COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 23

RIN 3038–AF06

Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (''Commission'' or ''CFTC'') is proposing to amend the margin requirements for uncleared swaps for swap dealers (''SD'') and major swap participants (''MSP'') for which there is no prudential regulator. The proposed amendments would permit the application of separate minimum transfer amounts (''MTA'') for initial margin (''IM'') and variation margin (''VM''), and the application of an MTA of up to $50,000 for separately managed accounts (''SMA'') (together, ''Proposal'').

DATES: With respect to the proposed amendments, comments must be received on or before October 22, 2020.

ADDRESSES: You may submit comments, identified by RIN 3038–AE77, by any of the following methods:

- *CFTC Comments Portal: https://comments.cftc.gov.* Select the ''Submit Comments'' link for this rulemaking and follow the instructions on the Public Comment Form.
- *Mail:* Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Center, 1155 21st Street NW, Washington, DC 20581.
- *Hand Delivery/Courier:* Follow the same instructions as for Mail, above.

Please submit your comments using only one of these methods. Submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *https://comments.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (''FOIA''), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission's regulations.[1]

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from *https://comments.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the FOIA.

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SUPPLEMENTARY INFORMATION:

I. Background

A. Statutory and Regulatory Background

In January 2016, the Commission adopted regulations 23.150 through 23.161 (collectively, ''CFTC Margin Rule'') [2] to implement section 4s(e) of the Commodity Exchange Act (''CEA''),[3] which requires SDs and MSPs for which there is not a prudential regulator (''covered swap entity'' or ''CSE'') to meet minimum IM and VM requirements adopted by the Commission by rule or regulation.[4]

Commission regulations 23.152 and 23.153 require CSEs to collect or post, each business day, VM [5] for uncleared swap transactions with each counterparty that is an SD, MSP, or financial end user, and IM [6] for uncleared swap transactions for each counterparty that is an SD, MSP, or a financial end user that has material swaps exposure.[7] IM posted or collected by a CSE must be held by one or more custodians that are not affiliated with the CSE or the counterparty.[8] VM posted or collected by a CSE is not required to be maintained with a custodian.[9]

However, to alleviate the operational burdens associated with making de minimis margin transfers without resulting in an unacceptable level of uncollateralized credit risk, Commission regulations 23.152(b)(3) and 23.153(c) provide that a CSE is not required to collect or post IM or VM with a counterparty until the combined amount of such IM and VM, as computed under Commission regulations 23.154 and 23.155 respectively, exceeds the MTA of $500,000.[10] The term MTA (or minimum transfer amount) is further defined in Commission regulation 23.151 as a combined amount of IM and VM, not exceeding $500,000, under which no exchange of IM or VM is required.[11] Once the MTA is exceeded, the SD or MSP must collect or post the full amount of both the IM and VM required to be exchanged with the counterparty.[12]

During the implementation of the CFTC Margin Rule, market participants identified certain operational and

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[1] 17 CFR 145.9. Commission regulations referred to herein are found at 17 CFR Chapter I.

[2] *See generally* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016). The CFTC Margin Rule, which became effective April 1, 2016, is codified in part 23 of the Commission's regulations. 17 CFR 23.150—23.159, 23.161. In May 2016, the Commission amended the CFTC Margin Rule to add Commission regulation 23.160, 17 CFR 23.160, providing rules on its cross-border application. *See generally* 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).

[3] 7 U.S.C. 6s(e) (capital and margin requirements).

[4] 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.

[5] VM (or variation margin), as defined in Commission regulation 23.151, is the collateral provided by a party to its counterparty to meet the performance of its obligation under one or more uncleared swaps between the parties as a result of a change in the value of such obligations since the trade was executed or the last time such collateral was provided. 17 CFR 23.151.

[6] IM (or initial margin) is the collateral (calculated as provided by § 23.154 of the Commission's regulations) that is collected or posted in connection with one or more uncleared swaps pursuant to § 23.152. IM is intended to secure potential future exposure following default of a counterparty (*i.e.,* adverse changes in the value of an uncleared swap that may arise during the period of time when it is being closed out). *See* CFTC Margin Rule, 81 FR at 683.

[7] 17 CFR 23.152; 17 CFR 23.153.

[8] *See* 17 CFR 23.157(a).

[9] Commission regulation 23.157 does not require VM to be maintained in a custodial account. 17 CFR 23.157.

[10] 17 CFR 23.152(b)(3); 17 CFR 23.153(c); 81 FR at 653.

[11] 17 CFR 23.151 (defining the term ''minimum transfer amount'').

[12] *See* 17 CFR 23.152(b)(3); 17 CFR 23.153(c).

compliance burdens associated with the application of the MTA. To mitigate these burdens, the Division of Swap Dealer and Intermediary Oversight (''DSIO'') staff issued two no-action letters.

B. DSIO No-Action Letter Addressing the Application of MTA to SMAs

In February 2017, DSIO staff issued a no-action letter in response to a request for relief from the Securities Industry and Financial Markets Association's Asset Management Group (''SIFMA AMG'').[13] SIFMA AMG sought relief on behalf of members that enter into uncleared swaps with SDs that are registered with the Commission and are subject to the CFTC Margin Rule.

DSIO stated that it would not recommend enforcement action against an SD that does not comply with the MTA requirements of Commission regulations 23.152(b)(3) (requiring the exchange of IM when the MTA has been exceeded) [14] or 23.153(c) (requiring the exchange of VM when the MTA has been exceeded),[15] with respect to the swaps of a legal entity that is the owner of multiple SMAs, provided that the SD applies an MTA no greater than $50,000 to each SMA.

In Letter 17–12, DSIO noted that SIFMA AMG's members are large institutional investors, such as pension plans and endowments, which typically hire asset managers to exercise investment discretion over a portion of their assets for management through separate accounts. Each separate account is governed by an investment management agreement that grants asset managers authority over a portion of their clients' assets. As a swap counterparty, an SD may face the same legal entity—the owner of the accounts—through multiple separate accounts managed by multiple asset managers. Each SMA that trades derivatives typically has its own payment netting set corresponding to each International Swaps and Derivatives Association (''ISDA'') Master Agreement and Credit Support Annex (''CSA'') used by the asset manager.[16]

SIFMA AMG represented that the application of the MTA at the owner or legal entity level presented significant practical challenges for SMAs because the assets for each SMA are held, transferred, and returned separately at the account level. As a result, it is impractical for asset managers to collectively calculate the MTA across the SMAs of a single owner, and, according to SIFMA AMG, asset managers cannot move collateral in aggregate across the accounts. SIFMA AMG also stated that SDs cannot dynamically calculate and manage the MTA across the owner's separate eligible master netting agreements either, for several reasons, including timing, additional regulatory risk, and confidentiality requirements.

C. DSIO No-Action Letter Concerning the Application of Separate MTAs for IM and VM

DSIO staff issued in December 2019 an additional no-action letter concerning the application of the MTA in response to a request for relief from ISDA on behalf of its member SDs.[17] DSIO stated that it would not recommend enforcement action against an SD or MSP that does not combine IM and VM amounts for the purposes of Commission regulations 23.152(b)(3) and 23.153(c). More specifically, the no-action position covers SDs or MSPs that apply separate MTAs for IM and VM obligations on uncleared swap transactions with each swap counterparty, provided that the combined MTA for IM and VM with respect to that counterparty does not exceed $500,000.

DSIO issued the no-action letter based on ISDA's representations. ISDA had stated that the MTA for VM and IM for each party to a swap transaction has, routinely and historically, been included in CSAs to avoid frequent exchanges of small amounts of collateral between the parties. ISDA noted that separate MTAs for IM and VM better reflect the operational requirements and the legal structure of the Commission's regulations. ISDA further stated that because the CFTC Margin Rule requires IM to be segregated with an unaffiliated third party and does not impose similar segregation requirements with respect to VM, distinct workflows for IM settlement through custodians and tri-party agents have been established that are completely separate from the VM settlement process.

D. Market Participant Feedback

Swap market participants, including a subcommittee established by the CFTC's Global Markets Advisory Committee (''GMAC subcommittee''), have expressed support for the adoption of regulations consistent with these no-action letters, noting that Letter 19–25 is time-limited and that, more generally, codifying no-action positions can be beneficial for market participants in providing certainty in the application of the Commission's regulations.[18] The Commission believes that adopting regulations in accordance with the terms of no-action letters, under certain circumstances, is appropriate and could facilitate efforts by market participants to take the operation of the Commission's regulations into account in planning their uncleared swap activities. Based on its implementation experience, and for the reasons provided below, the Commission preliminarily believes that it would be appropriate to amend the CFTC Margin Rule consistent with the staff positions set forth in the no-action letters discussed above.

II. Proposal

The Commission is proposing to amend Commission regulations 23.151, 23.152(b)(3), 23.153(c) and 23.158(a), consistent with Letters 17–12 and 19–25.[19] Commission regulation 23.151 defines MTA as a combined VM and IM amount of $500,000, under which no transfer of funds is required.[20] Commission regulations 23.152(b)(3) and 23.153 (c) describe the application of the MTA in determining whether the

[13] CFTC Letter No. 17–12, Commission Regulations 23.152(b)(3) and 23.153(c): No-Action Position for Minimum Transfer Amount with respect to Separately Managed Accounts (Feb. 13, 2017) (''Letter 17–12''), *https://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-12.pdf.*

[14] *See* 17 CFR 23.152(b)(3).

[15] *See* 17 CFR 23.153(c).

[16] The ISDA Master Agreement is a standard contract published by ISDA commonly used in over-the-counter derivatives transactions governing the rights and obligations of parties to a derivatives transaction. A CSA sets forth the terms of the collateral arrangement for the derivatives transaction.

[17] CFTC Letter No. 19–25, Commission Regulations 23.151, 23.152, and 23.153—Staff Time-Limited No-Action Position Regarding Application of Minimum Transfer Amount under the Uncleared Margin Rules (Dec. 6, 2019) (''Letter 19–25''), *https://www.cftc.gov/csl/19-25/download.*

[18] *See Recommendations to Improve Scoping and Implementation of Initial Margin Requirements for Non-Cleared Swaps,* Report to the CFTC's Global Markets Advisory Committee by the Subcommittee on Margin Requirements for Non-Cleared Swaps (April 2020), *https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download* (''GMAC Subcommittee Report''). The Global Markets Advisory Committee (''GMAC'') established the GMAC subcommittee to consider issues raised by the implementation of margin requirements for non-cleared swaps, to identify challenges associated with forthcoming implementation phases, and to make recommendations through a report. The GMAC subcommittee issued the GMAC Subcommittee Report recommending various actions, including the codification of Letters 17–12 and 19–25. The GMAC adopted the Report and recommended to the Commission that it consider adopting the Report's recommendations.

[19] Commission regulations are found at 17 CFR part 1 (2017), and may be accessed through the Commission's website, *https://www.cftc.gov.*

[20] 17 CFR 23.151.

exchange of IM or VM is required.[21] Commission regulation 23.158(a) requires the execution of documentation providing CSEs with contractual rights and obligations to exchange IM and VM in accordance with the Commission's regulations.[22]

A. Application of MTA to SMAs

The Commission proposes to amend the definition of MTA in Commission regulation 23.151 to allow a CSE to apply an MTA of up to $50,000 to each SMA owned by a counterparty with which the CSE enters into uncleared swaps. The proposed amendment is consistent with the terms of Letter 17–12, which provides that DSIO would not recommend enforcement action if an SD applies an MTA no greater than $50,000 to each SMA of a legal entity, subject to certain conditions.

When the Commission adopted the CFTC Margin Rule, it rejected the notion that SMAs of a legal entity should be treated separately from each other in applying certain aspects of the margin requirements for uncleared swaps.[23] However, after implementing the margin requirements for several years, the Commission preliminarily believes that separately treating SMAs, at least with respect to the application of the MTA, may be necessary from an operational perspective.

The GMAC subcommittee, in the GMAC Subcommittee Report recently submitted to the Commission for its consideration, stated that while the owner of the SMAs may be the same across the ISDA master agreements and credit support documents entered into with each CSE, the SMAs managed by each asset manager on behalf of the same SMA owner are contractually treated as distinct counterparties in uncleared swap transactions.[24] Given the separation between SMAs existing independently from each other, and the resulting lack of coordination, the management of collateral, and more specifically the calculation of the MTA, across the SMAs may be impractical for each asset manager, hindering efforts to comply with the CFTC Margin Rule.

The Commission acknowledges that certain owners of SMAs, such as pension funds, in administering investments for beneficiaries, may engage in collateral management exercises and may have the capability to aggregate collateral across SMAs that trade uncleared swaps with the same CSE. These beneficial owners of the SMA may be able to aggregate the MTA across each of their SMAs and centralize the management of collateral for all of their SMAs, which may result in increased netting among the SMAs and the CSE, and more efficient collateral management.

Other SMA owners, however, do not have the capability to manage the calculation and aggregation of MTA across their SMAs. In the GMAC Subcommittee Report, the GMAC subcommittee stated that SMA owners are not in a position to coordinate the trading activity across their SMAs, as they typically grant full investment discretion to their asset managers and do not employ a centralized collateral manager in-house.[25] Therefore, these SMA owners are not able to perform collateral management across their accounts.

In theory, asset managers could coordinate with each other the calculation of the MTA across SMAs under their management. However, the Report stated that owners of SMAs typically prohibit information sharing among their SMAs and require asset managers to keep trading information confidential. The Report noted that asset managers lack transparency and control over any assets of the SMA owner other than the specific assets under their management.

The Report also stated that, while a CSE may face the same legal entity—the owner of the accounts—through multiple SMAs managed by different asset managers, a duty of confidentiality to the legal entity prevents the CSE from sharing information with each asset manager concerning the overall legal entity's trading activity.[26] As a result, while each of the SMAs of an owner may contribute to reaching the MTA limit, asset managers for the SMAs only know the amounts of IM and VM being contributed by SMAs under their management.

In light of the practical challenges that the calculation of the MTA across SMAs poses, as described above, the Commission proposes to amend Commission regulation 23.151 to allow CSEs to apply an MTA of up to $50,000 for each SMA of a counterparty. The Commission notes, however, that under the proposed application of the MTA to SMAs, an MTA of up to $50,000 could be applied to an indefinite number of SMAs. This application of the MTA could effectively result in the replacement of the aggregate limit of $500,000 on a particular counterparty's uncollateralized risk for uncleared swaps with an individual limit of $50,000 on each SMA of such counterparty. In turn, the counterparty could have an aggregate amount of uncollateralized margin in excess of $500,000.

While the proposed approach to the application of the MTA for SMAs could provide an incentive for owners of SMAs to create separate accounts or formulate their trading strategies to reduce or avoid margin transfers, the Commission believes that an owner's inability to net collateral across separate accounts may serve as a disincentive to the fragmentation of investments across many SMAs.[27] This is particularly so because the MTA for SMAs, as proposed, would be set at a low level (*i.e.,* $50,000).

The Commission further notes that there are other provisions in the CEA and the Commission's regulations that would mitigate the increase in uncollateralized credit risk resulting from the absence of an aggregate limit on the amount of uncollateralized margin and the use of multiple SMAs by a single counterparty. Specifically, section 4s(j)(2) of the CEA requires CSEs to adopt a robust and professional risk management system adequate for the management of their swap activities,[28] and Commission regulation 23.600[29] mandates that CSEs establish a risk management program to monitor and manage risks associated with their swap activities that includes, among other things, a description of risk tolerance limits.

In addition to amending the definition of MTA, the Commission proposes to define the term SMA in Commission

[21] 17 CFR 23.152(b)(3); 17 CFR 23.153(c).

[22] 17 CFR 23.158(a) (setting forth margin documentation requirements).

[23] *See* 81 FR at 653 (rejecting commenters' request to extend to each separate account of a fund or plan its own initial margin threshold, while acknowledging that separate managers acting for the same fund or plan may not take steps to inform the fund or plan of their uncleared swap exposures on behalf of their principal on a frequent basis).

[24] GMAC Subcommittee Report at 16. However, it should be noted that for credit risk purposes, the beneficial owner of the SMA is the counterparty and the SD has credit exposure to the beneficial owner and not the asset manager.

[25] *Id.*

[26] The Commission notes that Commission regulation 23.410(c)(1)(i) prohibits disclosure by an SD or MSP, including a CSE, of confidential information provided by or on behalf of a counterparty to the SD or MSP. Nevertheless, Commission regulation 23.410(c)(2) provides that the SD or MSP may disclose the counterparty's confidential information if the disclosure is authorized in writing by the counterparty.

[27] As further discussed below, the proposed application of the MTA would only be available for separate accounts of an owner that, consistent with the proposed definition of SMA, are not subject to collateral agreements that provide for netting across the separate accounts.

[28] *See* 7 U.S.C. 6s(j).

[29] 17 CFR 23.600.

regulation 23.151. The term was defined in Letter 17–12 as an account managed by an asset manager and governed by an investment management agreement that grants the asset manager authority with respect to a portion of a legal entity's assets.

The proposed definition of SMA would include the definition of the term as well as certain conditions set forth in Letter 17–12. Specifically, Letter 17–12 provides that the no-action position would only apply with respect to swaps of an SMA of a legal entity that (i) are entered into by an asset manager on behalf of the SMA pursuant to authority granted under an investment management agreement, and (ii) are subject to a master netting agreement that does not permit the netting of IM or VM obligations across SMAs.

DSIO staff included these conditions in the no-action letter because SIFMA AMG stated, in seeking relief, that the authority of asset managers under their investment management agreements with the owners of the SMAs is limited to assets under their management. SIFMA AMG also stated that each SMA that trades uncleared swaps typically has its own payment netting set corresponding to each ISDA master agreement and CSA that is used by an asset manager. These conditions reflect DSIO's recognition that asset managers' limited authority over the assets of a legal entity and the practical inability to net collateral payments across SMAs pose obstacles in the calculation and aggregation of the MTA across SMAs.

As proposed, the term SMA would be defined as an account of a counterparty to a CSE that is managed by an asset manager pursuant to a specific grant of authority to such asset manager under an investment management agreement between the counterparty and the asset manager, with respect to a specified portion of the counterparty's assets.[30] In addition, the definition would require that the swaps of the SMA be: (i) Entered into between the counterparty and the CSE by the asset manager pursuant to authority granted by the counterparty to the asset manager through an investment management agreement, and (ii) subject to a master netting agreement that does not provide for the netting of IM or VM obligations across all SMAs of the counterparty that have swaps outstanding with the CSE.

Request for comment: The Commission requests comment regarding the proposed amendments to Commission regulation 23.151. The Commission specifically requests comment on the following questions:

• The proposed amendments to Commission regulation 23.151 would allow a CSE to apply up to $50,000 of MTA for each SMA of a counterparty with multiple SMAs. The aggregate MTA for the counterparty could thus exceed the $500,000 MTA threshold, which could result in delaying the exchange of IM and VM, as neither IM nor VM would need to be exchanged until the threshold has been exceeded. As such, less margin may be collected and posted than would be permitted under the current requirements. In light of the resulting potential uncollateralized swap risk, should the Commission consider an alternative to the proposed amendments? Should the Commission impose any additional limits or conditions? Would the proposed amendments to Commission regulation 23.151 incentivize SMA owners to create additional separate accounts to potentially benefit from a higher MTA limit, or otherwise alter their trading strategies, thus increasing the amount of uncollateralized swap risk? What measures could the Commission take to mitigate any such risk? Please provide data on the current average number of separate accounts per counterparty and the current average amount of daily collateral movements between CSEs and counterparties who own SMAs. Has there been a change in the number of SMAs per counterparty following the adoption of Letter 17–12?

• Market participants have indicated that the aggregation of the MTA across SMAs may not be practicable because SMA owners generally grant full investment discretion to asset managers and do not employ a centralized collateral manager in-house to coordinate swap activity and manage collateral payments across their SMAs. Nevertheless, as an alternative to the proposed rule, the Commission seeks comments on whether it is feasible and desirable to maintain the CFTC's existing requirements, which would therefore necessitate that owners of SMAs and their asset managers address these challenges through coordination and arrangements between themselves, so that they are able to manage the relationship with the CSE with whom the SMAs enter into uncleared swaps and are able to meet margin obligations as they arise. Do the practical challenges posed by the status quo outweigh any potential concerns raised by this Proposal?

• Should the Commission proceed to adopt the proposed amendments to Commission regulation 23.151 if the prudential regulators do not adopt similar regulatory changes? Is there a potential for confusion if that were to be the case?

B. Application of Separate MTAs for IM and VM

The Commission proposes to revise the margin documentation requirements outlined in Commission regulation 23.158(a) in recognition that, consistent with Letter 19–25, a CSE may apply separate MTAs for IM and VM with each counterparty, provided that the MTAs corresponding to IM and VM are specified in the margin documentation required by Commission regulation 23.158 and that the MTAs, on a combined basis, do not exceed the MTA specified in Commission regulation 23.151.

Letter 19–25 provides that CSEs can apply separate MTAs for IM and VM for determining whether IM and VM must be exchanged under Commission regulations 23.152(b)(2) and 23.153(c), provided that the MTAs set out for IM and VM for a counterparty, on a combined basis, do not exceed $500,000. In issuing Letter 19–25, DSIO acknowledged that applying separate MTAs for IM and VM may result in the exchange of less total margin than the amount that would be exchanged if the MTA were computed on an aggregate basis.[31] However, in DSIO's view, given that the total amount of combined IM and VM that would not be exchanged would never exceed $500,000, differences in the total margin exchanged would not be material and would not result in an unacceptable level of credit risk.[32]

[30] The proposed definition of the term SMA would refer to the aggregate account of a counterparty managed by an asset manager under the investment management agreement, and not to fund or pool sleeves overseen by sub-advisers.

[31] Letter 19–25 provides the following example to illustrate the effect of the no-action relief. An SD and a counterparty agree to a $300,000 IM MTA and a $200,000 VM MTA. If the margin calculations set forth in Commission regulations 23.154 (for IM) and 23.155 (for VM) require the SD to post $400,000 of IM with the counterparty and $150,000 of VM with the counterparty, the SD will be required to post $400,000 of IM with the counterparty (assuming that the $50 million IM threshold amount, defined in Commission regulation 23.151, for the counterparty has been exceeded). The SD, however, will not be obligated to post any VM with the counterparty as the $150,000 requirement is less than the $200,000 MTA. By contrast, in the absence of relief, the SD would have been required to post $550,000 (the full amount of both IM and VM), given that the combined amount of IM and VM exceeds the MTA of $500,000.

[32] The Commission acknowledges, however, that if the application of MTAs of up to $50,000 for SMAs is adopted as set forth in this Proposal, the amounts of margin that would not be exchanged may in some cases exceed the $500,000 limit. Specifically, this may be the case if the CSE enters into swaps with more than ten SMAs belonging to the same counterparty. If each SMA is allocated an MTA of $50,000, the amount of margin not exchanged between the counterparties may exceed $500,000, even if the sum of the separate IM and

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The Commission preliminarily believes that adopting regulations consistent with the terms of Letter 19–25 would accommodate a widespread market practice that facilitates the implementation of the CFTC margin requirements. The Commission notes that CSEs and their counterparties maintain separate settlement workflows for IM and VM to reflect, from an operational perspective, the different regulatory requirements applicable to IM and VM. IM posted or collected by a CSE must be held by one or more custodians that are not affiliated with the CSE or the counterparty.[33] VM posted or collected by a CSE is not required to be segregated with an independent custodian.[34]

DSIO, in taking a no-action position, stated its belief that the application of separate MTAs for IM and VM, subject to certain conditions, is consistent with the Commission's objective of requiring swap counterparties to mitigate credit and market risks, while reducing the cost and burdens associated with the transfer of small margin balances. The Commission preliminarily agrees with that view and requests public comment.

The Commission also notes that similar applications of the MTA are permitted in certain foreign jurisdictions, including the European Union.[35] The proposed amendment to Commission regulation 23.158(a) would therefore promote consistent regulatory standards across jurisdictions, in line with the statutory mandate set forth in the Dodd-Frank Act[36] and reduce the need for market participants to create and implement IM and VM settlement flows tailored to different jurisdictions.

The proposed amendment to Commission regulation 23.158(a) would incorporate the conditions set forth in Letter 19–25. To that effect, the Commission would require that the separate MTAs to be applied for IM and VM be specified in the margin documentation required by Commission regulation 23.158(a). Consistent with Letter 19–25 and the proposed definition of MTA, Commission regulation 23.158(a), as proposed, would further specify that, on a combined basis, the MTAs to be applied for IM and VM must not exceed the MTA as the term is defined in Commission regulation 23.151.

In imposing these conditions, the Commission seeks to ensure maximum margin coverage for uncleared swaps, while recognizing that swap counterparties may apply separate MTAs for IM and VM, thus facilitating the implementation and administration of the uncleared margin requirements.

Request for comment: The Commission requests comment regarding the proposed amendment to Commission regulation 23.158(a). The Commission specifically requests comment on the following questions:

- Is the proposed amendment to Commission regulation 23.158(a) appropriate in light of the CFTC's overall approach to margin requirements for uncleared swaps? Should the Commission impose any additional limits or conditions?
- The application of separate MTAs for IM and VM may result in less margin being exchanged as compared to the amounts that would be exchanged if separate MTAs are not permitted, increasing the amount of uncleared swap uncollateralized risk. Should the Commission consider any alternative to the proposed amendment that more fully addresses the risk of uncleared swaps?
- Should the application of separate MTAs for IM and VM be extended to SMAs of a counterparty, for each of which an MTA of up to $50,000 would be applied under the proposed amendment to Commission regulation 23.151?
- Should the Commission proceed to adopt the proposed amendment to Commission regulation 23.158(a) if the prudential regulators do not adopt similar regulatory changes? Is there a potential for confusion if that were to be the case?

C. Conforming Changes

Consistent with the proposed amendment to the definition of MTA in Commission regulation 23.151, the Commission proposes to make conforming changes to Commission regulations 23.152(b)(3) and 23.153(c) by replacing ''$500,000'' with ''the minimum transfer amount, as the term is defined in 23.151.'' The proposed changes would replace the reference to $500,000 in current Commission regulations 23.152(b)(3) and 23.153(c), which effectively limits the MTA to $500,000, with a reference to the revised definition of MTA, incorporating the proposed definition of MTA, which would allow for the application of an MTA of up to $50,000 for each SMA.

III. Administrative Compliance

The Regulatory Flexibility Act (''RFA'') requires Federal agencies to consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.[37] Whenever an agency publishes a general notice of proposed rulemaking for any rule, pursuant to the notice-and-comment provisions of the Administrative Procedure Act,[38] a regulatory flexibility analysis or certification typically is required.[39] The Commission previously has established certain definitions of ''small entities'' to be used in evaluating the impact of its regulations on small entities in accordance with the RFA.[40] The proposed amendments only affect certain SDs and MSPs and their counterparties, which must be eligible contract participants (''ECPs'').[41] The Commission has previously established that SDs, MSPs and ECPs are not small entities for purposes of the RFA.[42]

Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed amendments will not have a significant economic impact on a substantial number of small entities.

A. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (''PRA'')[43] imposes certain requirements on Federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA. The Commission may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid

VM MTAs applied to each SMA does not exceed the $50,000 MTA threshold applicable to SMAs.

[33] *See* 17 CFR 23.157(a).

[34] *See supra* note 9.

[35] *See* Commission Delegated Regulation (EU) 2016/2251 Supplementing Regulation (EU) No. 648/2012 of the European Parliament and of the Council of July 4, 2012 on OTC Derivatives, Central Counterparties and Trade Repositories with Regard to Regulatory Technical Standards for Risk-Mitigation Techniques for OTC Derivative Contracts Not Cleared by a Central Counterparty (Oct. 4, 2016), Article 25(4), *https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R2251&from=EN.*

[36] *See* section 752 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010), calling on the CFTC to consult and coordinate on the establishment of consistent international standards with respect to the regulation of swaps.

[37] 5 U.S.C. 601 *et seq.*

[38] 5 U.S.C. 553. The Administrative Procedure Act is found at 5 U.S.C. 500 *et seq.*

[39] *See* 5 U.S.C. 601(2), 603, 604, and 605.

[40] *See* Registration of Swap Dealers and Major Swap Participants, 77 FR 2613 (Jan. 19, 2012).

[41] Pursuant to section 2(e) of the CEA, 7 U.S.C. 2(e), each counterparty to an uncleared swap must be an ECP, as defined in section 1a(18) of the CEA, 7 U.S.C. 1a(18).

[42] *See* Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant,'' 77 FR 30596, 30701 (May 23, 2012).

[43] 44 U.S.C. 3501 *et seq.*

Office of Management and Budget control number. The proposed rules contain no requirements subject to the PRA.

B. Cost-Benefit Considerations

Section 15(a) of the CEA [44] requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) considerations.

The Commission is proposing to amend Commission regulation 23.151 consistent with Letter 17–12. The Commission proposes to revise the definition of MTA in Commission regulation 23.151 to permit CSEs to apply an MTA of up to $50,000 for each SMA of a counterparty that enters into uncleared swaps with a CSE. The Commission also proposes to amend Commission regulation 23.151 to add a definition for the term SMA (or separately managed account). The Commission is also proposing to revise Commission regulation 23.158(a) consistent with Letter 19–25 to state that if a CSE and its counterparty agree to have separate MTAs for IM and VM, the respective amounts of MTA must be reflected in the margin documentation required by Commission regulation 23.158(a). Finally, the Commission proposes conforming changes to Commission regulations 23.152(b)(3) and 23.153(c) to incorporate the proposed change to the definition of MTA in Commission regulation 23.151.

The baseline for the Commission's consideration of the costs and benefits of this Proposal is the CFTC Margin Rule. The Commission recognizes that to the extent market participants have relied on Letters 17–12 and 19–25, the actual costs and benefits of the proposed amendments, as realized in the market, may not be as significant.

The Commission notes that the consideration of costs and benefits below is based on the understanding that the markets function internationally, with many transactions involving U.S. firms taking place across international boundaries; with some Commission registrants being organized outside of the United States; with leading industry members typically conducting operations both within and outside the United States; and with industry members commonly following substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the below discussion of costs and benefits refers to the effects of the proposed amendments on all activity subject to the amended regulations, whether by virtue of the activity's physical location in the United States or by virtue of the activity's connection with or effect on U.S. commerce under section 2(i) of the CEA.[45]

1. Benefits

The proposed amendments to Commission regulation 23.151 would allow CSEs to apply an MTA of up to $50,000 to SMAs of a counterparty. Under the current requirements, a CSE must apply the MTA with respect to each counterparty to an uncleared transaction. As a result, in the context of a counterparty that has multiple SMAs through which uncleared swaps are traded, with each SMA potentially giving rise to IM and VM obligations, the amounts of IM and VM attributable to the SMAs of the counterparty must be aggregated to determine whether the MTA has been exceeded, which would require the exchange of IM or VM.

As previously discussed, because the assets of SMAs are separately held, transferred, and returned at the account level, and CSEs and SMA asset managers do not share trading information across SMAs, aggregation of IM and VM obligations across SMAs for the purpose of determining whether the MTA has been exceeded may be impractical, hindering efforts to comply with the CFTC Margin Rule. The Commission acknowledges, however, the possibility that, in certain contexts, an owner of SMAs, such as a pension fund that administers investments for beneficiaries, may be set up to and may perform collateral management exercises, and may have the capability to aggregate collateral across SMAs. Nevertheless, according to preliminary industry feedback, the only practical alternative to fully ensure compliance with the margin requirements is to set the MTA for each SMA at zero, so that trading by a given SMA does not result in an inadvertent breach of the aggregate MTA threshold without the exchange of the required margin.

The proposed amendments to Commission regulation 23.151, by allowing the application of an MTA of up to $50,000 for each SMA of a counterparty, would ease the operational burdens and transactional costs associated with managing frequent transfers of small amounts of collateral that counterparties would incur if the MTA for SMAs were to be set at zero. In addition, the proposed amendments give flexibility to CSEs, owners of SMAs, and asset managers to negotiate MTA levels within the regulatory limits that match the risks of the SMAs and their investment strategies, and the uncleared swaps being traded.

Furthermore, because the proposed amendments to Commission 23.151 would simplify the application of the MTA in the SMA context, thereby reducing the operational burden, market participants may be encouraged to participate in the uncleared swap markets through managed accounts, and account managers may also make their services more readily available to clients. As a result, trading in the uncleared swap markets may increase, promoting competition and liquidity.

The amendment of Commission regulation 23.158(a) would likewise lead to efficiencies in the application of the MTA. The proposed amendment would state that if a CSE and its counterparty agree to have separate MTAs for IM and VM, the respective amounts of MTA must be reflected in the margin documentation required by Commission regulation 23.158(a). CSEs would thus be able to maintain separate margin settlement workflows for IM and VM to address the differing segregation treatments for IM and VM under the CFTC Margin Rule.

The Commission notes that the application of separate MTAs for IM and VM has been adopted in other jurisdictions, including the European Union, and the practice is widespread. The proposed amendment, in aligning the CFTC with other jurisdictions with respect to the application of the MTA, would advance the CFTC's efforts in promoting consistent international standards, in line with the statutory mandate set forth in the Dodd-Frank Act.

Finally, the proposed amendments would provide certainty to market participants who may have relied on Letters 17–12 and 19–25, and could thereby facilitate their efforts to take the operation of the Commission's regulations into account in the planning of their uncleared swap activities.

[44] 7 U.S.C. 19(a).

[45] 7 U.S.C. 2(i).

2. Costs

The proposed amendments to Commission regulation 23.151 could result in a CSE applying an MTA that exceeds, in the aggregate, the current MTA limit of $500,000. That is because the proposed amendments would permit the application of an MTA of up to $50,000 for each SMA of a counterparty, without limiting the number of SMAs to which the $50,000 threshold may be applied. The amendments may even incentivize SMA owners to increase the number of separate accounts in order to benefit from the higher MTA limit. As a result, the collection and posting of margin for some SMAs may be delayed, since margin would not need to be exchanged until the MTA threshold is exceeded, which could result in the exchange of less collateral to mitigate the risk of uncleared swaps.

The proposed amendment to Commission regulation 23.158(a) would state that if a CSE and its counterparty agree to have separate MTAs for IM and VM, the respective amounts of MTA must be reflected in the margin documentation required by Commission regulation 23.158(a). The proposed amendment would recognize that CSEs can apply separate MTAs for IM and VM for determining whether Commission regulations 23.152(b)(3) and 23.153(c) require the exchange of IM or VM. The Commission acknowledges that the application of separate IM and VM MTAs may result in the exchange of a lower amount of total margin between a CSE and its counterparty to mitigate the risk of their uncleared swaps than the amount that would be exchanged if the IM and VM MTA were computed on an aggregate basis.[46] The Commission notes that this cost may be mitigated because the application of separate IM and VM MTAs could also result in the exchange of higher rather than lower amounts of margin.[47]

While the Commission recognizes that the uncollateralized exposure that may result from amending Commission regulations 23.151 and 23.158(a) in line with Letters 17–12 and 19–25 could increase credit risk associated with uncleared swaps, the Commission believes that a number of safeguards exist to mitigate this risk. The Commission notes that the proposed amendments set the MTA at low levels. When the MTA is applied to a counterparty, the sum of the IM and VM MTAs must not exceed $500,000. When the MTA is applied to an SMA of a counterparty, the sum of the IM and VM MTAs must not exceed $50,000. Even if the aggregate MTA applied to a counterparty that owns multiple SMAs may exceed $500,000, the total amount of margin that is permitted to remain unexchanged is expected to be low, because other regulatory safeguards exist to limit the credit exposure, including section 4s(j)(2) of the CEA,[48] which mandates that CSEs adopt a robust and professional risk management system adequate for the management of day-to-day swap activities, and Commission regulation 23.600,[49] which requires CSEs, in establishing a risk management program for the monitoring and management of risk related to their swap activities, to account for credit risk and to set risk tolerance limits.

3. Section 15(a) Considerations

In light of the foregoing, the CFTC has evaluated the costs and benefits of the Proposal pursuant to the five considerations identified in section 15(a) of the CEA as follows:

a. Protection of Market Participants and Public

As discussed above, the proposed amendments to Commission regulations 23.151 and 23.158(a), which address the application of the MTA to SMAs and the application of separate MTAs for IM and VM, would remove practical burdens in the application of the MTA, facilitating the implementation of the CFTC Margin Rule, with minimal impact on the protection of market participants and the public in general. Although the proposed amendments could result in larger amounts of MTA being applied to uncleared swaps, potentially resulting in the exchange of reduced margin to offset the risk of uncleared swaps, the impact is likely to be negligible relative to the size of the uncleared swap positions. The Commission notes that the MTA thresholds are set at low levels. In addition, CSEs are required to monitor and manage risk associated with their swaps, in particular credit risk, and to set tolerance levels as part of the risk management program mandated by Commission regulation 23.600. To meet the risk tolerance levels, CSEs may contractually limit the MTA or the number of SMAs with which they enter into transactions.

b. Efficiency, Competitiveness, and Financial Integrity of Markets

By amending Commission regulation 23.151 to allow CSEs to apply an MTA of up to $50,000 for each SMA of a counterparty, the Commission would eliminate burdens and practical challenges associated with the computation and aggregation of the MTA across multiple SMAs. In addition, the new MTA threshold for SMAs could have the effect of delaying how soon margin would be exchanged, as the aggregate MTA for SMAs would no longer be limited to $500,000.

The simplification of the process for applying the MTA to SMAs and the reduced cost that may be realized from the deferral of margin obligations may encourage market participants to enter into uncleared swaps through accounts managed by asset managers and also encourage asset managers to accept more clients. The proposed amendments to Commission regulation 23.151 could therefore foster competitiveness by encouraging increased participation in the uncleared swap markets.

The proposed amendment to Commission 23.158(a) would state that if a CSE and its counterparty agree to have separate MTAs for IM and VM, the respective amounts of MTA must be reflected in the margin documentation required by Commission regulation 23.158(a). The proposed amendment would recognize that CSEs can apply separate MTAs for IM and VM, enabling CSEs to accommodate the different segregation treatments for IM and VM under the CFTC's margin requirements and to more efficiently comply with the CFTC Margin Rule.

The proposed amendments to Commission regulations 23.151 and 23.158(a) could have the overall effect of permitting larger amounts of MTA being applied to uncleared swaps, resulting in the collection and posting of less collateral to offset the risk of uncleared swaps, which could undermine the integrity of the markets. The Commission, however, believes that the

[46] *Supra* note 31 (explaining how the application of separate MTAs for IM and VM could result in the exchange of lower amounts of margin than if IM and VM MTA were computed on an aggregate basis).

[47] The following illustration explains how the application of separate MTAs for IM and VM could result in the exchange of higher amounts of margin than if IM and VM MTA were computed on an aggregate basis: An SD and a counterparty agree to $300,000 IM MTA, and $200,000 VM MTA. If the margin calculations set forth in Commission regulations 23.154 (for IM), and 23.155 (for VM) require the SD to post $200,000 of IM with the counterparty and $250,000 of VM with the counterparty, the SD would not be required to post IM with the counterparty as the $200,000 requirement is less than the $300,000 MTA. However, the SD would be required to post $250,000 in VM as the VM required exceeds the $200,000 VM MTA, even though the total amount of margin owed is below the $500,000 MTA set forth in Commission regulations 23.152(b)(3) and 23.153(c). Letter 19–25 at 4.

[48] 7 U.S.C. 6s(j)(2).

[49] 17 CFR 23.600.

uncollateralized swap exposure would be limited given that the MTA thresholds are set at low levels, and there are other built-in regulatory safeguards, such as the requirement that CSEs establish a risk management program under Commission regulation 23.600 that provides for the implementation of internal risk parameters for the monitoring and management of swap risk.

The Commission also notes that the proposed amendments would provide certainty to market participants who may have relied on Letters 17–12 and 19–25, and thereby facilitate their efforts to take the operation of the Commission's regulations into account in planning their uncleared swap activities.

c. Price Discovery

The proposed amendments to Commission regulations 23.151 and 23.158(a) would simplify the process for applying the MTA, reducing the burden and cost of implementation. Given these cost savings, CSEs and other market participants may be encouraged to increase their participation in the uncleared swap markets. As a result, trading in uncleared swaps may increase, leading to increased liquidity and enhanced price discovery.

d. Sound Risk Management

Because the proposed amendments to Commission regulations 23.151 and 23.158(a) may permit the application of larger amounts of MTA, less margin may be collected and posted to offset the risk of uncleared swaps. Nevertheless, the Commission believes that the risk would be mitigated because the regulatory MTA thresholds are set at low levels, and CSEs are required to have a risk management program that provides for the implementation of internal risk management parameters for the monitoring and management of swap risk.

The Commission also notes that the proposed amendments would simplify the application of the MTA, reducing the burden and cost of implementation, without leading to an unacceptable level of uncollateralized credit risk. Such reduced burden and cost could encourage market participants to increase their participation in the uncleared swap markets, potentially facilitating improved risk management for counterparties using uncleared swaps to hedge risks. Moreover, by facilitating compliance with certain aspects of the Commission's regulations, the Commission would allow market participants to focus their efforts on monitoring and ensuring compliance with other substantive aspects of the CFTC Margin Rule, thus promoting balanced and sound risk management.

e. Other Public Interest Considerations

The proposed amendment to Commission regulation 23.158(a) would address the application of separate MTAs for IM and VM, contributing to the CFTC's alignment with other jurisdictions, such as the European Union, which would advance the CFTC's efforts to achieve consistent international standards. The CFTC's alignment with other jurisdictions with respect to the application of the MTA will benefit CSEs that are global market participants by eliminating the need to establish different settlement workflows tailored to each jurisdiction in which they operate.

Request for Comment. The Commission invites comment on its preliminary consideration of the costs and benefits associated with the proposed amendments to Commission regulations 23.151, 23.152(b)(3), 23.153(c) and 23.158(a), especially with respect to the five factors the Commission is required to consider under section 15(a) of the CEA. In addressing these areas and any other aspect of the Commission's preliminary cost-benefit considerations, the Commission encourages commenters to submit any data or other information they may have quantifying and/or qualifying the costs and benefits of the Proposal. The Commission also specifically requests comment on the following questions:

- Has the Commission accurately identified the benefits of this Proposal? Are there other benefits to the Commission, market participants, and/or the public that may result from the adoption of this Proposal that the Commission should consider? Please provide specific examples and explanations of any such benefits.
- Has the Commission accurately identified the costs of this Proposal? Are there additional costs to the Commission, market participants, and/or the public that may result from the adoption of this Proposal that the Commission should consider? Please provide specific examples and explanations of any such costs.
- Does this Proposal impact the section 15(a) factors in any way that is not described above? Please provide specific examples and explanations of any such impact.
- Whether, and the extent to which, any specific foreign requirement(s) may affect the costs and benefits of the Proposal. If so, please identify the relevant foreign requirement(s) and any monetary or other quantitative estimates of the potential magnitude of those costs and benefits.
- What are the benefits and costs if the Commission, as an alternative to this Proposal, were to maintain the status quo with respect to SMAs, which would therefore necessitate that the owners of SMAs and their asset managers address the practical challenges in the calculation of the MTA across SMAs through coordination and arrangements between the parties, in conjunction with the CSE that executes the swap trades? Would such an approach impose an undue burden on either the CSE or the SMA owner? Would the potential benefit of maintaining the existing $500,000 MTA threshold outweigh any potential costs?

C. Antitrust Considerations

Section 15(b) of the CEA requires the Commission to ''take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the CEA, in issuing any order or adopting any Commission rule or regulation (including any exemption under section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of the CEA.[50]

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requests comment on whether the Proposal implicates any other specific public interest to be protected by the antitrust laws.

The Commission has considered the Proposal to determine whether it is anticompetitive and has preliminarily identified no anticompetitive effects. The Commission requests comment on whether the Proposal is anticompetitive and, if it is, what the anticompetitive effects are.

Because the Commission has preliminarily determined that the Proposal is not anticompetitive and has no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA. The Commission requests comment on whether there are less anticompetitive means of achieving the relevant purposes of the CEA that would otherwise be served by adopting the Proposal.

[50] 7 U.S.C. 19(b).

List of Subjects in 17 CFR Part 23

Capital and margin requirements, Major swap participants, Swap dealers, Swaps.

For the reasons stated in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR part 23 as set forth below:

PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

■ 1. The authority citation for part 23 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b–1, 6c, 6p, 6r, 6s, 6t, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21.

Section 23.160 also issued under 7 U.S.C. 2(i); Sec. 721(b), Pub. L. 111–203, 124 Stat. 1641 (2010).

■ 2. In § 23.151:

■ a. Revise the definition of ''Minimum transfer amount''; and

■ b. Add the definition for ''Separately managed account'' in alphabetical order.

The revision and addition read as follows:

§ 23.151 Definitions applicable to margin requirements.

* * * * *

Minimum transfer amount means a combined initial and variation margin amount under which no actual transfer of funds is required. The minimum transfer amount shall be $500,000. Where a counterparty to a covered swap entity owns two or more separately managed accounts, a minimum transfer amount of up to $50,000 may be applied for each separately managed account.

* * * * *

Separately managed account means an account of a counterparty to a covered swap entity that meets the following requirements:

(1) The account is managed by an asset manager and governed by an investment management agreement, pursuant to which the counterparty grants the asset manager authority with respect to a specified amount of the counterparty's assets;

(2) Swaps are entered into between the counterparty and the covered swap entity by the asset manager on behalf of the account pursuant to authority granted by the counterparty through an investment management agreement; and

(3) The swaps of such account are subject to a master netting agreement that does not provide for the netting of initial or variation margin obligations across all such accounts of the counterparty that have swaps outstanding with the covered swap entity.

* * * * *

■ 3. Amend § 23.152 by revising paragraph (b)(3) to read as follows:

§ 23.152 Collection and posting of initial margin.

* * * * *

(b) * * *

(3) *Minimum transfer amount.* A covered swap entity is not required to collect or to post initial margin pursuant to §§ 23.150 through 23.161 with respect to a particular counterparty unless and until the combined amount of initial margin and variation margin that is required pursuant to §§ 23.150 through 23.161 to be collected or posted and that has not been collected or posted with respect to the counterparty is greater than the minimum transfer amount, as the term is defined in § 23.151.

* * * * *

■ 4. Amend § 23.153 by revising paragraph (c) to read as follows:

§ 23.153 Collection and posting of variation margin.

* * * * *

(c) *Minimum transfer amount.* A covered swap entity is not required to collect or to post variation margin pursuant to §§ 23.150 through 23.161 with respect to a particular counterparty unless and until the combined amount of initial margin and variation margin that is required pursuant to §§ 23.150 through 23.161 to be collected or posted and that has not been collected or posted with respect to the counterparty is greater than the minimum transfer amount, as the term is defined in § 23.151.

* * * * *

■ 5. Amend § 23.158 by revising paragraph (a) to read as follows:

§ 23.158 Margin documentation.

(a) *General requirement.* Each covered swap entity shall execute documentation with each counterparty that complies with the requirements of §§ 23.504 and that complies with this section, as applicable. For uncleared swaps between a covered swap entity and a counterparty that is a swap entity or a financial end user, the documentation shall provide the covered swap entity with the contractual right and obligation to exchange initial margin and variation margin in such amounts, in such form, and under such circumstances as are required by §§ 23.150 through 23.161. With respect to the minimum transfer amount, if a covered swap entity and a counterparty that is a swap entity or a financial end user agree to have separate minimum transfer amounts for initial and variation margin, the documentation shall specify the amounts to be allocated for initial margin and variation margin. Such amounts, on a combined basis, must not exceed the minimum transfer amount, as the term is defined in § 23.151.

* * * * *

Issued in Washington, DC, on August 14, 2020, by the Commission.

Robert Sidman,

Deputy Secretary of the Commission.

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Commission Voting Summary and Commissioners' Statements

Appendix 1—Commission Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz, Behnam, Stump, and Berkovitz voted in the affirmative. No Commissioner voted in the negative.

Appendix 2—Supporting Statement of Commissioner Dawn D. Stump Overview

I am pleased to support the proposed rulemaking that the Commission is issuing with respect to the ''minimum transfer amount'' provisions of its margin requirements for uncleared swaps.

This proposed rulemaking addresses recommendations that the Commission has received from its Global Markets Advisory Committee (''GMAC''), which I am proud to sponsor, and is based on a comprehensive report prepared by GMAC's Subcommittee on Margin Requirements for Non-Cleared Swaps (''GMAC Margin Subcommittee'').[1] It demonstrates the value added to the Commission's policymaking by its Advisory Committees, in which market participants and other interested parties come together to provide us with their perspectives and potential solutions to practical problems.

The proposed rulemaking contains two proposals, which have much to commend them. These proposals further objectives that I have commented on before:

- The need to tailor our rules to assure that they are workable for those required to comply with them; and
- the benefits of codifying relief that has been issued by our Staff and re-visiting our rules, where appropriate.

I am very appreciative of the many people whose efforts have contributed to bringing this proposed rulemaking to fruition. First, the members of the GMAC, and especially the GMAC Margin Subcommittee, who devoted a tremendous amount of time to

[1] *Recommendations to Improve Scoping and Implementation of Initial Margin Requirements for Non-Cleared Swaps,* Report to the CFTC's Global Markets Advisory Committee by the Subcommittee on Margin Requirements for Non-Cleared Swaps (April 2020), available at *https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download.*

quickly provide us with a high-quality report on complex margin issues at the same time they were performing their ''day jobs'' during a global pandemic. Second, Chairman Tarbert, for his willingness to include this proposed rulemaking on the busy agenda that he has laid out for the Commission for the rest of this year. Third, my fellow Commissioners, for working with me on these important issues. And finally, the Staff of the Division of Swap Dealer and Intermediary Oversight (''DSIO''), whose tireless efforts have enabled us to advance these initiatives to assure that our uncleared margin rules are workable for all, thereby enhancing compliance consistent with our responsibilities under the Commodity Exchange Act (''CEA'').

A Different Universe is coming into Scope of the Uncleared Margin Rules

The Commission's uncleared margin rules for swap dealers, like the Framework of the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions (''BCBS/IOSCO'') [2] on which they are based, were designed primarily to ensure the exchange of margin between the largest financial institutions for their uncleared swap transactions with one another. These institutions and transactions are already subject to uncleared margin requirements.

Pursuant to the phased implementation schedule of the Commission's rules and the BCBS/IOSCO Framework, though, a different universe of market participants—presenting unique considerations—is coming into scope of the margin rules. It is only now, as we enter into the final phases of the implementation schedule, that the Commission's uncleared margin rules will apply to a significant number of financial end-users, and we have a responsibility to make sure they are fit for that purpose.

Accordingly, now is the time we must explore whether the regulatory parameters that we have applied to the largest financial institutions in the earlier phases of margin implementation need to be tailored to account for the practical operational challenges posed by the exchange of margin when one of the counterparties is a pension plan, endowment, insurance provider, mortgage service provider, or other financial end-user.

The proposed rulemaking regarding the ''minimum transfer amount'' does exactly that. The Commission's uncleared margin rules provide that a swap dealer is not required to collect or post initial margin (''IM'') or variation margin (''VM'') with a counterparty until the combined amount of such IM and VM exceeds the minimum transfer amount (''MTA'') of $500,000. Yet, the application of the MTA presents a significant operational challenge for institutional investors that typically hire asset managers to exercise investment discretion over portions of their assets in separately managed accounts (''SMAs'') for purposes of diversification. As a practical matter, neither the owner of the SMA, the manager of the assets in the SMA, nor the swap dealer that is a counterparty to the SMA is in a position to readily determine when the MTA has been exceeded on an aggregate basis (or to assure that it is not).

To address this challenge, the Commission is proposing to amend the definition of MTA in its margin rules to allow a swap dealer to apply an MTA of up to $50,000 to each SMA owned by a counterparty with which the swap dealer enters into uncleared swaps. As noted in the proposing release, any potential increase in uncollateralized credit risk as a result would be mitigated both by the conditions set out in the proposed rules, as well as existing safeguards in the CEA and the Commission's regulations.[3]

I believe that this is a sensible approach and an appropriate refinement to make the Commission's uncleared margin rules workable for SMAs given the realities of the modern investment management environment. As I have stated before, no matter how well-intentioned a rule may be, if it is not workable, it cannot deliver on its intended purpose.[4]

The Benefits of Codifying Staff Relief and Re-Visiting our Rules

Application of MTA to SMAs: The proposal that I have discussed above to amend the application of the MTA to SMAs would codify no-action relief in Letter No. 17–12 that DSIO issued in 2017.[5] Our Staff often has occasion to issue relief or take other action in the form of no-action letters, interpretative letters, or advisories on various issues and in various circumstances. This affords the Commission a chance to observe how the Staff action operates in real-time, and to evaluate lessons learned. With the benefit of this time and experience, the Commission should then consider whether codifying such staff action into rules is appropriate.[6]

As I have said before, ''[i]t is simply good government to re-visit our rules and assess whether certain rules need to be updated, evaluate whether rules are achieving their objectives, and identify rules that are falling short and should be withdrawn or improved.'' [7] Experience with DSIO's no-action relief in Letter No. 17–12 supports today's proposal to tailor the application of the MTA under the Commission's uncleared margin rules in the SMA context.

Separate MTAs for IM and VM: The second proposal regarding the MTA in this proposed rulemaking similarly would codify existing DSIO no-action relief in recognition of market realities. Consistent with DSIO's Letter No. 19–25,[8] it would recognize that a swap dealer may apply separate MTAs for IM and VM with each counterparty, provided that the MTAs corresponding to IM and VM are specified in the margin documentation required under the Commission's regulations, and that the MTAs, on a combined basis, do not exceed the prescribed MTA.

DSIO's no-action relief, and the Commission's proposed codification, take into account the separate settlement workflows that swap counterparties maintain to reflect, from an operational perspective, the different regulatory treatment of IM and VM.[9] At the same time, given that the total amount of combined IM and VM exchanged would not exceed the prescribed MTA, separate MTAs for IM and VM would not materially increase the amount of credit risk at a given time. Under Letter No. 19–25 and this proposal, swap dealers and their counterparties can manage MTA in an operationally practicable way that aligns with the market standard.

There Remains Unfinished Business

The report of the GMAC Margin Subcommittee recommended several actions beyond those contained in this proposed rulemaking in order to address the unique challenges associated with the application of uncleared margin requirements to end-users. Having been present for the development of the Dodd-Frank Act, I recall the concerns expressed by many lawmakers about applying the new requirements to end-users. The practical challenges with respect to

[2] *See generally* BCBS/IOSCO, Margin requirements for non-centrally cleared derivatives (July 2019), available at *https://www.bis.org/bcbs/publ/d475.pdf.*

[3] Specifically, CEA Section 4s(j)(2), 7 U.S.C. 6s(j)(2), requires swap dealers to adopt a robust risk management system adequate for the management of their swap activities, and CFTC Rule 23.600, 17 CFR 23.600, requires swap dealers to establish a risk management program to monitor and manage risks associated with their swap activities.

[4] Statement of Commissioner Dawn D. Stump Regarding Final Rule: Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants (July 23, 2020), available at *https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement072320.*

[5] CFTC Letter No. 17–12, Commission Regulations 23.152(b)(3) and 23.153(c): No-Action Position for Minimum Transfer Amount with respect to Separately Managed Accounts (February 13, 2017), available at *https://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-12.pdf.*

[6] *See* comments of Commissioner Dawn D. Stump during Open Commission Meeting on January 30, 2020, at 183 (noting that after several years of no-action relief regarding trading on swap execution facilities (''SEFs''), ''we have the benefit of time and experience and it is time to think about codifying some of that relief. . . . [T]he SEFs, the market participants, and the Commission have benefited from this time and we have an obligation to provide more legal certainty through codifying these provisions into rules.''), available at *https://www.cftc.gov/sites/default/files/2020/08/1597339661/openmeeting_013020_Transcript.pdf.*

[7] Statement of Commissioner Dawn D. Stump for CFTC Open Meeting on: (1) Final Rule on Position Limits and Position Accountability for Security Futures Products; and (2) Proposed Rule on Public Rulemaking Procedures (Part 13 Amendments) (September 16, 2019), available at *https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement091619.*

[8] CFTC Letter No. 19–25, Commission Regulations 23.151, 23.152, and 23.153—Staff Time-Limited No-Action Position Regarding Application of Minimum Transfer Amount under the Uncleared Margin Rules (December 6, 2019), available at *https://www.cftc.gov/csl/19-25/download.*

[9] Under the Commission's uncleared margin rules, IM posted or collected by a swap dealer must be held by one or more custodians that are not affiliated with the swap dealer or the counterparty, whereas VM posted or collected by a swap dealer is not required to be segregated with an independent custodian. *See* 17 CFR 23.157.

uncleared margin that caused uneasiness back in 2009–2010 are now much more immediate as the margin requirements are being phased in to apply to these end-users.

So, while I am pleased at the steps the Commission is taking in this proposed rulemaking, I hope that we can continue to work together to address the other recommendations included in the GMAC Margin Subcommittee's report. The need to do so will only become more urgent as time marches on.

Conclusion

To be clear, these proposals to amend the Commission's uncleared margin rules are not a ''roll-back'' of the margin requirements that apply today to the largest financial institutions in their swap transactions with one another. Rather, the proposals reflect a thoughtful refinement of our rules to take account of specific circumstances in which they impose substantial operational challenges (*i.e.,* they are not workable) when applied to other market participants that are coming within the scope of their mandates. I look forward to receiving public input on any improvements that can be made to the proposals to further enhance compliance with the Commission's uncleared margin requirements.

Appendix 3—Statement of Commissioner Dan M. Berkovitz

I support issuing for public comments two notices of proposed rulemaking to improve the operation of the CFTC's Margin Rule.[1] The Margin Rule requires certain swap dealers (''SDs'') and major swap participants (''MSPs'') to post and collect initial and variation margin for uncleared swaps.[2] The Margin Rule is critical to mitigating risks in the financial system that might otherwise arise from uncleared swaps. I support a strong Margin Rule, and I look forward to public comments on the proposals, including whether certain elements of the proposals could increase risk to the financial system and how the final rule should address such risks.

The proposals address: (1) The definition of material swap exposure (''MSE'') and an alternative method for calculating initial margin (''the MSE and Initial Margin Proposal''); and (2) the application of the minimum transfer amount (''MTA'') for initial and variation margin (''the MTA Proposal''). They build on frameworks developed by the Basel Committee on Banking Supervision and International Organization of Securities Commissions (''BCBS/IOSCO''),[3] existing CFTC staff no-action letters, and recommendations made to the CFTC's Global Markets Advisory Committee (''GMAC'').[4] I thank Commissioner Stump for her leadership of the GMAC and her work to bring these issues forward for the Commission's consideration.

Today's proposed amendments to the Margin Rule could help promote liquidity and competition in swaps markets by allowing the counterparties of certain end-users to rely on the initial margin calculations of the more sophisticated SDs with whom they enter into transactions designed to manage their risks, subject to safeguards. They would also address practical challenges in the Commission's MTA rules that arise when an entity such as a pension plan or endowment retains asset managers to invest multiple separately managed accounts (''SMAs''). Similar operational issues are addressed with respect to initial and variation margin MTA calculations.

These operational and other benefits justify publishing the MSE and Initial Margin Proposal and the MTA Proposal in the **Federal Register** for public comment. However, I am concerned that specific aspects of each of these proposed rules could weaken the Margin Rule and increase risk by creating a potentially larger pool of uncollateralized, uncleared swaps exposure. My support for finalizing these proposals will depend on how the potential increased risks are addressed.

One potential risk in the MSE and Initial Margin Proposal arises from amending the definition of MSE to align it with the BCBS/IOSCO framework.[5] One element of the proposal would amend the calculation of the average daily aggregate notional amount (''AANA'') of swaps. The proposed rule would greatly reduce the number of days used in the calculation, reducing it from an average of all business days in a three month period to the average of the last business day in each month of a three month period.[6] The result would be that a value now calculated across approximately 60+ data points (*i.e.,* business days) would be confined to only three data points, and could potentially become less representative of an entity's true AANA and swaps exposure. Month-end trading adjustments could greatly skew the AANA average for an entity.

When the Commission adopted the Margin Rule in 2016, it rejected the MSE calculation approach now under renewed consideration. U.S. prudential regulators also declined to follow the BCBS/IOSCO framework in this regard. The Commission noted in 2016 that an entity could ''window dress'' its exposure and artificially reduce its AANA during the measurement period.[7] Even in the absence of window dressing, there are also concerns that short-dated swaps, including intra-month natural gas and electricity swaps, may not be captured in a month-end calculation window. While the MSE and Initial Margin Proposal offers some analysis addressing these issues, it may be difficult to extrapolate market participants' future behavior based on current regulatory frameworks. I look forward to public comment on these issues.

The MSE and Initial Margin Proposal and the MTA Proposal each raise additional concerns that merit public scrutiny and comment. The MTA Proposal, for example, would permit a minimum transfer amount of $50,000 for each SMA of a counterparty. In the event of more than 10 SMAs with a single counterparty (each with an MTA of $50,000), the proposal would functionally displace the existing aggregate limit of $500,000 on a particular counterparty's uncollateralized risk for uncleared swaps. The proposal would also state that if certain entities agree to have separate MTAs for initial and variation margin, the respective amounts of MTA must be reflected in their required margin documentation. Under certain scenarios, these separate MTAs could result in the exchange of less total margin than if initial and variation margin were aggregated.

The MSE and Initial Margin Proposal and the MTA Proposal both articulate rationales why the Commission preliminarily believes that the risks summarized above, and others noted in the proposals, may not materialize. The Commission's experience with relevant staff no-action letters may also appear to lessen concerns around the proposals. While each item standing on its own may not be a significant concern, the collective impact of the proposed rules may be a reduction in the strong protections afforded by the 2016 Margin Rule—and an increase in risk to the U.S. financial system. The Commission must resist the allure of apparently small, apparently incremental, changes that, taken together, dilute the comprehensive risk framework for uncleared swaps.

I look forward to public comments and to continued deliberation on what changes to the MSE and Initial Margin Proposal and the MTA Proposal are appropriate. I thank Commissioner Stump, our fellow Commissioners, and staff of the Division of Swap Dealer and Intermediary Oversight for their extensive engagement with my office on these proposals.

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[1] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016) (''Margin Rule'').

[2] *See also* Commodity Exchange Act (''CEA'') section 4s(e). The CEA, as amended by the Dodd-Frank Act, requires the Commission to adopt rules for minimum initial and variation margin for uncleared swaps entered into by SDs and MSPs for which there is no prudential regulator. Although addressed in the rules, there are currently no registered MSPs.

[3] BCBS/IOSCO, Margin requirements for non-centrally cleared derivatives (July 2019), *https://www.bis.org/bcbs/publ/d475.pdf.* The BCBS/IOSCO framework was originally promulgated in 2013 and later revised in 2015.

[4] Recommendations to Improve Scoping and Implementation of Initial Margin Requirements for Non-Cleared Swaps, Report to the CFTC's Global Markets Advisory Committee by the Subcommittee on Margin Requirements for Non-Cleared Swaps, April 2020, *https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download.*

[5] 17 CFR 23.151.

[6] Existing Commission regulation 23.151 specifies June, July, and August of the prior year as the relevant calculation months. The proposed rule would amend this to March, April, and May of the current year. The proposed rule would also amend the calculation date from January 1 to September 1. These amendments would be consistent with the BCBS/IOSCO framework.

[7] *See* CFTC Margin Rule, 81 FR at 645.