



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Market Participants  
Division

Thomas J. Smith  
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### **Re: Staff Interpretation Regarding Exchange-Traded Funds as Eligible Margin Collateral for Uncleared Swaps Transactions**

The Market Participants Division (“Division”) of the Commodity Futures Trading Commission (“Commission” or “CFTC”) is issuing this interpretation to clarify the types of assets that qualify as eligible margin collateral for certain uncleared swap transactions under Commission Regulation 23.156.<sup>1</sup> Specifically, the interpretation clarifies the Division’s view that swap dealers (“SDs”) and major swap participants (“MSPs”) may post and collect with counterparties certain U.S. Treasury exchange-traded funds (“UST ETFs”) as initial margin (“IM”) and variation margin (“VM”) for uncleared swap transactions as specified below.

#### **Regulatory Background**

Section 4s(e) of the Commodity Exchange Act (“CEA”)<sup>2</sup> requires the Commission to adopt rules establishing minimum IM and VM requirements for all swaps<sup>3</sup> that are: (i) entered into by an SD<sup>4</sup> or an MSP<sup>5</sup> for which there is no prudential regulator<sup>6</sup> (collectively, “covered swap entities”

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<sup>1</sup> 17 CFR 23.156. The Commission’s regulations may be found at 17 CFR Chapter I, and are also available through the Commission’s website, [www.cftc.gov](http://www.cftc.gov).

<sup>2</sup> 7 U.S.C. 6s(e).

<sup>3</sup> 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.

<sup>4</sup> CEA section 1a(49), 7 U.S.C. 1a(49) (swap dealer definition); Commission Regulation 1.3 (further definition of swap dealer).

<sup>5</sup> CEA section 1a(32), 7 U.S.C. 1a(32) (major swap participant definition); Commission Regulation 1.3 (further definition of major swap participant).

<sup>6</sup> 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.

or “CSEs”);<sup>7</sup> and (ii) not cleared by a registered derivatives clearing organization (“uncleared swaps”).<sup>8</sup> To offset the greater risk to the SD or MSP and the financial system arising from the use of uncleared swaps, these 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.<sup>9</sup>

In 2016, the Commission promulgated Commission Regulations 23.150 through 23.161 (“CFTC Margin Rule”) to implement section 4s(e) of the CEA.<sup>10</sup> The CFTC Margin Rule provides that the margin requirements may be satisfied with only certain types of collateral.<sup>11</sup> Commission Regulation 23.156(a)(1) sets forth the types of collateral that CSEs can post or collect as IM with covered counterparties, including cash funds, certain securities issued by the U.S. government or other sovereign entities, certain publicly traded debt or equity securities, securities issued by certain pooled investment funds such as money market funds meeting specified conditions, and gold.<sup>12</sup> Furthermore, Commission Regulation 23.156(b)(1) provides that a CSE may post or collect any eligible IM collateral asset as VM with a counterparty that qualifies as a financial end user and may only post or collect cash funds as VM with a counterparty that is an SD or MSP.<sup>13</sup>

Commission Regulation 23.156(a) aims to identify as eligible margin collateral assets that are liquid, and, with haircuts, will hold their value in times of financial stress.<sup>14</sup> In adopting the CFTC Margin Rule, the Commission added “redeemable securities in a pooled investment fund” to the list of eligible IM collateral in response to comments arguing for the inclusion of money market fund (“MMF”) securities as eligible collateral for IM.<sup>15</sup> The Commission explained that adding redeemable securities in a pooled investment fund to the list of eligible collateral would provide flexibility while maintaining a level of safety, noting that to qualify, such fund securities would need to meet the conditions in Commission Regulation 23.156(a)(1)(ix).<sup>16</sup>

Commission Regulation 23.156(a)(1)(ix) limits the pooled investment funds whose securities may qualify as eligible collateral to funds that invest only in securities issued or

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<sup>7</sup> 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).

<sup>8</sup> 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.

<sup>9</sup> CEA section 4s(e)(3)(A), 7 U.S.C. 6s(e)(3)(A).

<sup>10</sup> See generally *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 FR 636 (Jan. 6, 2016) (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.

<sup>11</sup> 17 CFR 23.156.

<sup>12</sup> 17 CFR 23.156(a)(1).

<sup>13</sup> 17 CFR 23.156(b)(1). The term “financial end user” is defined in Commission Regulation 23.151 as a counterparty that is not an SD or MSP and that is included in an enumerated list of financial institutions or funds including certain banking entities, credit institutions, private funds, and securities brokers or dealers. 17 CFR 23.151.

<sup>14</sup> CFTC Margin Rule, 81 FR 636 at 665. The haircuts are specified in Commission Regulation 23.156(a)(3) and vary by asset class and residual maturity of the asset. 17 CFR 23.156(a)(3).

<sup>15</sup> CFTC Margin Rule, 81 FR 636 at 666.

<sup>16</sup> Id. and 17 CFR 23.156(a)(1)(ix).

unconditionally guaranteed by the U.S. Department of the Treasury, the European Central Bank or certain other sovereign entities, and cash.<sup>17</sup> Eligible funds' securities must be redeemable securities representing the security-holder's proportional interest in the fund's net assets, 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.<sup>18</sup> In adopting the requirements, the Commission noted that these criteria are similar to those used for bank trust department common trust funds and common investment funds, to facilitate liquidity of the redeemable securities while still protecting holders of the fund's securities from dilution.<sup>19</sup> Commission Regulation 23.156(a)(1)(ix) also provides that assets of the fund may not be transferred through securities lending, securities borrowing, reverse repurchase agreements, or similar arrangements.<sup>20</sup>

### **Market Participants Feedback**

On March 6, 2024, the CFTC's Global Markets Advisory Committee's ("GMAC") Subcommittee on Global Market Structure ("GMAC Subcommittee")<sup>21</sup> issued a report recommending that the Commission provide clarity on whether certain UST ETFs would qualify as eligible IM collateral under the CFTC Margin Rule ("GMAC Recommendation").<sup>22</sup> Specifically, the GMAC Subcommittee recommended that the Commission specify that shares of a UST ETF that is registered as an open-end investment company with the U.S. Securities and Exchange Commission ("SEC") under the Investment Company Act of 1940 ("40 Act") should be considered "redeemable securities" in a pooled investment fund and, therefore, shares of such a UST ETF that meets other relevant conditions, as detailed in the CFTC Margin Rule, would be considered eligible IM collateral under the CFTC Margin Rule.<sup>23</sup>

In support of its recommendation, the GMAC Subcommittee notes that UST ETFs provide a diversified exposure to a portfolio of U.S. Treasury securities in a single instrument, which can help mitigate the idiosyncratic risk associated with an individual bond.<sup>24</sup> The GMAC Recommendation also describes the ETFs' unique mechanism for issuing and redeeming shares and highlights the additional liquidity of ETFs resulting from secondary market trading.<sup>25</sup> The

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<sup>17</sup> 17 CFR 23.156(a)(1)(ix)(A) and (B).

<sup>18</sup> 17 CFR 23.156(a)(1)(ix).

<sup>19</sup> Id.

<sup>20</sup> 17 CFR 23.156(a)(1)(ix)(C).

<sup>21</sup> The GMAC advises the Commission on issues that affect the integrity and competitiveness of U.S. markets and U.S. firms engaged in global business. The GMAC also makes recommendations regarding international standards for regulating futures, swaps, options, and derivatives markets, as well as intermediaries. Members include financial market infrastructures, market participants, end-users, service providers, and regulators.

<sup>22</sup> *Inclusion of U.S. Treasury ETFs as Eligible Margin Collateral*, March 6, 2024, CFTC GMAC Global Market Structure Subcommittee Recommendation, available at <https://www.cftc.gov/About/AdvisoryCommittees/GMAC>.

<sup>23</sup> GMAC Recommendation at 1.

<sup>24</sup> Id.

<sup>25</sup> Id. (noting that fixed income ETFs, including UST ETFs, empower investors to gain instant access to hundreds of bond market exposures at transparent prices and extra layers of liquidity from secondary, on-exchange trading).

GMAC Subcommittee further argues that in historic periods of volatility, certain UST ETFs have acted globally as “shock absorbers,” providing real-time prices and liquidity.<sup>26</sup>

The GMAC Subcommittee also asserts that allowing UST ETFs as margin collateral could increase the efficiency of the collateral management process. In that regard, the GMAC Subcommittee notes that for a significant number of market participants or CSEs, it may be simpler and more cost-effective to post shares of UST ETFs as eligible collateral, rather than posting U.S. Treasury securities directly. The Subcommittee further notes that the ongoing management of cash flows in UST ETFs is performed by the ETF itself, including reinvestment, rebalancing, and performing collateral substitutions when a bond matures, offering operational ease relative to holding individual bonds.

In conclusion, the GMAC Subcommittee argues that allowing UST ETFs as IM collateral could not only help safeguard CSEs from counterparty default but could also help reduce the overall risk in the financial system and limit the potential for financial contagion arising from uncleared swaps.

### **Staff Interpretation**

ETFs, including UST ETFs, are collective investment vehicles that issue and redeem shares, which are also traded at market-determined prices on national securities exchanges.<sup>27</sup> In 2019, the SEC adopted Rule 6c-11 under the 40 Act, creating a regulatory framework that allows ETFs meeting certain requirements to operate as investment companies under the 40 Act without having to obtain an exemptive order from the SEC as previously required.<sup>28</sup>

As described in the SEC ETFs Release, an ETF, like other investment companies, pools the assets of multiple investors and invests those assets according to a set investment objective and principal investment strategies.<sup>29</sup> Each share of an ETF represents an undivided fractional interest in the underlying assets of the ETF.<sup>30</sup> As an open-end investment company,<sup>31</sup> similar to a mutual fund,<sup>32</sup> an ETF continuously offers its shares for sale. Unlike mutual funds, however, ETFs do not

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<sup>26</sup> GMAC Recommendation at 1 (stating that “during the bond market volatility in 2020, volatility increased in U.S. Treasury bonds as dealers’ balance sheets were constrained. During this time, many UST ETFs traded at tighter bid-ask spreads than their portfolio of underlying bonds. For example, dislocations in U.S. Treasuries caused the bid/ask spreads of “off-the-run” bonds with a maturity of 20+ years to widen to almost 20 times that of the iShares 20+ Year Treasury Bond ETF (TLT)”).

<sup>27</sup> See generally *Mutual Funds and Exchange-Traded Funds (ETFs) – A Guide for Investors*, SEC, available at <https://www.sec.gov/about/reports-publications/investor-publications/introduction-mutual-funds>.

<sup>28</sup> *Exchange-Traded Funds*, 84 FR 57162 (Oct. 24, 2019) (“SEC ETFs Release”).

<sup>29</sup> *Id.* at 57164.

<sup>30</sup> *Id.*

<sup>31</sup> An “open-end company” is defined as a “management company which is offering for sale or has outstanding any redeemable security of which it is the issuer.” 15 U.S.C. 80a-5. Some ETFs may also be structured as unit-investment trusts (e.g., SPDR® S&P 500® ETF Trust and SPDR® Dow Jones Industrial Average ETF Trust), which have characteristics of both open-end and closed-end companies. 15 U.S.C. 80a-4 (defining unit investment trusts); Unit Investment Trusts (UITs), Glossary, available at <https://www.investor.gov/introduction-investing/investing-basics/glossary/unit-investment-trusts-uits>. The regulatory framework set forth by SEC Rule 6c-11, however, applies only to ETFs that are organized as open-end investment companies. 17 CFR 270.6c-11.

<sup>32</sup> A “mutual fund” is a type of open-end investment company, meaning that investors can purchase and redeem shares in the fund on a continuous basis at the net asset value (“NAV”) of the shares. See generally *Mutual Funds and*

sell shares to, or redeem shares from, investors directly. Instead, ETFs issue (and redeem) shares to (and from) “authorized participants”—market intermediaries that have a contractual arrangement with the ETF (or its distributor) and are members or participants of a clearing agency registered with the SEC—in blocks called “creation units.”<sup>33</sup>

Authorized participants play a key role for ETF shares as they are the only investors that are allowed to transact directly with the ETF.<sup>34</sup> An authorized participant that purchases a creation unit of ETF shares directly from the ETF deposits with the ETF a “basket” of securities and other assets identified by the ETF that day, and then receives the creation unit of ETF shares in return for those assets.<sup>35</sup> The basket is generally representative of the ETF’s portfolio and, together with a cash balancing amount, is equal in value to the aggregate NAV of the ETF shares in the creation unit.<sup>36</sup> The redemption process is the reverse of the purchase process: the authorized participant redeems a creation unit of ETF shares for a basket of securities and other assets.<sup>37</sup>

In addition, ETF shares are traded on securities exchanges at market-determined prices. The combination of the creation and redemption process with secondary market trading in ETF shares provides arbitrage opportunities that are designed to help keep the market price of ETF shares at or close to the NAV per share of the ETF.<sup>38</sup>

In adopting the regulatory framework in Rule 6c-11, the SEC determined that shares of ETFs that rely on Rule 6c-11 are most appropriately classified as “redeemable securities,” within the meaning of section 2(a)(32) of the 40 Act.<sup>39</sup> The SEC explained that although individual ETF shares cannot be redeemed, except in limited circumstances, they can be redeemed in creation unit aggregations.<sup>40</sup> In addition, the SEC noted that the arbitrage mechanism that is central to the operation of an ETF (and the conditions in SEC Rule 6c-11 designed to facilitate an effective arbitrage mechanism) serves to keep the market price of ETF shares at or close to the ETF’s NAV per share, thus providing an opportunity for investors to sell their ETF shares at or close to the ETF’s NAV.<sup>41</sup>

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*Exchange-Traded Funds (ETFs) – A Guide for Investors*, SEC, available at <https://www.sec.gov/about/reports-publications/investor-publications/introduction-mutual-funds>. Mutual funds pool the money of many investors to purchase a range of securities and other assets to meet specified investment objectives. *Id.*

<sup>33</sup> 17 CFR 270.6c-11 (defining “exchange-traded fund”) and GMAC Recommendation at 3.

<sup>34</sup> 17 CFR 270.6c-11 (defining “authorized participant”).

<sup>35</sup> SEC ETFs Release at 57165.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.* To describe the arbitrage mechanism, the SEC explains that if ETF shares are trading on national securities exchanges at a “discount” (a price below the NAV per share of the ETF), an authorized participant can purchase ETF shares in secondary market transactions and, after accumulating enough shares to compose a creation unit, redeem them from the ETF in exchange for the more valuable securities in the ETF’s redemption basket. The authorized participant’s purchase of an ETF’s shares on the secondary market, combined with the sale of the ETF’s basket assets, may create upward pressure on the price of the ETF shares, downward pressure on the price of the basket assets, or both, bringing the market price of ETF shares and the value of the ETF’s portfolio holdings closer together. Alternatively, if ETF shares are trading at a “premium” (a price above the NAV per share of the ETF), the transactions in the arbitrage process are reversed and, when arbitrage is working effectively, keep the market price of the ETF’s shares close to its NAV. *Id.*

<sup>39</sup> 17 CFR 270.6c-11 and SEC ETFs Release at 57171.

<sup>40</sup> SEC ETFs Release at 57171.

<sup>41</sup> *Id.*

When it adopted the CFTC Margin Rule, the Commission did not define the term “redeemable security” for purposes of Commission Regulation 23.156(a)(1)(ix). For ETFs that fall within the scope of SEC Rule 6c-11, the Division, consistent with the SEC’s determination, believes that shares issued by ETFs are “redeemable securities.” In addition, having considered the liquidity characteristics of UST ETFs, the Division notes that allowing UST ETFs that meet certain requirements to be used as IM collateral is consistent with the Commission’s intent to identify as eligible collateral assets that are liquid, and subject to haircuts, will maintain their value in times of financial stress.<sup>42</sup>

The Division, therefore, considers that UST ETFs that fall within the scope of the regulatory framework set forth in SEC Rule 6c-11 may qualify as eligible IM collateral as defined in the CFTC Margin Rule, provided the funds meet the criteria listed in Commission Regulation 23.156(a)(1)(ix). For full clarity, eligible UST ETFs must: (i) issue and redeem ETF shares 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; (ii) limit 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; and (iii) refrain from transferring fund assets through securities lending, securities borrowing, repurchase agreements, reverse repurchase agreements, or other means that involve the fund having rights to acquire the same or similar assets from the transferee. In addition, the Division believes that a CSE may collect or post UST ETFs that qualify as IM under Commission Regulation 23.156(a)(1)(ix) as VM for uncleared swap transactions with financial end users consistent with Commission Regulation 23.156(b)(1)(ii).

With respect to the applicable haircuts, Commission Regulation 23.156(a)(3) sets forth percentage discounts to be applied to the value of eligible margin collateral, varying according to asset class.<sup>43</sup> The haircut requirements are intended to address the possibility that the value of non-cash eligible collateral may decline between a counterparty’s default and the close out of such counterparty’s swap positions by the CSE.<sup>44</sup> To determine the haircut for shares of investment funds qualifying as eligible margin collateral pursuant to Commission Regulation 23.156(a)(1)(ix), CSEs may either calculate the weighted average discount on all assets within the funds at the end of the prior month<sup>45</sup> or use the haircut provided for the asset with longest residual maturity held by

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<sup>42</sup> GMAC Meeting Slides, March 6, 2024, at 7-9, available here: <https://www.cftc.gov/PressRoom/Events/opaeventgmac030624>.

<sup>43</sup> 17 CFR 23.156(a)(3) (specifying the applicable haircuts for eligible collateral collected or posted to satisfy IM requirements) and 17 CFR 23.156(b)(2) (specifying the applicable haircuts for eligible collateral collected or posted to satisfy VM requirements).

<sup>44</sup> CFTC Margin Rule, 81 FR 636 at 668.

<sup>45</sup> This 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-

the fund (e.g., 4 percent if an UST ETF holds U.S. Treasury securities with a residual maturity greater than five years).<sup>46</sup> The percentage discount, as determined pursuant to either alternative, 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).<sup>47</sup>

This interpretation represents the views of the Division only and does not necessarily represent the views of the Commission. Questions regarding this interpretation may be directed to Liliya Bozhanova, Associate Director, at [lbozhanova@cftc.gov](mailto:lbozhanova@cftc.gov) or Christine McKeveny, Attorney Advisor, at [cmckeveny@cftc.gov](mailto:cmckeveny@cftc.gov).

Sincerely,

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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.

<sup>46</sup> The Division understands that the latter approach, while more conservative, may be more practical for market participants. Market participants may apply this approach to both UST ETFs and U.S. government MMFs that meet the conditions of Commission Regulation 23.156(a)(1)(ix).

<sup>47</sup> 17 CFR 23.156(a)(3)(ii) and 17 CFR 23.156(b)(2)(ii).