U.S. COMMODITY FUTURES TRADING COMMISSION
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Market Participants Division
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RE: Staff Interpretation Regarding Preservation of Legacy Swap Status in an Anticipated Legal Entity Merger

Ladies and Gentlemen:

The Market Participants Division ("**MPD**") and the Division of Clearing and Risk ("**DCR**" and, together with MPD, the "**Divisions**") of the Commodity Futures Trading Commission ("**CFTC**" or "**Commission**") are issuing this letter in response to a request (the "**Request**") from Morgan Stanley, the parent of certain registered swap dealers more fully described below (each an "**SD**"), that the Divisions issue an interpretative letter pursuant to 17 CFR 140.99 providing guidance regarding the treatment of certain Legacy Swaps (as defined below). Specifically, Morgan Stanley requests guidance confirming for the benefit of all market participants, that, under the facts and circumstances summarized below, the transfer of a Legacy Swap as a result of its internal corporate merger involving its subsidiaries does not affect the swap's status as a Legacy Swap, and therefore, its obligations for margin under Section 4s(e)(1)(B) of the Commodity Exchange Act ("**CEA**")[1] and Commission regulations 23.150 through 23.161 (together, the "**CFTC Margin Rule**")[2] and clearing under Section 2(h)(1) of the CEA[3] and Commission regulations 50.2 and 50.4 (together, the "**Swap Clearing Requirement**").[4]

[1] 7 U.S.C. 6s(e)(1)(B).

[2] 17 CFR 23.150 through 23.161.

[3] 7 U.S.C. § 2(h)(1).

[4] 17 CFR 50.2 and 50.4.

I. CFTC Regulatory Background

(1) CFTC Margin Rule

Section 4s(e) of the CEA directs the Commission to adopt rules establishing minimum initial and variation margin requirements on all swaps[5] that are (i) entered into by an SD for which there is no prudential regulator (such SDs are collectively referred to as "**Non-Bank Covered Swap Entities**" or "**Non-Bank CSEs**") and (ii) not cleared by a derivatives clearing organization ("**DCO**") ("**uncleared swaps**").[6] The Commission implemented this statutory authority by promulgating rules in 2016, which establish requirements for a Non-Bank CSE to collect and post initial margin and variation margin for uncleared swaps.[7] These requirements vary based on the type of counterparty to such swaps and the location of the Non-Bank CSE and its counterparty.[8] Generally, these requirements also apply only to uncleared swaps entered into on or after the compliance date applicable to a particular Non-Bank CSE and its counterparty (each a "**covered swap**").[9] An uncleared swap entered into prior to a Non-Bank CSE's applicable compliance date for a particular counterparty (each a "**Margin Legacy Swap**") is generally not subject to the margin requirements in the CFTC Margin Rule.[10]

To the extent that more than one uncleared swap is executed between a Non-Bank CSE and its counterparty, the CFTC Margin Rule permits the netting of required margin amounts of each swap under certain circumstances.[11] In particular, the CFTC Margin Rule, subject to certain limitations, permits a Non-Bank CSE to calculate initial margin and variation margin, respectively, on an

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[5] For the definition of swap, *see* Section 1a(47) of the CEA and Commission regulation 1.3. 7 U.S.C. 1a(47) and 17 CFR 1.3. The "swap" definition includes, among other things, an interest rate swap, commodity swap, credit default swap, and currency swap.

[6] 7 U.S.C. 6s(e)(2)(B)(ii). In Commission regulation 23.151, the Commission defined uncleared swaps to mean those swaps that are not cleared by a registered DCO or a DCO that the Commission has exempted from registration as provided under the CEA. 17 CFR 23.151.

[7] *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016) ("**CFTC Margin Release**"); *see also* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements, 81 FR 34818 (May 31, 2016).

[8] *See* 17 CFR 23.152 and 23.153. For example, the CFTC Margin Rule does not require a Non-Bank CSE to collect margin from, or post margin to, a counterparty that is neither a swap entity nor a financial end user (each as defined in 17 CFR 23.151). Pursuant to Section 2(e) of the CEA, 7 U.S.C. 2(e), each counterparty to an uncleared swap must be an eligible contract participant, as defined in Section 1a(18) of the CEA, 7 U.S.C. 1a(18). *See also* 17 CFR 23.160 (for the cross-border application of the CFTC Margin Rule).

[9] Pursuant to Commission regulation 23.161, compliance dates for the CFTC Margin Rule are staggered such that Non-Bank CSEs must come into compliance in a series of phases. The first phase affected Non-Bank CSEs and their counterparties, each with the largest aggregate outstanding notional amounts of uncleared swaps and certain other financial products. These Non-Bank CSEs began complying with both the initial and variation margin requirements of the CFTC Margin Rule on September 1, 2016. The second phase began March 1, 2017, and required Non-Bank CSEs to comply with the variation margin requirements of Commission regulation 23.153 with all relevant counterparties not covered in the first phase. *See* 17 CFR 23.161. Initial margin requirements with counterparties with successively lesser outstanding notional amounts were phased in until September 1, 2022.

[10] *See* CFTC Margin Release, 81 FR at 651; and 17 CFR 23.161.

[11] *See* CFTC Margin Release, 81 FR at 651; and 17 CFR 23.152(c) and 23.153(d).

aggregate net basis across uncleared swaps that are executed under the same eligible master netting agreement ("**EMNA**"). Moreover, the CFTC Margin Rule permits swap counterparties to identify one or more separate netting portfolios (*i.e.*, a specified group of uncleared swaps the margin obligations of which will be netted only against each other) under the same EMNA, including having separate netting portfolios for covered swaps and Margin Legacy Swaps.[12] A netting portfolio that contains only Margin Legacy Swaps is not subject to the initial and variation margin requirements set out in the CFTC Margin Rule.[13] However, if a netting portfolio contains **any** covered swaps, the entire netting portfolio (including all Margin Legacy Swaps) is subject to such requirements.[14]

A Margin Legacy Swap may lose its legacy treatment under the CFTC Margin Rule, causing it to be subject to the requirements of the CFTC Margin Rule. For reasons discussed in the CFTC Margin Release, the Commission elected not to extend the meaning of Margin Legacy Swaps to include (1) Margin Legacy Swaps that are amended in a material or nonmaterial manner; (2) novations of Margin Legacy Swaps; and (3) new swaps that result from portfolio compression of Margin Legacy Swaps.[15]

(2) Swap Clearing Requirement

Section 2(h)(1)(A) of the CEA states that "[i]t shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a [DCO] that is registered under [the CEA] or a [DCO] that is exempt from registration under [the CEA] if the swap is required to be cleared."[16] In 2012, the Commission issued a Swap Clearing Requirement Determination, which requires certain market participants to clear two classes of credit default swaps and four classes of interest rate swaps.[17] In 2016, the Commission issued a second Swap Clearing Requirement Determination, which expanded the Swap Clearing Requirement to include additional interest rate swaps.[18]

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[12] *See* CFTC Margin Release, 81 FR at 651, 686; 17 CFR 23.152(c)(2)(ii) and 23.153(d)(2)(ii).

[13] *Id.*

[14] *Id.*

[15] *See* CFTC Margin Release, 81 FR at 675. The Commission and its staff have taken certain actions in relation to this standard. *See, e.g.,* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 83 FR 60341 (Nov. 26, 2018); CFTC Staff Letter 19-13 (Jun. 6, 2019) ("**Letter 19-13**"); CFTC Staff Letter No. 17-52 (Oct. 27, 2017). CFTC staff letters are available on the CFTC website, CFTC.gov. *See also* "CFTC Statement on Swaps Rules Implicated in Recent Bank Failures" (Mar. 16, 2023), *available at* https://www.cftc.gov/PressRoom/SpeechesTestimony/commissionstatement031623.

[16] 7 U.S.C. § 2(h)(1)(A).

[17] *See* Swap Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284, 74315–16, 74336–37 (Dec. 13, 2012) (establishing Commission regulation 50.4, which sets forth the classes of swaps that are required to be cleared) ("**2012 Swap Clearing Requirement**"); 17 CFR 50.4.

[18] *See* Swap Clearing Requirement Determination Under Section 2(h) of the CEA for Interest Rate Swaps, 81 FR 71202 (Oct. 14, 2016) (expanding the Swap Clearing Requirement to include fixed-to-floating interest rate swaps in nine additional currencies and making certain other modifications to the scope of the 2012 Swap Clearing Requirement) ("**2016 Swap Clearing Requirement**").

Like the CFTC Margin Rule, the Commission's Swap Clearing Requirement Determinations established a series of compliance dates to phase-in compliance with the Swap Clearing Requirement.[19] Commission regulation 50.5 provides that swaps entered into before July 21, 2010, or, if later, the application of the Swap Clearing Requirement for a particular class of swaps are not subject to the Swap Clearing Requirement so long as such swaps are reported to a swap data repository ("**Clearing Legacy Swaps**" and together with Margin Legacy Swaps, "**Legacy Swaps**").[20]

In its 2012 rulemaking, the Commission clarified that the Swap Clearing Requirement applies to all new swaps, as well as changes in the ownership of a swap, including assignment, novation, exchange, transfer, or conveyance.[21]

II. Summary of the Request

Based on the representations made in the Request, we understand the relevant facts to be as follows. As part of an internal corporate reorganization, Morgan Stanley informed the Divisions of an anticipated merger ("**Merger**") involving its subsidiaries, Morgan Stanley Capital Services LLC ("**MSCS**")[22] and Morgan Stanley Bank N.A. ("**MSBNA**"), both of which are Commission-registered SDs.

Morgan Stanley represented that the Merger will result in the merger of the fixed income derivatives and foreign exchange swaps business of MSCS (via a split from MSCS by operation of state corporation law) with, and into, MSBNA, with MSBNA being the surviving entity. Accordingly, the Merger will result in certain swaps in the name of MSCS (the "**Merger Portfolio**") being assumed by MSBNA and becoming part of the swap portfolio of MSBNA. Morgan Stanley represented that the Merger will not impact or change the economic terms and valuation of the swaps in the Merger Portfolio; only the name of the SD will be changed to MSBNA as the successor to the Merger Portfolio.[23] MPD has previously provided a no-action position stating that MPD would not recommend an enforcement action for failure to comply with the CFTC Margin Rule with respect to a Legacy Swap if such swap is amended in a way that does not affect "the economic obligations of the parties or the valuation of the Legacy Swap."[24]

The Merger Portfolio contains Legacy Swaps (the "**Legacy Portfolio**"). Morgan Stanley represents that the Legacy Portfolio comprises approximately 1% of the Merger Portfolio, as measured on a notional basis, and contains primarily interest rate and foreign exchange swaps entered into before the relevant compliance dates under the applicable uncleared swap margin rules.[25] Of the Legacy Portfolio, less than 15% by notional are Clearing Legacy Swaps and roughly

[19] *See* 2012 Swap Clearing Requirement, 77 FR at 74319–20; 2016 Swap Clearing Requirement, 81 FR at 71226–30.

[20] 17 CFR 50.5.

[21] *See* 2012 Swap Clearing Requirement, 77 FR at 74316.

[22] MSCS is Morgan Stanley's primary non-bank U.S. SD.

[23] Ancillary technical changes, such as basic corporate status representations, change of notice addresses, settlement instructions and other administrative or operational details may also be updated.

[24] Letter 19-13 at 8.

[25] Morgan Stanley noted that approximately 3% of the Merger Portfolio, measured on a notional basis, is composed of credit default swaps (inclusive of related products like credit swaptions) and commodities swaps. Furthermore, as

three quarters of its notional are with other dealers, some of which are Non-Bank CSEs that would otherwise be subject to the CFTC Margin Rule.

According to Morgan Stanley, the proposed Merger will merge the Legacy Portfolio of MSCS with and into the swap portfolio of MSBNA, where (i) the merger will occur by operation of law, as opposed to via novation, assignment or sale of assets, and will not alter the economic terms of any swap in the Legacy Portfolio; (ii) the specific commercial intent for the Merger is to merge the fixed income derivatives and foreign exchange swaps business of MSCS into MSBNA and is not to evade margin or swap clearing requirements; and (iii) the Merger is a unique corporate event with legitimate business objectives that do not implicate the evasion concerns expressed by the Commission regarding novations of, or amendments to, Legacy Swaps.

Although Commission staff has provided guidance and taken staff action recognizing a range of circumstances where a swap's status as a Legacy Swap could be maintained even after the occurrence of what might otherwise constitute a material event (e.g., in connection with the UBS/CS business transfer, LIBOR transition, and Brexit), Morgan Stanley requests that Commission staff, for the benefit and clarity of all market participants, confirm that a swap's status as a Legacy Swap is not affected by a merger as described above.[26]

III. Staff Interpretation Regarding Retention of Legacy Status Upon Merger

As described above, Morgan Stanley is planning an internal reorganization pursuant to which MSCS's fixed income derivatives and foreign exchange swaps business will be merged with and into MSBNA. Specifically, MSCS's Legacy Portfolio will be merged into the swap portfolio of MSBNA by means of an internal reorganization under operation of applicable state corporation laws.

As discussed in the CFTC Margin Rule, uncleared swaps entered into prior to a Non-Bank CSE's applicable compliance date for a particular counterparty are not subject to the margin requirements in Commission regulation 23.161.[27] As represented by Morgan Stanley, the Merger relates to a reorganization with legitimate business objectives. The Divisions note that, with respect to the Legacy Swaps, there is no change in ownership, including assignment, novation, exchange, transfer or conveyance.[28] Furthermore, the underlying facts with respect to this Merger indicate that the economic terms and valuation of the swaps in the Legacy Portfolio will not change as a result of this restructuring and will not be accompanied by any changes to the contractual terms of such swaps (other than a name change).[29] Thus, no amendments will be made to the swaps at issue that would affect the economic obligations or valuations of the swaps. The ownership and original counterparties that MSCS faces on such Legacy Swaps also remain the same, and the only change is that MSBNA is the successor to such Legacy Swaps as a result of the Merger by operation of

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measured on a notional basis, less than 5% of these swaps constitute Margin Legacy Swaps. With respect to the Clearing Legacy Swaps, Morgan Stanley noted that all such swaps are interest rate swaps.

[26] *See* Morgan Stanley Request at 5.

[27] *See* CFTC Margin Release, 81 FR at 651, and Commission regulation 23.161. 17 CFR 23.161.

[28] *See* 2012 Swap Clearing Requirement, 77 FR at 74316.

[29] *See supra* note 23 and accompanying text.

law, thus mooting Commission's concern of any "incentives to 'trade' historical swaps through the assignment, novation, exchange, transfer, or conveyance processes to avoid required clearing."[30] MPD is therefore of the view that the Legacy Swaps at issue retain their status as legacy swaps for any Non-Bank CSE counterparties and thus, remain exempt from the CFTC Margin Rule. DCR is also of the view that the Merger will not cause the Legacy Swaps at issue to lose their legacy status with respect to the Swap Clearing Requirement.

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[30] *See* 2012 Swap Clearing Requirement, 77 FR at 74316.

The interpretative positions in this letter represent the positions of the Divisions and do not necessarily represent the views of the Commission or of any other office or Division of the Commission. This letter and the interpretations set forth herein are not binding on the Commission.[31] Further, they are based upon the facts and circumstances represented to the staff of the Divisions. Any different, changed, or omitted material facts or circumstances may require a different interpretation or render this letter or any part thereof void. As with all staff letters, the Divisions retain the authority to condition further, modify, suspend, terminate, or otherwise restrict the interpretation provided herein, in their discretion.

If you have any questions concerning this correspondence, please contact Tom Smith, Acting Director, MPD, tsmith@cftc.gov, or Richard Haynes, Acting Director, DCR, rhaynes@cftc.gov.

Sincerely,

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cc: Kathleen Clapper, NFA Compliance
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[31] *See* 17 CFR 140.99(a)(2) and (3).