

Alert

Prudential Regulators Amend Swap Margin Rules; Prudential Regulators/CFTC Propose Extension of Compliance Dates

June 26, 2020

On June 25, 2020, federal agencies (the Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration and Federal Housing Finance Agency, collectively, the “Agencies”) finalized changes to their final rule (“Final Rule”)¹ in order to facilitate implementation of prudent risk management strategies at banks and other companies having significant swap activities. The Agencies and the Commodity Futures Trading Commission (“CFTC”) also both separately published interim rule announcements and requests for comment (“Interim Final Rules”),^{2,3} proposing to extend the swap initial margin compliance dates for smaller covered entities.

The Final Rule amends the Agencies’ regulations adopted in 2015 (“Swap Margin Rule”)⁴ requiring swap dealers and security-based swap dealers under the Agencies’ respective jurisdictions to exchange margin with their counterparties for swaps that are not centrally cleared.

Under the Final Rule⁵:

1. Entities within the same banking organization will not be required to hold a specific amount of initial margin for non-cleared inter-affiliate swaps. The Final Rule will allow firms greater flexibility to transfer collateral internally and support prudent risk management.⁶
2. Phase-five compliance (with compliance date of Sept. 1, 2020) has been changed to cover entities falling within \$50 billion up to \$750 billion of average daily aggregate notional amounts (“AANA”), and an additional phase-six compliance date of Sept. 1, 2021 will be available for the

¹ The Final Rule, available [here](#).

² The Interim Final Rule from the Agencies, available [here](#).

³ The proposed interim rule announcement from the CFTC, available [here](#).

⁴ The Swap Margin Rule, available [here](#).

⁵ In addition to other changes, the Final Rule makes certain technical changes to relocate the provision within the rule addressing amendments to legacy swaps in order to comply with qualified financial contract rules.

⁶ The inter-affiliate swap will still, however, remain subject to variation margin requirements. Initial margin will also still be required in the case of a depository institution’s total exposure to all affiliates exceeding 15% of its tier 1 capital. “Tier 1 capital” means the sum of common equity tier 1 capital as defined in 12 CFR 3.20(b) and additional tier 1 capital as defined in 12 CFR 3.20(c), as reported in the institution’s most recent Consolidated Reports of Income and Condition (Call Report).

smallest covered swap entities and financial end-users falling within \$8 billion up to \$50 billion of AANA.⁷

3. In order to aid transition from the London Interbank Offered Rate (“LIBOR”) to alternative reference rates, swap entities may amend legacy swaps (grandfathered from Swap Margin Rule compliance) to replace LIBOR (or other interbank offered rates which are also expected to undergo cessation) without triggering margin exchange requirements and thus retain their legacy status.
4. Swap entities may effect risk-reducing portfolio compression, or make other non-substantive technical amendments or notional reductions to their legacy swaps portfolios, without altering their legacy status.
5. Pursuant to documentation requirements under the Swap Margin Rule requiring execution of trading documentation regarding credit support arrangements, 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.
6. Previously published rules allowing certainty for covered swap entities as they prepare for Brexit remain unchanged.⁸

Under the Interim Final Rules:

The Agencies’ Interim Final Rule adds an additional proposed grace period for phase-five and phase-six entities, extending their respective compliance dates to Sept. 1, 2021 (for phase five) and Sept. 1, 2022 (for phase six). The CFTC also announced a proposal for an extension for phase-six covered entities for initial margin compliance to Sept. 1, 2022. Comments on each will be accepted for 60 days following their respective publications in the Federal Register.

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⁷ The Swap Margin Rule took effect under a phased compliance schedule from 2016 to 2020 for both initial and variation margin. Swaps entered into by a covered entity prior to its effective phase-in date, and which continue to be held, are grandfathered from the Swap Margin Rule’s requirements until they expire. While variation margin was completely phased-in for all covered entities by March 1, 2017, initial margin has been phased in over five phases from Sept. 1, 2016 to Sept. 1, 2020, depending on the size of the covered swap entity’s portfolio of non-cleared swaps and the counterparty’s portfolio of non-cleared swaps.

⁸ The previously published interim final rule provided a covered swap entity with the ability to continue to service its cross-border clients in the event that the United Kingdom withdrew from the European Union without a withdrawal agreement. A withdrawal agreement was later ratified in January 2020.