform such calculations.²⁵⁵ In the Associations Joint Letter, the commenters explained that due to the lack of timely publication by the MMFs about the fund's portfolio composition, market participants who want to use MMF securities as margin collateral would be required to either calculate the haircut to the MMF securities based on the longest dated asset the MMF could hold, which information may not always be available from the MMFs, or regularly ascertain any changes in an MMF's portfolio, including through other sources.²⁵⁶ Further, the ICI/SIFMA AMG Letter stated that the proposed methodology would require parties to an uncleared swap transaction to contractually

²⁵⁰ Associations Joint Letter at p. 15.

²⁵¹ ICI at p. 9.

²⁵² ICI at pp. 8-9; Associations Joint Letter at p. 15.

²⁵³ Associations Joint Letter at pp. 15-16.

²⁵⁴ ICI at p. 9.

²⁵⁵ ICI at pp. 8-9; Associations Joint Letter at p. 15.

²⁵⁶ Associations Joint Letter at p. 16.

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allocate the calculation obligations in their credit support documents, which are highly negotiated documents, and require the designated party to build a system to “look-through” and identify the haircut applicable to each of the fund’s holdings and then routinely run such calculations to assess the appropriate haircut.²⁵⁷ ICI and SIFMA AMG argued that these “laborious and resource-intensive” tasks are not necessary for money market and similar funds, given the existing eligibility requirements limiting the types of fund holdings.²⁵⁸ ICI and SIFMA AMG further asserted that the same practical challenges would apply to any methodology that requires a “look-through” and assessment of characteristics of fund holdings.²⁵⁹

ICI and the Associations Joint Letter, therefore, both supported a fixed percentage haircut. Although ICI recommended that the Commission utilize a fixed haircut, it did not recommend a specific numerical percentage.²⁶⁰ The Associations Joint Letter recommended that the Commission allow CSEs to determine the appropriate haircut pursuant to their respective standard risk management processes or, alternatively, that the Commission adopt a standard 2 percent haircut.²⁶¹ The Associations Joint Letter stated the high liquidity and low volatility of MMFs securities as a result of SEC’s regulation of MMFs makes it unnecessary to apply a complex, MMF-specific valuation and haircut calculation as such calculation would result in negligible changes to an investment product with economic attributes very similar to cash.²⁶² The Associations Joint Letter further asserted that a 2 percent haircut is consistent with the standard practice outside of the uncleared swaps margin rules to apply a 2 percent haircut to

²⁵⁷ ICI/SIFMA AMG Letter at p. 2.

²⁵⁸ ICI/SIFMA AMG Letter at p. 2.

²⁵⁹ *Id.* at p. 3.

²⁶⁰ ICI at pp. 8-9.

²⁶¹ Associations Joint Letter at pp. 15-16.

²⁶² Associations Joint Letter at p. 16.

MMF securities pledged as collateral, and that 2 percent is likely higher than the haircut percentage that would be determined using the methodology in the proposed haircut footnote.²⁶³ Finally, the ICI/SIFMA AMG Letter recommended applying a static 0.5 percent haircut to securities of funds that are regulated under SEC Rule 2a-7 and other eligible funds that limit their investments to securities with maturities of less than one year or otherwise maintain a dollar-weighted average portfolio maturity of less than one year.²⁶⁴ For funds that are eligible under Commission Regulation 23.156(a)(1)(ix) but do not meet these criteria, ICI/SIFMA AMG recommended a static 2 percent haircut.²⁶⁵

3. Discussion

Following consideration of comments received in response to the Proposal and based on its analysis, the Commission is revising the haircuts schedule in Commission Regulation 23.156(a)(3)(i)(B) as discussed below.

As noted above, the Commission's intent was to align the haircut schedule under the CFTC Margin Rule with the Prudential Regulators Margin Rule. The Commission, however, recognizes the challenges associated with a dynamic haircut approach that requires a CSE, as a fund participant, to develop a process to compute a monthly weighted average discount on all assets within the funds after applying the specified haircut for each asset as established in

²⁶³ ICI at p. 9.

²⁶⁴ ICI/SIFMA AMG Letter at p. 3.

²⁶⁵ *Id.* at p. 4. In subsequent discussions with Commission staff, ICI and SIFMA AMG further clarified their recommended approach and acknowledged that if the fund invests in instruments of longer duration, a third tier of haircuts (*i.e.*, 4 percent) may be appropriate to achieve consistency with the haircuts that would be applicable to the underlying instruments pursuant to the standardized haircut schedule in Commission Regulation 23.156(a)(3). ICI and SIFMA AMG also requested that the Commission provide guidance on the process of determining the applicable haircut.

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Commission Regulation 23.156(a)(3). These challenges also include the ability of CSEs to monitor and ascertain information from a third-party portfolio.²⁶⁶

The Commission agrees that it is appropriate to balance consistency with the Prudential Regulators Margin Rule with practical accommodations that reflect the realities of the marketplace. The Commission also agrees that a fixed percentage haircut is an acceptable and practical approach for establishing appropriate haircuts for MMF and similar fund securities to account for potential changes in market value. Therefore, the Commission is adopting specific percentage haircuts for securities representing redeemable interest in eligible investment funds. To set the haircut percentages for shares of redeemable investment funds that are eligible margin collateral, the Commission used as reference the haircuts set forth in the haircut schedule in Commission Regulation 23.156(a)(3) for direct holding of the securities that comprise the assets of the investment fund. Currently, CSEs are permitted under the CFTC Margin Rule to post and collect securities issued by, or unconditionally guaranteed by, the U.S. Department of Treasury as IM for uncleared swaps.²⁶⁷ The CFTC Margin Rule also permits CSEs to post and collect securities issued by, or unconditionally guaranteed 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 SDs subject to regulation by the prudential regulators.²⁶⁸ The standardized haircut schedule

²⁶⁶ A dynamic haircut approach is consistent with the haircut requirements of the Prudential Regulators Margin Rule, with which the Commission intended to align the CFTC Margin Rule. Prudential Regulators Margin Rule, 80 FR 74840 at 74910 and CFTC Margin Rule, 81 FR 636 at 668. The haircut schedule of the Prudential Regulators Margin Rule includes a footnote, which was inadvertently omitted from the CFTC Margin Rule, providing that 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 footnote further specifies 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. 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. 80 FR 74840 at 74910.

²⁶⁷ 17 CFR 23.156(a)(1)(ii).

²⁶⁸ 17 CFR 23.156(a)(1)(iv).

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requires CSEs to haircut the market value of each security by 0.5 percent, 2 percent, or 4 percent depending on whether the remaining maturity of the security is less than one year, one year to five years, or greater than five years, respectively.²⁶⁹ To retain consistency with the fixed percentage haircuts imposed on individual securities, the Commission is adopting the same fixed percentage haircuts on securities representing redeemable interest in pooled investment funds that are comprised of the same individual securities and cash. In this regard, CSEs currently are permitted to post and collect as IM redeemable securities in investment funds that limit their investments to cash and 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.²⁷⁰ CSEs are also permitted to post and collect as IM securities in investment funds that limit their investments to securities denominated in a common currency and issued by, or fully guaranteed as to 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 SDs subject to regulation by a prudential regulator, and cash funds denominated in the same currency as the securities.²⁷¹ To be consistent with the existing haircuts on direct holding of eligible securities, the Commission is amending the haircut schedule to provide that a CSE must take haircuts on the market value of eligible redeemable securities in pooled investment funds of 0.5 percent or 2 percent if the fund limits its investments to securities with a remaining maturity of less than one or one to five years, respectively. CSEs may also be able to apply a 0.5 percent or 2 percent haircut to an investment fund, if the CSEs can demonstrate, based on the fund's stated

²⁶⁹ 17 CFR 23.156(a)(3)(B).

²⁷⁰ 17 CFR 23.156(a)(1)(ix)(A).

²⁷¹ 17 CFR 23.156(a)(1)(ix)(B).

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investment restrictions, that the fund’s maximum value-weighted average time to maturity would never exceed one year or one to five years, respectively. For funds that do not restrict their investments to securities with a remaining maturity of less than five years or do not restrict the maximum value-weighted average portfolio maturity to less than five years, the applicable haircut is 4 percent. The relevant percentage discount is to be applied to the market value of the fund shares, in accordance with Commission Regulations 23.156(a)(3)(ii) and 23.156(b)(2)(ii).²⁷²

The comments generally focused on the use of SEC-registered MMFs as eligible IM collateral. The Commission notes that investment funds that qualify as MMFs pursuant to SEC Rule 2a-7 are limited to investing only in securities with a remaining maturity of less than 397 days and are required to maintain a dollar-weighted average portfolio maturity that does not exceed 120 calendar days.²⁷³ As such, shares of MMFs that meet the IM eligibility requirements of Commission Regulation 23.156(a)(1)(ix) will be subject to a 0.5 percent haircut.²⁷⁴

Other eligible investment funds that are subject to comparable risk-limiting conditions in the jurisdictions in which they are established and thus limit their investments to securities with a

²⁷² 17 CFR 23.156(a)(3)(ii) and 17 CFR 23.156(b)(2)(ii).

²⁷³ 17 CFR 270.2a-7(d).

²⁷⁴ On April 14, 2025, MPD issued an interpretive letter (“Staff Letter 25-11”) stating that exchange-traded funds (“ETFs”) that fall within the regulatory framework set forth in SEC Rule 6c-11 may qualify as eligible IM as defined in the CFTC Margin Rule, provided the ETFs meet the criteria listed in Commission Regulation 23.156(a)(1)(ix) (*i.e.*, (i) the ETF issues and redeems ETF shares only on the basis of the market value of the fund’s net assets prepared each business day after security-holders make their investment commitments or redemption requests to the fund; and (ii) the ETF limits its investments to 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. With respect to the applicable haircuts, Staff Letter 25-11 provided that a CSE may either calculate the weighted average discount on all assets within the fund at the end of the prior month or use the haircut provided for the asset with longest residual maturity held by the fund (*e.g.*, 4 percent if an ETF that holds U.S. Treasury securities with a residual maturity greater than five years). The Commission’s revisions to the haircut schedule for eligible redeemable securities in pooled investment funds adopted in this rulemaking, however, supersede the haircuts specified in Staff Letter 25-11. Therefore, a CSE may apply a haircut of 0.5 percent, 2 percent, or 4 percent on eligible ETF fund shares posted to, or collected from, a counterparty depending on the value-weighted average time to maturity of the ETF’s investment portfolio.

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residual maturity of less than one year or maintain, as part of their investment strategy, a defined maximum value-weighted average portfolio maturity of less than one year, would also be subject to a 0.5 percent haircut. To demonstrate that the fund meets the criteria for applying a 0.5 percent haircut, the CSE will be able to rely on the fund's offering documents. Similarly, for funds that do not apply such restrictive time-to-maturity limitations, CSEs will be able to determine the applicable 2 percent or 4 percent haircut based on the underlying securities' maximum residual maturity or the fund's maximum value-weighted average portfolio maturity stated in the fund's prospectus or relevant offering document if such investment restriction is explicitly included. The ability to refer to the maximum residual maturity of the underlying securities or to the fund's maximum potential value-weighted average portfolio maturity, as such investment restrictions are stated in the fund's offering documents, will allow CSEs to implement a practical approach to selecting the applicable static haircut that does not implicate a dynamic review of the fund's actual portfolio.

The Commission expects that a haircut approach based on the residual maturity of underlying securities or the value-weighted average time to maturity of an eligible investment fund's portfolio will incentivize the use of funds that invest in short-term instruments, which would be better positioned to retain their value in periods of market stress.

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA") requires Federal agencies to consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and provide a regulatory flexibility analysis respecting the impact.²⁷⁵ Whenever an

²⁷⁵ 5 U.S.C. 601(2), 603, 604, and 605.

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agency publishes a general notice of proposed rulemaking for any rule, pursuant to the notice-and-comment provisions of the Administrative Procedure Act,²⁷⁶ a regulatory flexibility analysis or certification typically is required.²⁷⁷ As discussed in the Proposal, the amendments being adopted herein would only affect certain SDs and MSPs and their counterparties, which must be eligible contract participants (“ECPs”).²⁷⁸ The Commission has previously established that SDs, MSPs and ECPs are not small entities for purposes of the RFA.²⁷⁹

Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the Final Rule 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”)²⁸⁰ 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. Under the PRA, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number from the Office of Management and Budget (“OMB”).²⁸¹ The PRA is intended, in part, to minimize the paperwork burden created for individuals, businesses, and other persons as a result of the collection of information by Federal

²⁷⁶ 5 U.S.C. 553.

²⁷⁷ 5 U.S.C. 601(2), 603, 604, and 605.

²⁷⁸ *Regulation of Swap Dealers and Major Swap Participants*, 77 FR 2613, 2620 (Jan. 19, 2012) (SDs and MSPs); *Exemptions From Swap Trade Execution Requirement*, 86 FR 8993, 8998 (Feb. 11, 2021) (stating that ECPs by the nature of their definition in the CEA should not be considered small entities).

²⁷⁹ *See Regulation of Swap Dealers and Major Swap Participants*, 77 FR 2613, 2620 (Jan. 19, 2012) (SDs and MSPs); *Exemptions From Swap Trade Execution Requirement*, 86 FR 8993, 8998 (Feb. 11, 2021) (stating that ECPs by the nature of their definition in the CEA should not be considered small entities).

²⁸⁰ 44 U.S.C. 3501 *et seq.*

²⁸¹ 44 U.S.C. 3507(a)(3); 5 CFR 1320.5(a)(3).

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agencies, and to ensure the greatest possible benefit and utility of information created, collected, maintained, used, shared, and disseminated by or for the Federal Government.²⁸² The PRA applies to all information, regardless of form or format, whenever the Federal Government is obtaining, causing to be obtained, or soliciting information, and includes required disclosure to third parties or the public, of facts or opinions, when the information collection calls for answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons.²⁸³ This Final Rule does not contain any requirements subject to the PRA. Accordingly, the Commission has not prepared a PRA submission to OMB with respect to the final rule.

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.²⁸⁴ 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.

As described in more detail above, the Commission is revising the definition of “margin affiliate” to provide for a limited eligible seeded fund exception, pursuant to which, during a period of up to three years after the fund’s trading inception date, a seeded fund meeting certain

²⁸² 44 U.S.C. 3501.

²⁸³ 44 U.S.C. 3502(3).

²⁸⁴ 7 U.S.C. 19(a).

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specified requirements would be deemed to not have margin affiliates. This treatment for eligible seeded funds will effectively relieve CSEs that enter into uncleared swaps with certain seeded funds from the requirement to exchange IM with the seeded funds for a period not to exceed earlier of three years after the funds' trading inception date or the applicable compliance date if the AANA of the uncleared swaps, uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps entered into between the CSE and the seeded funds exceeds \$8 billion.²⁸⁵ The Seeded Funds Amendment makes the treatment available only to eligible seeded funds that, among other requirements: (i) are distinct legal entities from each sponsor entity; (ii) 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; (iii) have an asset manager who maintains independence in carrying out its management responsibilities and exercising its investment discretion, and has independent fiduciary duties to the fund and other investors in the fund (if any), such that no sponsor entity or any margin affiliate of a sponsor entity, except for the fund's asset manager in the exercise of its management responsibilities, controls or has transparency into the management or trading of the seeded fund; (iv) 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; (v) 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 (vi) are not securitization vehicles.

²⁸⁵ Commission Regulations 23.161(a) (compliance dates) and 23.151 (definition of "material swaps exposure") provide that a CSE is required to post and collect IM with an FEU starting on September 1st of a given year if the AANA of uncleared swaps, uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps in March, April, and May of that year exceeded \$8 billion. 17 CFR 23.161(a) and 17 CFR 23.151.

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With the Eligible Collateral Amendment, the Commission is eliminating 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 whose manager transfers the fund's assets through repurchase or similar arrangements. The Margin Subcommittee Report stated that the asset transfer restriction significantly limits the money market fund securities that are available for use as collateral under the CFTC Margin Rule.²⁸⁶ The Commission is also revising the haircut schedule for eligible collateral in Commission Regulation 23.156(a)(3) to address the haircut applicable to money market and similar funds.

The baseline against which the benefits and costs associated with the 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's 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 amendments on all activity subject to the amended regulations, whether by

²⁸⁶ 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.

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. commerce under section 2(i) of the CEA.²⁸⁷

The Commission recognizes that the amendments may impose additional costs on market participants, including CSEs. The Commission has endeavored to assess the expected costs and benefits of the Final Rule in quantitative terms where possible. In situations where the Commission is unable to quantify the cost and benefits, the Commission identifies and considers the costs and benefits of the applicable rules in qualitative terms. The lack of data and information to estimate costs is attributable to the nature of the Final Rule and uncertainty relating to how particular market participants would implement the Final Rule.

To further inform the Commission's consideration of the costs and benefits of the Proposal, the Commission invited comments from the public on all aspects of its cost-benefit considerations, including the identification and assessment of any costs and benefits not discussed by the Commission; data or any other information to assist or otherwise inform the Commission's ability to quantify or qualitatively describe the costs and benefits of the proposed amendments; and any other information to support positions posited by commenters with respect to the Commission's discussion. To the extent that the Commission received comments that directly or indirectly address the costs and benefits of the Proposal, those comments are discussed below. The commenters supporting the Proposal recommended or requested revisions to several proposed amendments and proposed conditions specified in the Proposal; however, no specific costs were identified by these commenters that would affect SDs, MSPs, or their counterparties as a result of the changes.

1. General Cost-Benefits Considerations - Seeded Funds Amendment

²⁸⁷ 7 U.S.C. 2(i).

a. Benefits

The Seeded Funds Amendment will effectively relieve CSEs entering into uncleared swaps with eligible seeded funds from the requirement to collect IM from the funds, subject to specified conditions. As discussed in more detail in section II.A., the Commission is adopting revisions to the definition of “margin affiliate” to provide that an eligible seeded fund will be deemed not to have margin affiliates or to constitute a margin affiliate of another entity for a period not to exceed three years from the fund’s trading inception date. Additionally, the term “eligible seeded fund” is defined to set forth the conditions that investment funds must meet to qualify for the eligible seeded fund exception. Absent this amendment, 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.²⁸⁸ The Final Rule will level the playing field domestically and globally with respect to the treatment of seeded funds.

As noted in the Proposal, the adoption of the eligible seeded fund exception 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 Amendment 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.

²⁸⁸ Margin Subcommittee Report at 7, 30 and 33.

The Commission expects that the Seeded Funds Amendment will tend to benefit seeded funds whose AANA falls below the \$8 billion MSE threshold. Given this level of swap activity, such seeded funds 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 are typically capitalized with \$50 million to \$100 million and have limited notional exposure.²⁸⁹

The Report further cited an informal sampling of members of SIFMA AMG and ACLI conducted in 2018, which indicated that a total of 33 seeded 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 seeded funds had an average gross notional exposure of \$32 million and would not be required to post IM with a CSE absent the consolidation requirement.²⁹⁰

The Seeded Funds Amendment addresses 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 will be in an initial stage of operation and development, will presumably have fewer resources to devote to IM compliance and hence will benefit from being discharged from posting IM during their seeding period without contributing significantly to systemic risk. During the seeding period, investment funds typically focus resources on establishing a performance track record to attract unaffiliated investors. The removal of an IM requirement during this period will increase flexibility for these funds without compromising general market stability. In this connection, ICI noted that the Seeded Funds Amendment would “minimize potential negative impacts of IM requirements on

²⁸⁹ Margin Subcommittee Report at 31.

²⁹⁰ *Id.*

the performance of seeded funds . . . without diminishing the inherent safeguards that the CFTC’s requirements for uncleared swaps margin provide regarding systemic risk.”²⁹¹

In addition, the Commission believes that the Seeded Funds Amendment will be beneficial for CSEs that enter into swap transactions with investment funds. As a result of the amendments, CSEs will be able to 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 will 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.²⁹² Several commenters highlighted global alignment and enhanced competitive footing as benefits of the Seeded Funds Amendment.²⁹³

The 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

²⁹¹ ICI at p. 3. *See also* ACLI at p. 3 (asserting that existing regulatory safeguards, including those in the proposed definition of “eligible seeded fund” are sufficient to prevent sponsors from evading margin requirements and that seeded funds pose minimal risk during the seeding period) and Associations Joint Letter at p. 11 (asserting that the Commission has ample means, pursuant to its anti-evasion authority, to address the concern that market participants may abuse the exemption for seeded funds to circumvent IM requirements).

²⁹² Margin Subcommittee Report at 30.

²⁹³ ICI at p. 3, MFA at p.1.

The Seeded Funds Amendment may lead to the exchange of less margin between a CSE and a seeded fund resulting in uncollateralized exposures that could increase credit risk associated with uncleared swaps and the potential for default. In certain circumstances, the increase in uncollateralized credit risk resulting from the Seeded Funds Amendment could also negatively impact the sponsor entity or the asset manager of a seeded fund. 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 or legal obligation 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.

Commenters critical of the Seeded Funds Proposal also underscored the potential costs of the amendment including increased confusion and operational difficulties as well as general costs associated with inconsistency with other U.S. regulators.²⁹⁴ Further, one commenter voiced a concern that the changes proposed would incentivize parties to engage in high-risk transactions with insufficient collateralization.²⁹⁵

To account for these potential risks, the Commission is defining 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

²⁹⁴ Better Markets at pp. 7-8; Senator Warren at p. 2.

²⁹⁵ Uy.

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sponsor entities or asset managers. Among other conditions, the seeded fund must 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 some of the incentive for the sponsor's assets to be used if the seeded fund fails.

Further, eligible seeded funds impacted by the amendments adopted in this Final Rule will typically be small funds that have limited swaps activity.²⁹⁶ To grow, the funds will 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 will primarily impact the exchange of IM between a CSE and investment funds that are in their seeding period. During the seeding period, such investment funds pose less risk to a CSE counterparty and the financial system given the small size of the funds and the limited scope of their derivatives activity. To ensure that eligible seeded funds are afforded the benefit of separate treatment from margin affiliates only during the seeding period, the Commission is limiting the applicability of the eligible seeded fund exception to a maximum of 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 definition of eligible seeded fund includes 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." In addition, pursuant to Commission Regulation 23.161(c), a CSE and a seeded fund will become subject to the IM requirement if the AANA as computed under

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Commission Regulation 23.151, exceeds the \$8 billion threshold prior to the end of the three-year period.²⁹⁷ Commission Regulation 23.161 thus addresses the potential growth of seeded funds during the seeding period.

The Commission is also addressing the potential risks of the Seeded Funds Amendment by retaining the existing requirement in Commission Regulation 23.153 for a CSE to collect or post variation margin with each FEU counterparty, including seeded funds, on a daily basis, subject to the applicable minimum transfer amount.²⁹⁸ The settlement of daily variation margin between CSEs and seeded funds prevents the aggregation of cumulative losses over an extended period of time which may adversely impact the counterparties in the event of a subsequent default.

Furthermore, in addition to the safeguards incorporated into the Seeded Funds Amendment, section 4s(j)(2) of the CEA and Commission Regulation 23.600 require CSEs to monitor and manage risks related to their swap activities, including credit risk, and to set tolerance limits.²⁹⁹ As such, 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 to reduce their credit exposures, including collecting collateral from the seeded fund or liquidating positions.

²⁹⁷ 17 CFR 23.151 (definition of "material swaps exposure") and 17 CFR 23.161(c) (addressing the "change of status" of the CSE's counterparty).

²⁹⁸ 17 CFR 23.153. Variation margin is calculated each business day and represents the mark-to-market change in the value of the swap since the last point in time that the swap was marked-to-market. *See* Commission Regulation 23.151 and 23.155 (17 CFR 23.151 and 17 CFR 23.155).

²⁹⁹ 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).

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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 is incorporating in the definition of eligible seeded fund certain conditions designed to ensure that the fund has a bona fide business purpose. The conditions include a requirement that the fund is 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 have independence in carrying out its management responsibilities and exercising its investment discretion, and to the extent applicable, has independent fiduciary duties to the fund and other investors in the fund, such that no sponsor entity or a margin affiliate of a sponsor entity (other than the asset manager) controls or has transparency into the management or trading of the seeded fund.

These requirements, as outlined above, would mitigate the costs associated with the potential evasion of IM requirements by ensuring that the Seeded Fund Amendment is narrowly tailored. As noted in the Proposal, the Commission also intends to use its anti-evasion authority to prevent circumvention of the margin requirements.³⁰⁰

At this time, the Commission understands that U.S. prudential regulators have not amended or proposed to amend their margin requirements in line with the Seeded Funds Amendment. This will result in a divergence from the U.S. prudential regulators and require 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. Two

³⁰⁰ Proposal at 53422.

commenters discussed the potential costs that would result if the prudential regulators do not amend their rules in a manner consistent with the Proposal. Better Markets asserted that the potential inconsistency between U.S. regulators would increase the costs associated with adapting swap-related documentation and collateral management systems for counterparties who engage with both prudentially regulated and CFTC-regulated SDs.³⁰¹ In contrast, ISDA, SIFMA, and SIFMA AMG stated that the burden on market participants to make documentation and operational changes would not be significant because current documentation and systems can continue to be used in connection with prudentially regulated entities.³⁰²

While the divergence from the prudential regulators may result in a short-term increase in costs for market participants regarding documentation, based on the public comments received and the Commission's understanding of margin documentation, the Commission believes that these costs will be minimal.³⁰³

2. General Cost Benefit Analysis - Eligible Collateral Amendment

a. Benefits

The Eligible Collateral Amendment will expand the scope of assets that qualify as eligible collateral. As discussed in the Proposal, the Margin Subcommittee Report highlighted the benefits of eliminating the asset transfer restriction, noting that the securities of very few MMFs currently qualify as eligible collateral because nearly all U.S. MMFs engage in some

³⁰¹ Better Markets at p. 8.

³⁰² Associations Joint Letter at p. 16.

³⁰³ Associations Joint Letter at p. 16 (anticipating that the burden on market participants to make documentation and operational changes to accommodate different requirements under the two U.S. regimes would not be significant, because current documentation and systems can continue to be used in connection with prudentially regulated SDs and noting that the costs for developing the new operational system and documentation for non-prudentially regulated SDs would be the same whether or not the prudential regulators' margin rules are amended at the same time).

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form of repurchase or similar arrangements.³⁰⁴ By increasing the number of investment funds that qualify as eligible collateral, the amendment may thus reduce the potential concentration of collateral in the few funds whose securities currently qualify as eligible collateral under Commission Regulation 23.156(a)(1)(ix). Commenters noted that the amendment would expand the potential universe of MMFs and similar funds that are considered eligible collateral.³⁰⁵ The Eligible Collateral Amendment could therefore lead to greater diversity of assets used for collateral, thereby reducing the riskiness of IM assets.

By eliminating the asset transfer restriction, the Eligible Collateral Amendment may also facilitate more efficient collateral management practices. In this regard, 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.³⁰⁶ 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.³⁰⁷ 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 in a negative interest rate environment.³⁰⁸

³⁰⁴ Proposal at 53423; Margin Subcommittee Report at 24.

³⁰⁵ ICI at pp. 5-7; Associations Joint Letter at pp. 3-4; Barnard at p. 2; MFA at pp. 3-4; and Federated Hermes at p. 2.

³⁰⁶ Report at p. 26 (stating that many custodians offer money market sweep programs that permit FEUs to pledge cash into segregated collateral accounts and instruct the custodian to sweep the cash into MMF shares, which are pledged as collateral to CSE counterparties for swap transactions).

³⁰⁷ Report at pp. 26-27.

³⁰⁸ *Id.*

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The Eligible Collateral Amendment could also promote asset management policies that improve the performance of money market and similar funds. Without the asset transfer 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.

Further, CSEs and their counterparties will likely benefit from the more efficient use of their capital as discussed above and enhanced returns on securities posted as collateral. Furthermore, the amendment 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 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.³⁰⁹

Several commenters agreed with the Commission's analysis of the potential benefits of the Eligible Collateral Amendment.³¹⁰ Another commenter, echoing the statements in the Margin Subcommittee Report, noted that without relief from the asset transfer restriction, market

³⁰⁹ SEC Rule 18a-3(c)(4) permits cash, securities, money market instruments, certain foreign currencies and gold as margin collateral for non-cleared security-based swaps, provided that the margin collateral is readily marketable and transferable. 17 CFR 240.18a-3(c)(4). See also Proposal at 53423-53424; *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.).

³¹⁰ MFA at p. 3; ICI at p. 7; Federated Hermes at p. 1; Barnard at p. 2.

participants may be forced to use other less efficient or optimal forms of non-cash IM collateral, thus increasing costs, settlement delays, tracking errors, and operational burdens.³¹¹

b. Costs

Eliminating the asset transfer restriction in paragraph (C) of Commission Regulation 23.156(a)(1)(ix) will 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. As explained in the Proposal, 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. Better Markets and Senator Warren expressed similar concerns over the safety and security of MMFs as collateral, particularly in times of stress.³¹² In this regard, the Commission notes, however, that subparagraphs (A) and (B) of Commission Regulation 23.156(a)(1)(ix) will remain in effect to limit the types of assets that a money market and similar fund can receive in

³¹¹ MFA at p. 3.

³¹² Better Markets at pp. 3-4; Senator Warren at p. 3.

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repurchase or similar arrangements to certain currencies, securities issued, or unconditionally guaranteed, by the U.S. Treasury, and securities fully guaranteed by the European Central Bank or sovereign entity that is assigned a risk weight of no more than 20 percent under the capital rules established by a prudential regulator.

Further, 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 23.161.³¹³ As such, 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, including those associated with a divergence between the margin rules of the CFTC and the U.S. prudential regulators. This may require 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. The Eligible Collateral Amendment also may incentivize trading with CSEs over SDs or MSPs subject to the U.S. prudential regulators' margin rules given that the prudential regulators' rules may continue to restrict the use of securities of money market and similar funds that transfer their assets through repurchase or similar arrangements. In this connection, Better Markets

³¹³ 17 CFR 23.156(c).

expressed concern about the lack of alignment with prudential regulators, arguing that the proposed amendment has a potential for “fostering a detrimental ‘race to the bottom’ scenario where entities may exploit regulatory disparities to seek arbitrage opportunities among less stringent regulators, thereby compromising the overall effectiveness of our regulatory framework.”³¹⁴

At the same time, the removal of the asset transfer restriction will bring the CFTC’s eligible collateral framework closer to the approach adopted by the SEC which, as noted above, does not impose asset transfer restrictions with respect to money market and similar fund securities and expressly permits the use of government money market fund securities as collateral. Therefore, although there is the potential for greater costs because of the divergence with the U.S. prudential regulators, overall costs may be reduced, given that many CSEs are also cross-registered with the SEC as security-based SDs.

3. *General Cost-Benefits Considerations –Haircut Schedule Amendment*

a. *Benefits*

The amendment to the haircut schedule in Commission Regulation 23.156(a)(3) specifies the percentage discount to be applied to the market value of the shares of eligible pooled investment funds posted to satisfy IM requirements. The discount ranges from 0.5 to 4 percent depending on the value-weighted average portfolio maturity of the fund (*e.g.*, the market value of eligible redeemable securities in pooled investment fund funds that have a value-weighted average portfolio maturity of less than one year is subject to 0.5 percent haircut). The haircuts are consistent with the discounts applicable to the underlying instruments of the eligible investment funds pursuant to Commission Regulation 23.156(a)(3).

³¹⁴ Better Markets at p. 7.

By imposing a fixed percentage discount, the Commission will provide flexibility to market participants for whom a dynamic approach based on a weighted average discount on fund assets is operationally burdensome while balancing the regulatory objective of applying an appropriately conservative haircut to account for possible decline in value of the collateral. In this connection, imposing a lower haircut for funds that maintain a shorter value-weighted average portfolio maturity will incentivize the use of funds that invest in short-term instruments that generally retain their value in periods of market stress as compared to funds whose investment portfolios are hold longer-dated investments. Funds comprised of short-dated investments also provide an opportunity for the fund manager to hold the investments to maturity rather than liquidate the securities during periods when the value of the securities has declined.

b. Costs

The amendment to the haircut schedule in Commission Regulation 23.156(a)(3) specifies a fixed percentage discount to be applied to the value of the share of eligible pooled investment funds posted to satisfy IM requirements. A fixed haircut approach, while simpler, may not reflect as accurately the potential decline in value of a fund share as a dynamic haircut approach based on a weighted average discount. The highest discount (*i.e.*, 4 percent), may in some cases also be more conservative than the haircut that would be applicable if CSEs were calculating a weighted average discount. As discussed above, however, market participants stated that a dynamic haircut approach is overly cumbersome and supported the Commission's alternative proposal to establish a fixed percentage haircut.³¹⁵

4. *Section 15(a) Considerations – Seeded Funds Amendment*

³¹⁵ ICI at pp. 8-9; Associations Joint Letter at p. 15.

The Commission has evaluated the costs and benefits of the Seeded Fund Amendment pursuant to the five considerations identified in section 15(a) of the CEA as follows:

a. Protection of Market Participants and the Public

Following the adoption of the Seeded Funds Amendment, a seeded fund meeting specific requirements would be deemed not to have margin affiliates or to constitute a margin affiliate of another entity during a period of up to three years from the fund's trading inception date. As a result, only the seeded fund's individual AANA will 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 will be used to determine whether the posting and collection of IM is required.

The Seeded Funds Amendment's approach to eligible seeded funds is consistent with the BCBS-IOSCO Framework and similar approaches adopted by jurisdictions such as Australia, Canada and the EU.³¹⁶ As such, the Seeded Funds Amendment will 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 Amendment will 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 Amendment will 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.

³¹⁶ See *supra* notes 25 and 54.

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As a result of the Seeded Funds Amendment, 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 Amendment 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 Amendment, 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, continues to believe that such concerns are mitigated by the requirements incorporated in the 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 Amendment revises the definition of "margin affiliate" in Commission Regulation 23.151 to provide an exception for eligible seeded funds, which effectively relieves

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CSEs from the requirement to exchange IM for uncleared swaps with such eligible seeded funds, subject to specified conditions. This exception 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. As noted in the Proposal, this amendment has the potential to spur greater interest in seeded funds as potential counterparties in uncleared swap transactions. Further, the amendment will 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 Amendment will also reduce the operational costs associated with the exchange of IM for CSEs and their eligible seeded funds counterparties and will allow seeded funds to allocate their financial resources to testing and establishing their investment strategy and attracting unaffiliated investors. The cost reduction may incentivize more market participants to enter into uncleared swaps and ultimately promote efficiency in the uncleared swaps market by increasing the pool of swap counterparties and fostering competition.

As noted above, the Seeded Funds Amendment will also result in differing margin requirements for CSEs subject to the CFTC Margin Rule and swap dealers subject to the Prudential Regulators Margin Rule, which may encourage seeded funds to elect to engage with CSEs to avoid being subject to IM requirements. The Commission, however, believes that an asset manager of a seeded fund would take into consideration a variety of factors in determining the swap dealers to use as counterparties for swap transactions, including the size and credit risk

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of the swap dealer, as well as the extent that the fund uses the swap dealer for other business transactions.

Given that the Seeded Funds Amendment 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, continues to believe 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. Additionally, the Commission believes that the Seeded Funds Amendment is narrowly tailored given the requirements incorporated in the definition of “eligible seeded fund” and the maximum three-year limit on the availability of the eligible seeded fund exception to each individual seeded fund. Furthermore, the Commission believes that the continued requirement for CSEs and seeded funds post and collect daily variation margin to address mark-to-market gains and losses mitigates the potential impact of not collecting IM from seeded funds. By posting and collecting variation margin daily, CSEs and seeded funds eliminate the exposure to the long-term accumulation of unsettled gains and losses that would accrue absent the daily VM requirement, which may have a material impact on the entities in the event of a counterparty default.

c. Price Discovery

By amending the definition of “margin affiliate” in Commission Regulation 23.151, the Seeded Funds Amendment 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 amendment would

permit eligible seeded funds to direct more resources to its established trading strategies with the objective of demonstrating 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

As a result of the Seeded Funds Amendment, less initial margin may be collected and posted to offset the risk of uncleared swaps, which could increase the risk of default.

Nevertheless, the Commission continues to believe 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 would likely be limited. In addition, CSEs will continue to be 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. CSEs and seeded funds would also continue to be required to mark open positions to market each business day and to post and collect variation margin to settle gains and losses associated with their swap transactions.

The Commission also notes that the Seeded Funds Amendment 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 Amendment would encourage careful consideration and selection of counterparties and promote sound risk management.

e. Other Public Interest Considerations

By adopting a treatment of certain investment funds that is consistent with the BCBS-IOSCO Framework, the Seeded Funds Amendment would alleviate the potential disadvantages 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 Seeded Fund Amendment, it is possible 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. The divergence could lead to trades that do not reflect the relative merits of competing SDs. It may also result in 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 account for the differing rule systems. Despite this potential divergence between U.S. regulators, the Commission believes that the benefits of price discovery and efficiency outweigh the potential costs of the Seeded Funds Amendment for market participants.

5. *Section 15(a) Considerations - Eligible Collateral Amendment*

The Commission has evaluated the costs and benefits of the Eligible Collateral Amendment pursuant to the five considerations identified in section 15(a) of the CEA as follows:

a. Protection of Market Participants and the Public

The Commission believes that the Eligible Collateral Amendment 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 Eligible Collateral Amendment 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 Amendment.

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 or similar arrangements, 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 elimination of the asset transfer restriction may negatively impact market participants. If a money market or 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 Eligible Collateral Amendment eliminates the asset transfer restriction, allowing the use of securities of money market and similar 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 or 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.³¹⁷

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

³¹⁷ 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.

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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 or 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 Eligible Collateral Amendment 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 asset transfer 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 Amendment, it is possible that the U.S. prudential regulators may not amend their margin rule in line with the Eligible Collateral Amendment. 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 Eligible Collateral Amendment 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 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.

6. *Section 15(a) Considerations – Haircut Schedule Amendment*

The Commission has evaluated the costs and benefits of the Haircut Schedule Amendment pursuant to the five considerations identified in section 15(a) of the CEA as follows:

a. *Protection of Market Participants and the Public*

The Commission believes that the amendment to the haircut schedule in Commission Regulation 23.156(a)(3) will protect market participants and the public by imposing an appropriately conservative discount to the market value of shares of eligible pooled investment funds posted to satisfy the IM requirement.

b. *Efficiency, Competitiveness, and Financial Integrity of Markets*

Imposing a fixed percentage discount on the value of eligible pooled investment fund securities posted as collateral will provide market participants with the opportunity to implement more efficient collateral management practices. As discussed by commenters, a fixed percentage discount is less burdensome to market participants than a dynamic haircut approach based on a weighted average discount.³¹⁸

³¹⁸ ICI at pp. 8-9; Associations Joint Letter at p. 15.

c. Price Discovery

By imposing an easy to implement, appropriately calibrated haircut, the amendment may contribute to a reduction in the overall costs of entering into an uncleared swap transaction. In turn, trading in uncleared swaps may increase, leading to increased liquidity and enhanced price discovery.

d. Sound Risk Management

The haircut percentage applicable to eligible securities in pooled investment funds under the amendment to the haircut schedule in Commission Regulation 23.156(a)(3) is calibrated in consideration of the maturity of the fund's underlying instruments. By imposing a lower haircut to funds that limit their investments to securities with a shorter residual maturity or restrict their maximum value-weighted average portfolio maturity, the amendment will incentivize the use of funds that invest in short-term instruments, thus encouraging the selection of funds that better retain their value in episodes of market stress.

e. Other Public Interest Considerations

The fixed percentage haircut approach established by the amendment to the haircut schedule in Commission Regulation 23.156(a)(3) is different from the dynamic haircut approach based on a weighted average discount implemented by the Prudential Regulators Margin Rule. It is possible that the U.S. prudential regulators may not amend their margin rule to align it with the Commission's haircut approach. The divergence may 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 the documentation and collateral management systems to address the differing treatments for fund securities under the different rules.

On the other hand, the amendment to the haircut schedule in Commission Regulation 23.156(a)(3) introduces a simpler, less burdensome approach to calculating the applicable haircut and may thus lead to operational efficiencies and cost reduction.

D. Antitrust Laws

Section 15(b) of the Act 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 (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.³¹⁹

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. In the Proposal, the Commission requested comment on whether: (i) the Proposal implicates any other specific public interest to be protected by the antitrust laws; (ii) the Proposal is anticompetitive and, if it is, what the anticompetitive effects are; (iii) whether there are less anticompetitive means of achieving the relevant purposes of the Act that would otherwise be served by adopting the Proposal.³²⁰ The Commission did not receive comments on the anticompetitive effects of the Proposal.

The Commission does not believe that the Final Rule would result in anti-competitive behavior. The Seeded Funds Amendment provides a limited exemption that will provide greater flexibility to CSE to enter into uncleared swaps with eligible seeded funds, thus promoting competition between U.S. and non-U.S. funds. The Eligible Collateral Amendment may

³¹⁹ 7 U.S.C. 19(b).

³²⁰ Proposal at 53427.

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promote competition by allowing for a broader range of money market and similar fund securities to qualify as eligible IM collateral. Because the Commission has determined that the Final Rule is not anti-competitive and may promote competition, the Commission has not identified any less anticompetitive means of achieving the purposes of the Act.

E. Executive Orders 12866, 13563, and 14192

Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select those regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; and distributive impacts). Section 3(f) of Executive Order 12866 defines a “significant regulatory action” as any regulatory action that is likely to result in a rule that may: (1) have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities; (2) create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raise novel legal or policy issues arising out of legal mandates, or the President's priorities.

The Office of Management and Budget has determined that this action is not a significant regulatory action as defined in Executive Order 12866, as amended, and therefore it was not subject to Executive Order 12866 review.

This Final Rule is not an Executive Order 14192 regulatory action, because it is not a significant regulatory action under E.O. 12866.

F. Congressional Review Act

Pursuant to the Congressional Review Act,³²¹ the Office of Information and Regulatory Affairs has designated this Final Rule as not a “major rule,” as defined by 5 U.S.C. 804(2).

List of Subjects

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, revise the definition of “Margin affiliate”; and add the definition of “Eligible seeded fund” in alphabetical order.

The revision and addition 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;

³²¹ 5 U.S.C. 801 *et seq.*

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- (2) 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;
- (3) 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 the fund and other investors in the fund, such that no sponsor entity or any of the sponsor entity's margin affiliates, except for the fund's asset manager in the exercise of its management responsibilities, controls or has transparency into the management or trading of the seeded fund;
- (4) 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;
- (5) 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
- (6) 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 or to constitute a margin affiliate of another entity.

* * * * *

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 [Amended]

(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:

* * * * *

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(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:

Standardized Haircut Schedule

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

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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 redeemable securities in pooled investment funds that limit their investments as specified in paragraphs (a)(1)(ix)(A) or (a)(1)(ix)(B) of this section, as applicable, and the respective fund's maximum value-weighted average time to maturity or maximum residual maturity of any individual investment is less than one year	0.5
Eligible redeemable securities in pooled investment funds that limit their investments as specified in paragraphs (a)(1)(ix)(A) or (a)(1)(ix)(B) of this section, as applicable, and the respective fund's maximum value-weighted average time to maturity or maximum residual maturity of any individual investment is between one and five years	2.0
Eligible redeemable securities in pooled investment funds that limit their investments as specified in paragraphs (a)(1)(ix)(A) or (a)(1)(ix)(B) of this section, as applicable, and the respective fund's maximum value-weighted average time to maturity or maximum residual maturity of any individual investment is 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

* * * * *

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(subject to pre-publication technical corrections)

Issued in Washington, DC on [date] by the Commission.

Christopher Kirkpatrick,

Secretary of the Commission.