



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

September 14, 2012

Mr. David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Mr. John Walsh
Office of the Comptroller of the Currency
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Mail Stop 2-3
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Mr. Alfred M. Pollard, General Counsel
Attention: Comments/RIN 3038-AC97
Federal Housing Finance Agency
Fourth Floor, 1700 G Street, NW
Washington, DC 20552

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve
System
20th Street and Constitution Ave., NW
Washington, DC 20551

Mr. Gary K. Van Meter, Acting Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

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

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

- CFTC: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (RIN 3038-AC97)
- Board: Margin and Capital Requirements for Covered Swap Entities [Docket No. R-1415] (RIN 7100 AD74)
- FCA: Margin and Capital Requirements for Covered Swap Entities (RIN 3052-AC69)
- FDIC: Margin and Capital Requirements for Covered Swap Entities (RIN 3064-AD79)
- FHFA: Margin and Capital Requirements for Covered Swap Entities (RIN 2590-AA45)
- OCC: Margin and Capital Requirements for Covered Swap Entities [Docket No. OCC-2011-0008] (RIN 1557-AD43)

The American Benefits Council (the “Council”), the Committee on Investment of Employee Benefit Assets (“CIEBA”), the European Federation for Retirement Provision

("EFRP"), the Multi-Employer Council of Canada ("MEBCO"), the National Coordinating Committee for Multiemployer Plans ("NCCMP"), and the Pension Investment Association of Canada ("PIAC") (together, the "Global Pension Coalition") appreciate this opportunity to provide comments to the Commodity Futures Trading Commission ("CFTC") regarding margin requirements for uncleared swaps.

In May 2011, the CFTC proposed rules to establish margin requirements for uncleared swaps.¹ Also in May 2011, the U.S. Prudential Regulators proposed similar rules (together with the CFTC's proposal the "U.S. Proposed Rules").² In July 2012, the Working Group on Margining Requirements of the Basel Committee on Banking Supervision ("BCBS") and the Board of the International Organization of Securities Commissions ("IOSCO") (together the "Working Group") issued a Consultative Document titled "Margin requirements for non-centrally-cleared derivatives" (the "Consultative Document"). In light of the Consultative Document, the CFTC reopened its comment period for its uncleared swap margin rules. Although the Prudential Regulators did not formally reopen their comment period, the Global Pension Coalition also addresses this letter to the Prudential Regulators because our comments are equally applicable to the Prudential Regulators' proposal.

The Global Pension Coalition represents a very significant portion of the largest private defined benefit and defined contribution pension plans in the U.S., Canada and Europe as well as the companies that sponsor those pension plans. The pension plans represented by the Global Pension Coalition provide retirement benefits for over a hundred million individuals in more than a dozen countries. Unlike financial firms that use derivatives and take risks to enhance their financial position vis a vis their competitors, pension plans exist solely to provide retirement security for pensioners and utilize derivatives primarily to hedge risks which could jeopardize such retirement security.

In addition to being important to millions of pensioners throughout the world, pension plans provide a crucial source of stable liquidity to the derivatives markets and their continued participation in these markets is welcome and needed by other market participants. Because they are highly creditworthy and liquid counterparties, with low or practically no leverage, pension plans actually reduce systemic risk by their participation in the derivative markets. Were pension plans to stop participating in these markets, such markets would clearly be riskier.

¹ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants , Proposed Rule, 76 Fed. Reg. 27,621 (May 12, 2011). The CFTC's rules would apply to swap dealers and major swap participants that are not regulated by a U.S. Prudential Regulator (defined below).

² Margin and Capital Requirements for Covered Swap Entities, Proposed Rule, 76 Fed. Reg. 27,564 (May 11, 2011). The Prudential Regulators' proposed rules would apply to swap dealers and major swap participants that are regulated by one of the Prudential Regulators. The Prudential Regulators are the Office of the Comptroller of the Currency ("OCC"), Board of Governors of the Federal Reserve System ("Board"), Federal Deposit Insurance Corporation ("FDIC"), Farm Credit Administration ("FCA"), and the Federal Housing Finance Agency ("FHFA").

We believe that these systemic risk reducing characteristics of pension plans need to be taken into consideration as global regulators adopt margin requirements for uncleared swaps. The Global Pension Coalition is grateful that the international regulators are seeking to coordinate their margin standards for uncleared swaps because it strongly believes that consistent international regulation of derivatives margining is essential to smooth and efficient markets. Accordingly, we support the CFTC's action in considering additional public comments regarding the Consultative Document.

We favor several Elements set forth in the Consultative Document over the CFTC's and Prudential Regulator's original proposals. First, we agree that when margin is required it should be a two-way obligation. Second, we believe as set forth in the Consultative Document that the type of permitted collateral for uncleared swaps should be broad enough to ensure that there is sufficient eligible collateral available to market participants. We also strongly support the principles of collateral protection set forth in the Consultative Document and believe that buy-side clients should be offered the option to segregate collateral by pledging such collateral through a third-party custodian of their choosing subject to arrangements that fully protect the posting party if their counterparty enters bankruptcy.

However, the Consultative Document lacks clarity in several important areas, such as what types of entities would be subject to uncleared margin requirements. We do not support the notion that all "financial entities" should be subject to margin requirements. As discussed below, we respectfully submit that pension plans should be excluded from any uncleared swap margin requirements. Consistent with prior comments to the CFTC and Prudential Regulators,³ we are also recommending changes to the specifications for calculating initial margin.

At the outset, we believe that it would be useful to market participants if the CFTC and Prudential Regulators inform the public whether they support the framework in the Consultative Document and whether they intend to follow the approach ultimately settled on by the Working Group. Although the CFTC and Prudential Regulators have a significant representation in the Working Group, neither the CFTC nor the Prudential Regulators have provided any indication to date on whether they agree with the Consultative Document's suggested framework, which differs in many important respects from the U.S. Proposed Rules. Given the importance of these rules to pension plans and other market participants, once the Working Group issues its ultimate recommendation, the Global Pension Coalition strongly encourages the CFTC and Prudential Regulators to repropose their rules to incorporate the appropriate aspects of the final BCBS/IOSCO approach, as outlined below.

SUMMARY

³ *E.g.*, Comment Letter filed by CIEBA and the Council, dated July 11, 2011 (<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47786&SearchText=>).

We support the CFTC's and Prudential Regulators' goals of protecting the financial system from systemic risk. Imposing margin requirements, particularly on riskier counterparties, will help toward achieving that goal. However, requiring initial margin of highly regulated, highly creditworthy, low leveraged and prudently managed counterparties such as pension plans, which use swaps primarily for hedging, will unnecessarily increase the cost of hedging for pension plans without providing a meaningful benefit to the stability of the US financial system. In fact, if such margin requirements result in pension plans exiting or reducing their participation in the derivatives markets, we would advance the argument that such margin requirements could actually increase systemic risk.

We believe that, under a risk-based approach to initial margin, as indicated by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"),⁴ the CFTC and Prudential Regulators should conclude that pension plans present virtually no risk to dealers and should not be required to post initial margin with respect to uncleared swaps. Unnecessary margin requirements may leave market participants with few options and effectively preclude them from hedging and mitigating risks, such as the funding risk for a pension plan.

The Consultative Document suggests a general framework consisting of seven concepts (referred to as "Elements") to be addressed in uncleared margin rules to be proposed later by the Working Group. The framework addresses, very generally, the following topics and provides some conceptual discussion of each:

- Which transactions should be subject to margin requirements
- What types of entities should be subject to margin requirements
- Methods for calculating initial and variation margin
- Types of acceptable collateral
- Protection of collateral collected as initial margin
- Treatment of inter-affiliate transactions⁵
- Interaction of national regimes in cross-border transactions

These issues are of great importance to our members, to the workers and retirees relying on pension plans, and to the economy. We look forward to working with the CFTC and Prudential Regulators to ensure that the new rules strengthen financial regulations in a manner that enhances retirement security. It is critical that the new rules not be developed in a way that weakens such security.

1. The CFTC And Prudential Regulators Should Re-Propose Their Uncleared Margin Rules Consistent With The Working Group's Final Rules And Must Allow

⁴ Dodd-Frank §§ 731 and 764.

⁵ We are not providing any comments on Element 6 at this time.

Market Participants To Comment On The Working Group's Quantitative Impact Study

The Global Pension Coalition appreciates the CFTC's recognition that it ought to solicit public input on a revised, international approach to uncleared margin. We encourage the Prudential Regulators to do the same. However, we believe that the CFTC and the Prudential Regulators should allow market participants to comment on the Working Group's Quantitative Impact Study and should repropose their uncleared margin rules consistent with the Working Group's final proposal.

The Consultative Document provides only a framework for uncleared swap margin requirements. "Importantly, the framework discussed in [the Consultative Document] does not represent a final proposal."⁶ The Consultative Document is very preliminary; it is the functional equivalent of an Advance Notice of Proposed Rulemaking.⁷ There is little doubt that the Consultative Document will be followed by a proposal that incorporates the knowledge that the Working Group gathers from the comments on the Consultative Document. Market participants deserve an opportunity to comment on the final rule proposal ultimately settled on by the Working Group.

Indeed, the Working Group intends to conduct a Quantitative Impact Study that will inform its final proposal. The Working Group believes the study "will provide incremental information that will be informative and useful for balancing the need to impose margin requirements to reduce systemic risks and promote central clearing against the liquidity costs stemming from these requirements."⁸ It is essential not only that the CFTC and Prudential Regulators consider the Quantitative Impact Study in their rulemaking, but also that the public be afforded the opportunity to comment on the study. Absent this critical information, the regulators cannot fully analyze the costs and benefits of either the Working Group's proposal or the U.S. Proposed Rules, and market participants' ability to provide meaningful input into the rulemaking process will be limited.

Moreover, the CFTC and Prudential Regulators have not stated whether they endorse all or part (or any) of the Consultative Document. The Consultative Document suggests distinctly different approaches from the U.S. Proposed Rules in many critical areas, as discussed in the remainder of this letter. We generally support the approach outlined in the Consultative Document that international regulations on uncleared swap margin must be consistent across jurisdictions. We also understand that the representatives from the CFTC, Board, FDIC and OCC that are part of the Working Group were also some of the lead individuals responsible for developing the U.S. Proposed Rules. It therefore is reasonable to assume that the CFTC and Prudential Regulators might adopt at least some of the Working Group's approach. If so, it can be expected that the differences from the U.S. Proposed Rules will be sufficient to require a

⁶ Consultative Document, p. 5.

⁷ Administrative Procedures Act, 5 U.S.C. § 553 (2011).

⁸ Consultative Document, p. 31.

re-proposal by both the CFTC and Prudential Regulators as well as consideration of additional public comments on the final proposal.

2. Scope Of Coverage

a. Element 1⁹ – Extending Uncleared Margin Requirements To All Uncleared Derivatives Is Inconsistent With Dodd-Frank’s Risk-Based Mandate

The key principle for Element 1 is that “[a]ppropriate margining practices should be in place with respect to all derivative transactions that are not cleared by CCPs.”¹⁰ The proposed requirement is that the margin requirements would apply to all uncleared swaps.¹¹

Although we do not disagree that market participants should have credit support agreements, margin should not be required in all cases. Both the CFTC’s and Prudential Regulators’ proposals would require all market participants to have credit support arrangements, but would not require margin in every case. Consistent with Dodd-Frank’s mandate, uncleared margin requirements should be risk-based and should not be imposed on all uncleared swaps. As discussed in more detail below, we believe that pension plans should be excluded from uncleared margin requirements under a risk-based approach.

This type of risk-based approach is consistent with the treatment of pension plans’ swap activities in Europe. At the European level, a (temporary) exemption from mandatory clearing requirements of swaps has been included in the European Markets Infrastructure Regulation (“EMIR”).¹² This exemption ensures that pension scheme arrangements, as defined therein, can continue to hedge their risks without a disproportionate impact on costs as long as no solution has been found to post variation margin in a form other than cash. In addition, the credit valuation adjustment charge that will be imposed on banks for bilateral uncleared derivatives trades will not apply to trades between banks and pension scheme arrangements during the period of the abovementioned exemption. With this exception, European lawmakers have recognized the creditworthiness of pension scheme arrangements and have made it clear that the positive effect from the EMIR clearing exemption should not be negated by capital

⁹ The Consultative Document is organized by Elements 1-7. Each Element sets out a “key principle” accompanied by a “proposed requirement” describing how the key principle would be implemented. The Consultative Document also asks a number of specific questions, some of which we specifically address.

¹⁰ Consultative Document, p. 7.

¹¹ *Id.*

¹² Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July, 2012 on OTC derivatives, central counterparties and trade repositories. In this letter, where reference is made to such exemption, or alternatives thereto, “pension plans” should be read to mean “pension scheme arrangements” as defined in EMIR Article 372a of the proposed Capital Requirement Regulation (the European implementation of Basel III). “Pension scheme arrangements” within the meaning of EMIR includes not only pension plans, but also legal entities set up for the purpose of investment of such institutions (acting solely and exclusively in the interest of the pension plan).

charges for banks. It is for these same reasons that no margin requirements should be imposed on pension plans for uncleared swaps.

b. Element 2 – Pension Plans Should Not Be Treated The Same As Other, Much Riskier “Financial Entities”

Element 2 sets forth a key principle that “financial firms and systemically-important non-financial entities” should “exchange initial and variation margin as appropriate to the risks posed by such transactions.”¹³ The proposed requirement adds that margin should be exchanged in “minimum mandatory amounts,” which is apparently intended to mean that swap dealers cannot extend credit to their counterparties “for the sole purpose of funding initial margin requirements.”¹⁴ Thus, Element 2 suggests that margin requirements should be risk-based and should apply to “financial firms,” a term that is not defined. We agree that uncleared margin requirements should be risk-based and believe such an approach results in pension plans not being required to post initial margin because they are highly regulated, highly creditworthy, low leveraged and prudently managed counterparties that use swaps primarily for hedging.

Pension Plans Should Not Be Subject To Margin Requirements

The Consultative Document would apply uncleared margin requirements to “financial firms.” Although that term is not defined, the ordinary meaning of the term “financial firm” (at least prior to Dodd-Frank) would mean banks and other large firms with a financial business, such as hedge funds and mutual funds, but not pension funds. To the extent BCBS and IOSCO intend the term “financial firm” to include pension plans, we think such a broad approach is not consistent with a risk-based standard. As noted above, financial firms typically use derivatives and take risks to enhance their financial position vis a vis their competitors (e.g., share price). These type of counterparties’ derivative activities typically add to systemic risk. Pension plans exist solely to provide retirement security for pensioners and utilize derivatives primarily to hedge risks that could jeopardize such retirement security.

Question 12 in the Consultative document asks whether there are “specific exemptions that would not compromise the goal of reducing systemic risk and promoting central clearing that should be considered.”¹⁵ We believe that an exemption for pension plans from initial margin requirements on uncleared swaps is the kind of exemption that will not compromise those goals. Pension plans are highly regulated, highly creditworthy, low leveraged and prudently managed counterparties that use swaps primarily for hedging. Pension plans are exactly the type of counterparties whose swap activity does not increase systemic risks. In fact, pension plans’ derivative activities can be viewed as reducing systemic risk because they are perhaps the safest of counterparties, providing a stabilizing force to the markets and prudent diversification for dealers. Notably,

¹³ Consultative Document, p. 14.

¹⁴ Consultative Document, p. 14, n. 9.

¹⁵ Consultative Document, p. 16.

recognizing the soundness of pension plans, European regulators have determined to exempt pension plans from mandatory clearing requirements to avoid a disproportionate cost impact.¹⁶ Further, no capital charges will be imposed on banks for their uncleared derivatives trades with pension scheme arrangements.¹⁷

In fact, not requiring initial margin from pension plans would be consistent with current practice in OTC markets. Dealers rarely, if ever, require pension plans to post an independent amount (*i.e.* initial margin) to transact in the OTC markets. Dealers, clearly in the best position to conduct the extensive credit analysis needed to protect themselves against a client default, have determined that pension plans are low-risk counterparties that do not pose material default risk.¹⁸

Further, exempting pension plans from uncleared swap margin requirements will not compromise the goal of promoting central clearing. The intent of promoting central clearing is to reduce systemic risk by mitigating exposure to risky counterparties for standardized products. However, not all swaps will be clearable. In fact, for some period of time, *many* swaps will not be clearable.

Some pension plans have obligations that can only be effectively hedged with customized transactions that are not clearable. Thus, onerous margin requirements will impede the ability of such pension plans to hedge their liabilities. The margin levels currently proposed by the CFTC and the Prudential Regulators will increase costs and ultimately reduce long term returns for pension plans. The inability to effectively hedge pension liabilities in a cost effective manner because of the margin imposed on uncleared swaps could be added to the list of reasons for the current trend toward plan sponsors terminating defined benefit pension plans and shifting investment risk back to individuals. We do not believe the result of the uncleared margin proposals should be to take away the ability of pension plans to cost-effectively use customized hedges for plan liabilities.

Alternatively, Pension Plans Should Be Permitted Unlimited Initial Margin Thresholds

Much of the discussion of Element 2 focuses on initial margin thresholds and various ways thresholds could be used. We support the notion that thresholds should be permitted to reflect the risks posed by specific counterparties. As noted above, we strongly believe that pension plans should be completely exempt from initial margin

¹⁶ Article 89 of Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July, 2012 on OTC derivatives, central counterparties and trade repositories.

¹⁷ Article 37a of the proposed Capital Requirements Regulation, the European implementation of Basel III, that states that the credit valuation adjustment charge should not be applied to transactions with pension scheme arrangements as defined in EMIR.

¹⁸ Exhibit A summarizes the key reasons that U.S.-regulated ERISA plans present virtually no counterparty risk. Exhibit B summarizes the key reasons that Canadian pension plans present virtually no counterparty risk. Exhibit C summarizes the key reasons that pension plans established in Europe Union member states present virtually no counterparty risk.

requirements for uncleared swaps. However, if pension plans are subject to uncleared swap initial margin requirements, dealers should be able to provide initial margin thresholds for pension plans.¹⁹ Further, the rules should not provide arbitrary maximum limits on thresholds; dealers should be permitted to make a case-by-case determination.

Although not entirely clear, the Consultative Document seems to suggest that only prudentially-regulated entities should be permitted initial margin thresholds. Such an approach would be similar to that in the U.S. Proposed Rules. Similar treatment should be extended to pension plans, because funding requirements imposed on pension plans²⁰ are comparable to prudential capital requirements and pension plans must be prudently managed and diversified. If the regulators limit the availability of initial margin thresholds, pension plans should be treated the same as or better than entities that are subject to prudential regulation.

c. Element 2 – If Pension Plans Are Treated As “Financial Entities,” Uncleared Margin Should Be A Two-Way Obligation

Element 2 would require both parties to a swap to post initial margin to one another (*i.e.*, two-way margin). If pension plans are subject to uncleared swap margin requirements, initial and variation margin should be a two-way requirement. Because of their fiduciary responsibilities, funding obligations, and the importance of their mission, pension plans are particularly sensitive to counterparty risk. As evidenced by the 2008 financial crisis and the recent MF Global and Peregrine episodes, dealers pose significantly more counterparty risk to pension plans than pension plans do to dealers. To the extent that pension plans are required to post initial margin, we support the notion that dealers also should be required to post equivalent initial margin if requested by a pension plan. Accordingly, if pension plans are not completely exempted from uncleared margin rules, as we believe they should be, the U.S. Proposed Rules should adopt the Element 2 approach of requiring both parties to a swap to post initial margin to each other.

3. Calculating And Collecting Initial Margin

a. Element 3 – Requirements For Initial Margin Models Should Be Revised

Element 3 sets forth requirements for models used to calculate initial margin. The key principle and proposed requirement are lengthy, but, overall, the requirements would

¹⁹ If pension plans were subject to initial margin requirements, some members of the Global Pension Coalition would advocate that regulators establish predetermined, high thresholds for pension plans to prevent banks from lowering thresholds simply because they desire to have additional capital for reasons unrelated to any risk of a pension plan counterparty.

²⁰ For example, in the U.S., ERISA plans are subject to stringent funding requirements pursuant to the Pension Protection Act of 2006. Canadian and European pension plans are similarly subject to stringent funding requirements.

be similar to those in the U.S. Proposed Rules.²¹ Specifically, the Consultative Document would require initial margin models to set initial margin to reflect extreme but plausible potential changes consistent with a one-tailed 99-percent confidence interval over a 10-day liquidation period. Notably, the Consultative Document does not provide any explanation for requiring a 10-day liquidation period to calculate initial margin. The Consultative Document would also require initial margin models to be approved by the dealer's prudential regulator.

We believe a 10-day liquidation period substantially overstates the risk of many uncleared swaps and will create unnecessarily high initial margin requirements, particularly since models must use a 99-percent confidence interval and be calibrated to a period of financial stress.²² Element 3, and the U.S. Proposed Rules, should instead require a 3 to 5 day liquidation period in initial margin models, which is sufficient to allow close-out, offset or other risk mitigation for uncleared swaps.

In addition, Element 3 would only permit initial margin models to account for diversification, hedging or risk offsets within the same asset class and covered by a single master netting agreement. We believe that initial margin models should permit risk offsets across instruments and asset classes. Common trading practices recognize the risk-reducing relationship between cash positions and derivatives on related underliers or a combination of derivative types, each targeting a different component of the individual risks presented by the cash position. The calculation of initial margin should give full recognition to the risk mitigating benefits arising from related trades across derivatives risk categories as well as across related derivatives and cash positions.

Further, Element 3 would require that initial margin models be approved by a relevant supervisory authority. Although we agree that initial margin models must be approved by the relevant regulator, initial margin models and calculations should be consistent with commonly accepted market practices and dealers should be required to disclose the methodologies, inputs and key assumptions underlying such calculations. Accordingly, the information above pertaining to initial margin models should be available for review by end-user counterparties such as pension plans upon request.²³ At more than \$700 trillion notional value, the size and importance of the swaps market makes transparency critical. In addition, if, as proposed, the CFTC permits dealers and major swap participants to use internal margin models available for licensing by registered Derivatives Clearing Organizations or third-party vendors, those initial margin models should also be open for review by market participants.

²¹ See Consultative Document, pp. 16-21.

²² See Consultative Document, p. 17.

²³ Recent incidents involving large multi-national banks, such as the London Interbank Offered Rate scandal highlight the need for transparency. See, e.g., *In re Barclays PLC*, CFTC Docket No. 12-25 (June 27, 2012).

b. Element 3 – The Initial Margin Look-Up Table Is An Appropriate Alternative To An Initial Margin Model

Element 3 provides an alternative method for calculating initial margin that uses a look-up table based upon the notional value of a swap.²⁴ The look-up table is similar to that proposed by the Prudential Regulators, but contrasts with the CFTC’s proposed alternative method that would set initial margin as a multiple of the initial margin required for a similar futures contract or cleared swap. We believe that the look-up table is a far better approach than the CFTC’s proposal, which would far overstate the risks of many uncleared swaps and be unworkable because dealers will have a difficult identifying a “similar” futures contract or cleared swap.²⁵

We also support that dealers “should not be allowed to switch between model- and schedule-based margin calculations in an effort to ‘cherry pick’ the most favourable initial margin terms.”²⁶ Dealers should be required to take a consistent approach over time.

c. Element 3 –Parties Should Be Permitted a Commercially Reasonable Time After Executing a Swap Before Posting Initial and Variation Margin

Element 3 provides that “[i]nitial margin should be collected at the outset of a transaction.”²⁷ This appears consistent with the U.S. Proposed Rules that would require dealers to collect initial margin “on or before the date it enters into” a swap and collect variation margin on the date it enters into the swap.²⁸ This collection timeframe is too aggressive and will lead to significant operational disruptions, errors and costs as a result of industry-wide collateral operational limitations. Any standard that requires dealers to collect margin “on or before the date it enters into” a swap cannot even be effectuated in a simpler, highly mature derivatives marketplace such as futures markets. Initial margin is never called by a dealer until T+1.

Pension plans, like other parties, need a commercially reasonable time to operationally move money to a new counterparty or a new third party custodian. Under all proposed approaches, a pension plan may have to establish new arrangements with new counterparties or custodians and set aside collateral several days before the plan even knows with certainty that the swap will be executed. This will tie up funds that otherwise could be used to generate income for retirees. We suggest that the regulators permit a commercially reasonable time of two local business days after entering into a swap before requiring initial margin to be posted. For the same reasons, we also suggest

²⁴ See Consultative Document, pp. 18-19, App. A.

²⁵ As a general matter, a main reason that an uncleared swap will not be cleared is because it is not similar to any cleared product.

²⁶ Consultative Document, p. 19.

²⁷ *Id.*

²⁸ *E.g.*, Prudential Regulators Proposed Rules §§ __.3(b) and __.4(a).

that parties not be required to make variation margin calls until the local business day after the swap is executed and not be required to post variation margin until two local business days after the swap is entered into.

4. Element 4 – The Definition Of Eligible Collateral Is Appropriately Broad

Element 4 would define eligible collateral and provide other guidelines regarding haircuts and diversification.²⁹ The Consultative Document lists as eligible collateral cash, high quality government and central bank securities, high quality corporate bonds, high quality covered bonds, equities included in major stock indices, and gold. Although the list in the Consultative Document is not intended to be exclusive, we recommend adding to the list interests in money market mutual funds and certificates of deposit.

The U.S. Proposed Rules as proposed would only permit cash, U.S. Treasuries, and, for initial margin only, senior debt obligations of certain government-sponsored entities (“GSE”). Rather than limiting eligible collateral to those few instruments, we strongly favor the approach in the Consultative Document of expanding the types of permitted collateral. We believe the types of permitted collateral should be broad enough to ensure that there is sufficient eligible collateral available to all market participants. We are also concerned that the U.S. Proposed Rules ultimately would decrease diversification in pension plans’ investment portfolios and could serve to increase overall funding risks. The restriction of non-cash collateral to US Treasuries and senior GSE debt, as set forth in the U.S. Proposed Rules, could unnecessarily force pension plans to hold a greater percentage of such instruments than might otherwise be prudent. The U.S. Proposed Rules’ restrictions on eligible collateral may also conflict with pension laws in certain jurisdictions that limit the amount of exposure that a pension plan can have to a particular issuer or asset. For example, Canadian law imposes on pension plans a 10 percent concentration limit for each issuer, including U.S. Treasury securities.

5. Element 5 – Collateral Should Be Held By A Third Party Custodian, Be Bankruptcy Remote From A Defaulting Counterparty, And Not Be Rehypothecated Or Reused

Element 5 would require parties to exchange gross margin and sets out three principles for uncleared swaps: 1) initial margin must be individually segregated; 2) initial margin should be held in a way that fully protects the posting party from the bankruptcy of a defaulting counterparty; and 3) collateral cannot be rehypothecated or reused.³⁰ We strongly support these margin protecting principles, if requested by a client, and also recommend that such protections be expanded to variation margin.

The Consultative Document makes clear that existing collateral protections available in over-the-counter swap markets should not go away. These existing protections include segregation of both initial and variation margin with a third party

²⁹ See Consultative Document, p. 22.

³⁰ See Consultative Document, p. 25.

custodian and restrictions on rehypothecation and reuse of collateral. These types of collateral arrangements protect investors, reduce systemic risk, and aid regulators in overseeing the liquidation of a dealer because collateral can be identified faster and with greater certainty in a dealer bankruptcy.³¹ The benefits of these arrangements have been recognized by the European Union in its rules for cleared swaps that require central clearing parties and clearing members to offer segregation of margin to their customers.³² The Consultative Document is also consistent with provisions in Dodd-Frank that provides non-dealer counterparties the option to elect to have their initial margin held by a third-party custodian.³³

7. Element 7 – International Rules Must Be Consistent

Element 7 proposes a framework whereby entities would only be subject to margin requirements of their home jurisdiction and market participants would not be subject to duplicative requirements where margin requirements between jurisdictions are comparable.³⁴ We believe this proposed Element highlights the importance of consistent international regulation to avoid flight to the most appealing jurisdiction. However, only the uncleared margin rules of the jurisdiction where a transaction occurs should apply. If international regulations are consistent, applying the law of a single jurisdiction will greatly reduce pension plans' compliance burden and, accordingly, transaction costs. We also believe that pension plans should be able to avail themselves of the best protections that exist globally and should not be limited by the rules of their home jurisdiction where those rules provide less protection than another jurisdiction. For example, if a U.S. pension plan desires to avail itself of collateral protections that are offered only in Europe and enters in a transaction in Europe with a counterparty to avail itself of such protections, local regulation should prevail and the U.S. pension plan should not lose such protections solely because they are not offered in the U.S.

8. Uncleared Margin Rules Should Only Take Effect After The Clearing System Is In Place And Initial Margin Models Have Been Approved

³¹ The SEC also notes that requiring segregation with a third-party custodian “may impose a disproportionate impact on U.S. SEC-registered broker-dealers in comparison to banks, as a result of the differences in regulatory capital treatment of the initial margin deposited with third party custodians.” Consultative Document, p. 26. We believe that uncleared margin requirements must be designed to protect the counterparties to a transaction. If broker-dealers are disadvantaged relative to banks, then the SEC should consider other relief for its broker-dealers. It would not be appropriate to attempt to mitigate such disproportionate impact at the expense of the very market participants that the uncleared margin rules are designed to protect.

³² Regulation (EU) No 648/2012 of the European Parliament of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, Article 39.

³³ Dodd-Frank §§ 724 and 764.

³⁴ See Consultative Document, pp. 28-30.

Question 1 in the Consultative Document asks what would be an appropriate phase-in period for uncleared margin requirements.³⁵ The framework in the Consultative Document will create higher initial margin requirements for uncleared swaps than those applicable for cleared swaps, particularly where initial margin is not calculated using an initial margin model. It will take some time for the clearing requirements to be implemented. If uncleared swap margin requirements take effect before the clearing infrastructure is in place, pension plans will have no option but to pay the higher margin requirements under the uncleared swap rules until cleared swaps are available. Similarly, if the uncleared swap margin rules take effect before initial margin models are approved, which timeframe is highly uncertain given the various regulators' resource constraints, pension plans will be forced to post initial margin in accordance with the look-up table, which is expected to impose higher margin requirements than initial margin models.

We recommend that implementation of the uncleared margin rules be delayed to coordinate with the clearing system and the approval of internal margin models. We also ask that the Agencies phase in the uncleared swap margin rules to permit market participants to time to put in place the necessary arrangements once the rules are final. We suggest, at a minimum, a delay of at least 180 days after the clearing rules take effect before uncleared margin rules take effect. Our strong hope, however, is that the global regulators will exempt pension plans from initial margin requirements for uncleared swaps for the reasons stated herein.

* * * *

We appreciate your consideration of our views.

American Benefits Council
Committee on Investment of Employee Benefit Assets
European Federation for Retirement Provision
The Multi-Employer Council of Canada
The National Coordinating Committee for Multiemployer Plans
The Pension Investment Association of Canada

³⁵ Consultative Document, p. 5.

EXHIBIT A

Below is a summary of some of the key reasons U.S.-regulated ERISA plans present virtually no counterparty risk.

- ERISA plans are required to be prudently diversified. In entering into swaps for plans, ERISA requires that plan fiduciaries act solely in the interest of the plan’s participants and beneficiaries and with the care, skill, prudence, and diligence that a prudent person familiar with such matters would use.³⁶
- “Investment managers” for ERISA plans are required to be regulated entities (registered investment advisers, banks, or insurance companies) that are (1) subject to the highest standard of care under US law, (2) liable for significant financial penalties for failure to comply with relevant provisions of ERISA, and (3) liable in many instances for the acts of other fiduciaries.³⁷
- ERISA plan assets are required to be held in trust for future payment, subject to the oversight of a trustee which is typically a US regulated bank.³⁸
- Because of the regulatory structure that applies to ERISA plans, ERISA plans typically have minimal leverage (if at all).
- ERISA plans are subject to stringent funding requirements pursuant to the Pension Protection Act of 2006.
- ERISA plans are financially transparent; they typically have third-party custodians report their net asset value to dealers on a monthly basis and are required by law to report their holdings annually to the Department of Labor.³⁹
- ERISA plans are not operating entities subject to business-line risks and competitive challenges.
- There is no provision under any law for ERISA plans to file for bankruptcy or reorganization to avoid their financial obligations to counterparties. Even the filing of bankruptcy by an ERISA plan sponsor or the involuntary termination of the plan does not relieve a plan of its financial obligations to counterparties.
- ERISA plans are typically (and correctly) not treated the same as unregulated investment entities in CFTC regulations. For example, Rule 4.5 excludes certain ERISA plans from the definition of a “commodity pool” and operators of most ERISA plans from the definition of “commodity pool operator.” The CFTC has relied on ERISA’s “pervasive” regulation of plans and plan fiduciaries as a reason

³⁶ ERISA section 404(a)(1)(B).

³⁷ ERISA sections 3(38) (investment manager requirements), 404(a) (fiduciary standards), 405 (co-fiduciary liability), 409 (fiduciary liability), 502 (ERISA enforcement).

³⁸ ERISA section 403(a).

³⁹ See Form 5500.

it does not need to regulate these plans.⁴⁰ Similarly, pension trusts are exempt from registration as “investment companies” with the SEC.⁴¹

- Based on a survey of over a dozen major dealers by one of our members, ERISA plans have in all cases met their swap obligations to dealers despite the bankruptcy of Fortune 500 plan sponsors, the market crash of 2008, and every other significant financial event since the adoption of ERISA in 1974.

⁴⁰ See Commodity Pool Operators; Exclusion for Certain Otherwise Regulated Persons From the Definition of the Term “Commodity Pool Operator,” Final Rules, 50 Fed. Reg. 15,868, 15,869 and 15,873 (1985); 58 Fed. Reg. 6,371, 6,373 (1993).

⁴¹ Section 3(c)(11) of the Investment Company Act of 1940 (“Investment Company Act”).

EXHIBIT B

Below is a summary of some of the key reasons Canadian plans present virtually no counterparty risk. Note that Canadian pension funds may be regulated by provincial or federal laws and regulations so certain of the factors below may not apply to all pension plans.

- Pension plans are subject to a prudent portfolio investment standard. For example, the administrators of pension plans subject to the laws of Ontario are required to "exercise the care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person."⁴² In doing so, the administrator must use all relevant knowledge and skill that it possesses, or ought to possess, in the administration and investment of the pension fund.⁴³
- Pension plans are subject to investment restrictions, concentration limits and other restrictions mandated by law.
- Pension plans must establish and file with the appropriate regulators a detailed statement of investment policies and procedures, including with respect to the use of derivatives, options and futures.⁴⁴ Such document outlines the plans expectations with respect to diversification, asset mix, expected returns and other factors.
- Administrators of pension funds are subject to strict prohibitions concerning conflicts of interest. Similar prohibitions are also imposed on employees and agents of the administrator.⁴⁵
- Pension plans are generally prohibited from borrowing.⁴⁶
- The assets of pension plans are held in trust by licensed trust companies or other financial institutions and are separate from the assets of their sponsors.
- Funding shortfalls may be funded by the pension plan's corporate or government sponsor, by increasing contributions of pensioners or by lowering benefit payments, depending on the nature of the plan.
- Pension plans must regularly file an actuarial valuation with the appropriate regulators.

⁴² *E.g.*, Pension Benefits Act, RSO 1990, c P.8 ("PBA"), s 22(1).

⁴³ *E.g.*, PBA s 22(2).

⁴⁴ Pension Benefits Standards Regulations, 1985, SOR/87-19, s 7.1.

⁴⁵ *E.g.*, PBA ss22(4) and 22(8).

⁴⁶ Income Tax Regulations, CRC c 945, s 8502(i).

- Pension plans are transparent to members and regulators. Provincial legislation requires that pension plans file a detailed annual financial statement accompanied by an auditor's report.⁴⁷
- Pension plans are not operating entities subject to business-line risks and competitive challenges.
- The governance of Canadian pension plans is subject to statutory requirements and guided by best practices.
- There is no provision under any Canadian law for pension plans to file for bankruptcy or reorganization to avoid their financial obligations to counterparties or other creditors. Additionally, the voluntary termination of a plan does not relieve the plan of its financial obligations.

⁴⁷ *E.g.*, Pension Benefits Act, RRO 1990, Reg 909, s 76. In addition, an auditor's report is required for pension plans with \$3 million or more in assets.

EXHIBIT C

Below is a summary of some of the key reasons pension plans established in a European Union member state present virtually no counterparty risk.

European pension funds are subject to regulation and extensive regulatory oversight, including the IORP Directive⁴⁸ and the national Pension acts. Article 18 of the IORP Directive imposes broad investment regulations on pension plans that are intended to assure the security and affordability of occupational pensions. These regulations are designed to enable pension plans to meet their obligations to beneficiaries and creditors.

European pension funds are also subject to an extensive set of rules regarding their solvency and liability coverage ratio. The regulatory framework ensures that pension funds' coverage ratios do not fall below certain minimum levels. European pension plans are therefore conservatively managed and very creditworthy. European pension funds are constrained by regulation to use swaps solely for risk management purposes. Article 18(d) of the European IORP Directive 3 restricts pension funds from using OTC derivatives for any purpose other than to manage risks associated with their long-term liabilities.

European pension funds are users of long dated interest rate and currency and inflation swaps for purposes of limiting investment risk. Their liabilities (*i.e.*, the pension cash flows) are hedged against inflation and interest rate risks, to offer protection for - ultimately the pension beneficiaries. Pension funds do not speculate with derivatives. They even are not allowed to do so under on Article 18d of the IORP Directive (2003/41/EC) that requires that pension funds may only use derivatives for risk mitigation purposes.

The policy of pension funds is usually determined by a board of trustees, consisting of an equal representation of employers and employees. Pension funds are structured as foundations or similar entities, with key characteristics being that these are not-for-profit and independent entities, without shareholders. Mandatory participation typically is an inherent feature of many pension funds in EU countries. This implies that an employer, or a group of employers, has the requirement to offer a pension scheme to its employees. For employees, participation in such a pension scheme is compulsory. This compulsory system for pension funds works on the basis of solidarity and risk sharing among participants. Any return on investment will be to the sole benefit of the future pensioners.

Due to the compulsory nature of pension funds in combination with their conservative long-term investment strategy, the theoretical risk of a bankruptcy of a pension funds is very remote. The pension fund can mitigate such risk, for instance, by (i)

⁴⁸ Directive 2003/41/EC, Jun. 3, 2003, on the activities and supervision of the institutions for occupational retirement provision, OJL 235, 23/9/2003, (<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:235:0010:0021:EN:PDF>).

increasing the premiums (ii) no indexation and/or (iii) decreasing payments to the pensioners.

In addition, national rules and regulations will often provide for an extensive set of rules in relation to pension funds investments to avoid that the coverage ratio of pension funds will fall below certain minimum levels. Pension funds are stable long term investors with a high degree of solidarity offering a low-priced product for the pensioners, which are:

- highly creditworthy;
- highly regulated;
- low leveraged; and
- very prudently managed.

Pension funds, as well as the authorised entities responsible for managing such institutions and/or set up for the purpose of investment thereof, present virtually no counterparty risk.