

**MEMO# 31989**

October 1, 2019

# **FDIC Proposes Amendments to Margin and Capital Requirements for Covered Swap Entities**

[31989]

October 1, 2019 TO: Derivatives Markets Advisory Committee

ICI Global Trading & Markets Committee

Securities Operations Advisory Committee RE: FDIC Proposes Amendments to Margin and Capital Requirements for Covered Swap Entities

The Federal Deposit Insurance Corporation (FDIC) recently approved a proposal that would amend its rules on margin and capital requirements for covered swap entities.[\[1\]](#) The proposal is a joint rulemaking by regulators including, in addition to the FDIC, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Farm Credit Administration, and the Federal Housing Finance Agency (together with the FDIC, “prudential regulators”).[\[2\]](#) The proposal, which is summarized briefly below, addresses several key issues regarding the application of the prudential regulators’ swap margin rules (“swap margin rules”),[\[3\]](#) including: (i) amending the rules’ implementation requirements consistent with July revisions by the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) to the global framework on margin requirements for non-centrally cleared derivatives; (ii) not subjecting legacy swaps to margin requirements based on amendments to address LIBOR transition or amendments for certain lifecycle events; and (iii) removing the rules’ requirement that affiliates exchange initial margin.[\[4\]](#) CFTC Chairman Heath Tarbert has recommended that the CFTC propose similar amendments to its margin rules for uncleared swaps.[\[5\]](#)

## **Background**

In July, BCBS and IOSCO revised the global framework on margin requirements for non-centrally cleared derivatives to delay the final implementation date by one year.[\[6\]](#) This would result in covered entities with an aggregate average notional amount (AANA) of uncleared swaps greater than €8 billion being subject to initial margin requirements on September 1, 2021, rather than September 1, 2020. To facilitate this extension, BCBS and IOSCO added an additional implementation phase whereby as of September 1, 2020 covered entities with an AANA of uncleared swaps greater than €50 billion will be subject to initial margin requirements. In March, BCBS and IOSCO published a statement clarifying that the global framework does not specify documentation, custodial, or operational requirements if a covered entity’s bilateral initial margin amount does not exceed the

framework's €50 million initial margin threshold.<sup>[7]</sup> That statement also provided that amendments to legacy swaps made solely for the purpose of addressing interest rate benchmark reform do not require the application of margin requirements, although BCBS and IOSCO noted that the position may be different under relevant implementing laws.

## **Compliance Date and Documentation Requirements**

Consistent with the recent revisions to the BCBS/IOSCO margin framework, the proposal would amend the swap margin rules to give covered swap entities an additional year to implement initial margin requirements for smaller counterparties. The prudential regulators propose to amend the rules' compliance schedule to add a sixth compliance phase for some of the entities that currently are subject to the "phase five" compliance deadline. The proposed amendments would require compliance by September 1, 2020 for counterparties with an AANA of \$50 billion-\$750 billion and extend the compliance date for remaining counterparties (AANA of \$8 billion-\$50 billion) to September 1, 2021.

The prudential regulators also propose to amend their rules to clarify that a covered swap entity is not required to execute initial margin trading documentation with a counterparty prior to the time that it is required to collect or post initial margin under the rules. The agencies note, however, that they expect covered swap entities to closely monitor their exposures and take appropriate steps to ensure that trading documentation is in place when initial margin is required to be exchanged.

## **Treatment of Legacy Swaps**

Consistent with the approach taken by BCBS and IOSCO, the proposal would amend the swap margin rules to preserve the legacy status of an uncleared swap after a covered swap entity replaces certain reference rates. The proposed amendments are intended to be flexible regarding the method of amendment, including by permitting amendments accomplished by the parties: (i) adherence to a protocol; (ii) contractual amendment of an agreement or confirmation; or (iii) execution of a new contract in replacement of, and immediately upon termination of, an existing contract (i.e., a tear-up). The proposal would permit amendments to be executed with respect to an individual uncleared swap or on a netting set level, as long as the other requirements of the rules are met. The proposal specifies the type of rate that can be replaced and the types of changes that would be permitted, including the replacement of an interbank offered rate (IBOR), such as LIBOR, or any other non-IBOR interest rate that a covered swap entity reasonably expects to be discontinued or reasonably determines has lost its relevance as a reliable benchmark due to a significant impairment.

The prudential regulators contemplate that, in connection with benchmark transition, an uncleared swap may need to be amended more than once, and that other contractual changes may be necessary to maintain the economics of the swap and preserve the relative values to the parties after the reference rate change. For example, the amended rules would permit changes that incorporate spreads and other adjustments that accompany and implement the replacement rate amendment, and necessary related technical changes. The proposal clarifies, however, that to continue to be treated as a legacy swap under the rules, any amendments could not extend the maturity or increase the total effective notional amount of the uncleared swap.

The proposal also would amend the swap margin rules to preserve the legacy status of uncleared swaps that are amended or modified for logistical or risk-management purposes as part of routine industry practices over the lifecycle of the swap. The amended rules

would permit three categories of such amendments to an uncleared swap:

- Amendments to reflect technical changes, such as addresses, the identities of parties for delivery of formal notices, and other administrative or operational provisions of the uncleared swap that do not alter the uncleared swap's underlying asset or indicator, such as a security, currency, interest rate, commodity, or price index, the remaining maturity, or the total effective notional amount.[\[8\]](#)
- Subject to certain conditions, amendments solely to reduce the notional amount of the uncleared swap, without altering other terms of the original swap.[\[9\]](#)
- Amendments as part of certain portfolio compression exercises used as a risk management tool.[\[10\]](#)

## **Inter-affiliate Margin Requirements**

The proposal would amend the agencies' rules to remove the requirement that initial margin be exchanged for transactions in uncleared swaps between covered swap entities and their affiliates.[\[11\]](#) Covered swap entities would still be required to exchange variation margin with their affiliates.

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### **endnotes**

[\[1\]](#) The proposal is available at <https://www.fdic.gov/news/board/2019/2019-09-17-notice-dis-b-fr.pdf>.

[\[2\]](#) These other regulators are expected to approve the joint proposal shortly.

[\[3\]](#) The swap margin rules were adopted by the prudential regulators in 2015. The swap margin rules establish margin and capital requirements for uncleared swaps of swap dealers and major swap participants registered with the Commodity Futures Trading Commission (CFTC) and security-based swap dealers and major security-based swap participants registered with the Securities and Exchange Commission that are regulated by a prudential regulator (collectively, "covered swap entities"). Those rules' requirements apply to all of a covered swap entity's swap and security-based swap activities (referred to collectively in this memorandum as "uncleared swaps"), regardless of whether the entity has registered as a swap entity, a security-based swap entity, or both. For a summary of the swap margin rules, please see ICI Memorandum No. 29484 (Nov. 12, 2015), *available at* [https://www.ici.org/my\\_ici/memorandum/memo29484](https://www.ici.org/my_ici/memorandum/memo29484).

[\[4\]](#) Comments on the proposal are due 30 days following publication of the proposal in the *Federal Register*. At this time, ICI does not anticipate filing a comment letter. If you have comments or concerns, however, please let us know as soon as possible.

[\[5\]](#) See <https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement092419>.

[\[6\]](#) See <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD635.pdf>.

[\[7\]](#) See <https://www.bis.org/press/p190305a.htm>.

[\[8\]](#) The prudential regulators note that a change in the uncleared swap's underlying index

would not be a technical change for these purposes.

[9] The other conditions proposed are that: (i) all payment obligations attached to the total effective notional amount being eliminated as a result of the amendment are fully terminated, or (ii) all payment obligations attached to the total effective notional amount being eliminated as a result of the amendment are fully novated to a third party, which complies with the applicable margin rules for the novated portion upon the transfer.

[10] Under the proposed rules, amended swaps resulting from a compression exercise would be treated slightly differently than replacement swaps resulting from the compression exercise. If an uncleared swap is amended solely as a result of a compression exercise, the amendments could not extend the remaining maturity or increase the total effective notional amount of the uncleared swap. In addition, an uncleared swap entered into as a replacement to reflect the outcome of a compression exercise could not: (i) exceed the sum of the total effective notional amounts of all of the swaps that were submitted to the compression exercise that had the same or longer remaining maturity as the replacement swap, or (ii) exceed the longest remaining maturity of all the swaps submitted to the compression exercise.

[11] An “affiliate” generally is defined in the swap margin rules as an entity that is consolidated with the covered swap entity on an accounting basis, or is consolidated on a common basis by another entity. The proposal would supplement this definition to also include as an affiliate a company that controls, is controlled by, or is under common control with the covered swap entity through the direct or indirect exercise of controlling influence over the management or policies of the controlled company. This proposed amendment is intended to ensure that covered swap entities will not be required to exchange initial margin with unconsolidated entities that are treated as affiliates for other legal or regulatory purposes.