

**MEMO# 32474**

May 21, 2020

# **CFTC's GMAC Margin Subcommittee Issues Report on Implementation of Initial Margin Requirements for Non-Cleared Swaps**

[32474]

May 21, 2020 TO: ICI Members

ICI Global Members

Derivatives Markets Advisory Committee

ICI Global Trading & Markets Committee SUBJECTS: Compliance

Derivatives

International/Global

Investment Advisers

Trading and Markets RE: CFTC's GMAC Margin Subcommittee Issues Report on Implementation of Initial Margin Requirements for Non-Cleared Swaps

On May 19, 2020, the Global Markets Advisory Committee (GMAC) of the Commodity Futures Trading Commission held a meeting at which it approved a report issued by its Subcommittee on Margin Requirements for Non-Cleared Swaps ("Margin Subcommittee").<sup>[1]</sup> The report, entitled "Recommendations to Improve Scoping and Implementation of Initial Margin Requirements for Non-Cleared Swaps," addresses challenges to industry participants from the upcoming Phases 5 and 6 of the implementation of the initial margin requirements for non-cleared swaps and makes a series of recommendations for further consideration and action by the CFTC. The recommendations are summarized briefly below.

## **Short Term Recommendations**

The report states that these recommendations are expected to have the most beneficial impact if adopted by the CFTC prior to, or as of, the Phase 5 compliance date.

*Confirm Interpretation that a CSE Can Continue to Trade with an SMA Client in the Case of an Inadvertent Breach of the \$50M IM Threshold.* The Margin Subcommittee recommends that, as long as a covered swap entity (CSE) and a separately managed account (SMA) client<sup>[2]</sup> allocate no more than a total of the \$50M initial margin (IM) threshold amount across the SMAs, the CFTC permit a CSE to treat each SMA separately for compliance purposes. Thus, if the CSE were to inadvertently exceed \$50M in uncollateralized

regulatory IM exposure with an SMA client in the aggregate, the Margin Subcommittee requests that the CFTC confirm that an SMA could continue to trade with the CSE, if (i) the asset manager for the SMA is trading under regulatory compliant IM documentation; or (ii) the CSE and asset manager for the SMA have agreed to a regulatory IM sub-threshold and the asset manager for the SMA is trading at or below the agreed regulatory IM sub-threshold, provided that the CSE and the asset managers of the other SMAs of the SMA client are no longer continuing to trade (absent other relief) and are working to reduce the aggregate uncollateralized regulatory IM exposure of the SMA client back to \$50M or less.[\[3\]](#)

*Removal of Certain Collateral Eligibility Restrictions on Money Market Funds.* The Margin Subcommittee recommends that the CFTC eliminate restrictions in its regulations with respect to money market funds that may serve as eligible collateral for non-cleared swap transactions to permit the use of funds that engage in securities lending, securities borrowing, repurchase agreements, and reverse repurchase agreements.[\[4\]](#)

*Removal of Consolidation Requirement for Seeded Funds.* The Margin Subcommittee recommends that, consistent with the BCBS/IOSCO framework and regulations of other global jurisdictions, the CFTC provide an exemption from the consolidation of seeded funds with their sponsors (provided such sponsors do not guarantee the seeded funds' obligations) for purposes of calculating the average aggregate notional amount (AANA) and material swaps exposure threshold (MSE) during a fund's limited seeding period in order to provide a level playing field domestically and globally for these seeded funds.

*Relief Relating to IM Calculations for Small Covered Swap Entities.* The Margin Subcommittee recommends that the CFTC provide relief to small CSEs that are not approved to calculate IM using quantitative IM models to permit them to rely on the IM amounts calculated by their CSE counterparties for purposes of IM monitoring and IM exchange.

*Provide a Grace Period to Reduce Congestion and Facilitate Compliance.* The report explains that, notwithstanding best efforts and relief provided to date, many Phase 5 and Phase 6 firms will not be ready to exchange regulatory IM as of the phase-in dates. The Margin Subcommittee therefore recommends a 6-month grace period commencing from the day the regulatory IM for a relationship exceeds the IM threshold during which the parties must complete the IM documentation and operational set-ups and begin exchanging IM.

## **Longer Term Recommendations**

The report states that these recommendations are anticipated to have substantial beneficial impact if adopted by the CFTC prior to, or as of, the Phase 6 compliance date.

*Application of Separate IM Threshold to Each Separately Managed Account of an SMA Client.* The Margin Subcommittee recommends that, given the lack of transparency and coordination among SMA asset managers and the independent operation of their SMAs, the CFTC allow each SMA to be treated as a distinct entity to which a separate regulatory IM threshold will apply, thereby giving each manager much-needed certainty and control over when an SMA is at or near the IM threshold. As an alternative, the Margin Subcommittee recommends allowing an option for each CSE and SMA asset manager to agree to apply a flat IM threshold of \$10M per SMA, subject to meeting certain conditions, in light of the operational and practical difficulties of sharing the \$50M IM threshold at the SMA client level.

*Adjustments to the MSE Calculation's Timing and Methodology and the Post Phase-In Compliance Periods.* The report describes certain differences between the CFTC's and US prudential regulators' margin rules for non-cleared swaps and the global BCBS/IOSCO framework with respect to the timing and method of conducting MSE calculations and the compliance dates.<sup>[5]</sup> The Margin Subcommittee recommends that the CFTC align the timing and methodology for MSE calculations and the post phase-in compliance periods under its margin rules with global standards.

*Codification of Relief Related to Minimum Transfer Amount.* The report explains that the CFTC's regulations with respect to the minimum transfer amount (MTA) do not account for certain operational issues that may limit the ability of CSEs and their covered counterparties to use the MTA, including issues with the application of an MTA for each SMA client and the ability to split the maximum allowable MTA between distinct IM and variation margin flows. The report recommends that the CFTC amend its margin rules to codify the relief its staff issued in CFTC staff letters 17-12 and 19-25, which addressed these concerns.<sup>[6]</sup>

*Removal of Deliverable FX from MSE Calculation.* The Margin Subcommittee recommends reassessment of the market impact of including deliverable FX in the MSE calculation, particularly upon small financial end users, and recommends amendment of the CFTC's margin rules for non-cleared swaps to exclude deliverable FX from the MSE calculation. The report explains that, since deliverable FX itself does not have IM requirements, its inclusion in MSE calculations and resulting burdens on small financial end users is not warranted.

Sarah A. Bessin  
Associate General Counsel

#### **endnotes**

<sup>[1]</sup> Information about the meeting, including the report and the commissioners' statements, is available at <https://www.cftc.gov/PressRoom/Events/opaeventgmac051920>. In addition, in his opening remarks at the meeting, CFTC Chairman Tarbert indicated his support for extending, by an additional year, the CFTC's deadlines for Phase 5 and Phase 6 of the initial margin requirements for non-cleared swaps, consistent with the recent extension of the Phase 5 and Phase 6 deadlines by BCBS and IOSCO in recognition of COVID-19 related challenges faced by market participants. See Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, Margin Requirements for Non-Centrally Cleared Derivatives (April 2020), available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD651.pdf>. Under the revised BCBS/IOSCO framework, the deadline for Phase 5 compliance is September 1, 2021, and the deadline for Phase 6 compliance is September 1, 2022. For these extensions to have effect, global regulators, including the CFTC, must make conforming amendments or take other actions as necessary to implement the decision in their respective jurisdictions.

<sup>[2]</sup> For purposes of the report, an SMA client is defined as a small financial end user (*i.e.*, a financial end user that may be subject to Phase 5 or Phase 6), such as a pension fund, insurance company or retail fund, that has multiple investment mandates executed through separate asset managers (such as a multi-managed registered investment company).

[3] Appendix C of the report includes examples of the application of this requested interpretive guidance in various scenarios.

[4] Under CFTC regulations and regulations of the US prudential regulators, money market funds that engage in these activities do not qualify as eligible collateral for uncleared swap transactions. Last August, ICI participated in a joint trade association letter to the CFTC and the US prudential regulators requesting that they provide relief or adopt rule amendments to expand the types of money market funds that can be used as eligible collateral, including allowing non-US money market funds. See ICI Memorandum No. 31882 (August 1, 2019), *available at* [https://www.ici.org/my\\_ici/memorandum/memo31882](https://www.ici.org/my_ici/memorandum/memo31882)

[5] Appendix D to the report includes a chart comparing these differences.

[6] See CFTC Letter No. 17-12 (February 13, 2017), *available at* <https://cftc.gov/csl/17-12/download>; CFTC Letter No. 19-25 (December 6, 2019), *available at* <https://cftc.gov/csl/19-25/download>.

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