* * * * *

Issued in Washington, DC, on November 25, 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 Portfolio Reconciliation Requirements for Swap Dealers and Major Swap Participants—Revision of ''Material Terms'' Definition—Voting Summary and Chairman's and Commissioners' Statements

Appendix 1—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—Statement of Commissioner Dan M. Berkovitz

I support today's interim final rule that will maintain the continuity of swap portfolio reconciliation requirements for swap dealers. In September 2012, the Commission established in regulation 23.502 the requirement for swap dealers to regularly reconcile key material terms of swaps in portfolios with certain counterparties. These portfolios can include hundreds, thousands, and even tens of thousands of individual swap transactions. Regularly reconciling economic terms that determine the periodic payments made on swap portfolios reduces the likelihood of significant disputes and potential payment shortfalls or interruptions. Reducing these events reduces risk in the financial system, particularly during times of market stress.[1]

On September 17, 2020, the Commission adopted a final rule revising parts 45, 46, and 49 of its regulations on swap data recordkeeping and reporting requirements. In the amendments, significant changes were made to material terms that are cross-referenced in regulation 23.502. The unintended consequence would be to render the portfolio reconciliation requirement ineffective when the swap data regulations go into effect in approximately 60 days. The IFR corrects this unintended consequence by reestablishing the same material economic terms identified for regulation 23.502, thereby maintaining the status quo for the portfolio reconciliation requirement. This is a necessary action to maintain the risk reducing effects of that requirement.

[FR Doc. 2020–26536 Filed 1–4–21; 8:45 am]

BILLING CODE 6351–01–P

[1] *See* Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 FR 55904, 55927 (Sept. 11, 2012).

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 23

RIN 3038–AF05

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

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission (''Commission'' or ''CFTC'') is adopting amendments (''Final Rule'') to its margin requirements for uncleared swaps for swap dealers (''SDs'') and major swap participants (''MSPs'') for which there is not a prudential regulator (''CFTC Margin Rule''). The Commission is amending the CFTC Margin Rule to revise the calculation method for determining whether certain entities come within the scope of its initial margin (''IM'') requirements for uncleared swaps beginning in the last phase of the phased compliance schedule, which starts on September 1, 2022, and the timing for compliance with the IM requirements after the end of the phased compliance schedule. These amendments align certain aspects of the CFTC Margin Rule with the Basel Committee on Banking Supervision and the International Organization of Securities Commissions' (''BSBS/IOSCO'') Framework for margin requirements for non-centrally cleared derivatives (''BCBS/IOSCO Framework''). The Commission is also amending the CFTC Margin Rule to allow SDs and MSPs subject to the CFTC Margin Rule to use the risk-based model calculation of IM of a counterparty that is a CFTC-registered SD or MSP to determine the amount of IM to be collected from the counterparty and to determine whether the IM threshold amount for the exchange of IM has been exceeded such that documentation concerning the collection, posting, and custody of IM would be required.

DATES: This rule is effective February 4, 2021.

FOR FURTHER INFORMATION CONTACT: Joshua B. Sterling, Director, 202–418–6056, *jsterling@cftc.gov;* Thomas J. Smith, Deputy Director, 202–418–5495, *tsmith@cftc.gov;* Warren Gorlick, Associate Director, 202–418–5195, *wgorlick@cftc.gov;* or Carmen Moncada-Terry, Special Counsel, 202–418–5795, *cmoncada-terry@cftc.gov,* Market Participants Division, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Background

Section 4s(e) of the Commodity Exchange Act (''CEA'' or ''Act'')[1] requires the Commission to adopt rules establishing minimum initial and variation margin requirements for all swaps[2] that are (i) entered into by an SD or MSP for which there is no prudential regulator[3] (collectively, ''covered swap entities'' or ''CSEs'')[4] and (ii) not cleared by a registered derivatives clearing organization (''uncleared swaps'').[5] To offset the greater risk to the SD[6] or MSP[7] and the financial system arising from the use of uncleared swaps, these requirements must (i) help ensure the safety and soundness of the SD or MSP and (ii) be appropriate for the risk associated with the uncleared swaps held by the SD or MSP.[8]

Pursuant to its rulemaking authority under section 4s(e), the Commission in 2016 promulgated Regulations 23.150 through 23.161, namely the CFTC Margin Rule, which requires CSEs to

[1] 7 U.S.C. 6s(e) (capital and margin requirements).

[2] CEA section 1a(47), 7 U.S.C. 1a(47) (swap definition); Regulation 1.3, 17 CFR 1.3 (further definition of a swap). A swap includes, among other things, an interest rate swap, commodity swap, credit default swap, and currency swap.

[3] CEA section 1a(39), 7 U.S.C. 1a(39) (defining the term ''prudential regulator'' to include the Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Farm Credit Administration; and the Federal Housing Finance Agency). The definition of prudential regulator further specifies the entities for which these agencies act as prudential regulators. The prudential regulators published final margin requirements in November 2015. *See generally* Margin and Capital Requirements for Covered Swap Entities, 80 FR 74840 (Nov. 30, 2015) (''Prudential Margin Rule''). The Prudential Margin Rule is substantially similar to the CFTC Margin Rule, including with respect to the CFTC's phasing-in of margin requirements.

[4] CEA section 4s(e)(1)(B), 7 U.S.C. 6s(e)(1)(B). SDs and MSPs for which there is a prudential regulator must meet the margin requirements for uncleared swaps established by the applicable prudential regulator. CEA section 4s(e)(1)(A), 7 U.S.C. 6s(e)(1)(A).

[5] CEA section 4s(e)(2)(B)(ii), 7 U.S.C. 6s(e)(2)(B)(ii). In Regulation 23.151, the Commission further defined this statutory language to mean all swaps that are not cleared by a registered derivatives clearing organization or a derivatives clearing organization that the Commission has exempted from registration as provided under the CEA. 17 CFR 23.151.

[6] CEA section 1a(49), 7 U.S.C. 1a(49) (swap dealer definition); Regulation 1.3 (further definition of swap dealer).

[7] CEA section 1a(32), 7 U.S.C. 1a(32) (major swap participant definition); Regulation 1.3 (further definition of major swap participant).

[8] CEA section 4s(e)(3)(A), 7 U.S.C. 6s(e)(3)(A).

collect and post IM [9] and variation margin (''VM'') [10] for uncleared swaps.[11] In administering the CFTC Margin Rule, the Commission has identified matters, further described below, that may pose challenges in the implementation of the IM requirements.

A. Calculation Method for Determining Whether Certain Entities Are Subject to the IM Requirements and the Timing for Compliance With the IM Requirements After the End of the Phased Compliance Schedule

Regulation 23.161 sets forth a schedule for compliance with the CFTC Margin Rule, spanning from September 1, 2016, to September 1, 2022.[12] Under the schedule, entities are required to comply with the IM requirements in staggered phases,[13] starting with entities with the largest average aggregate notional amount (''AANA''), calculated on a daily basis, of uncleared swaps, uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps (''covered products'') and then successively with lesser AANA. The last phase of compliance, which begins on September 1, 2022, encompasses CSEs and covered counterparties [14] that did not come into the scope of the IM requirements in prior phases, including financial end users (''FEUs'') with material swaps exposure (''MSE'') [15] of more than $8 billion in AANA of covered products.[16]

The method for determining which entities come within the scope of the CFTC's IM requirements beginning in the last phase of compliance, as set forth in the Commission's regulations, differs from the method set out in the BCBS/IOSCO Framework.[17] More specifically, the BCBS/IOSCO Framework requires that in the last phase of implementation of the IM requirements, which begins on September 1, 2022, entities with €8 billion [18] in average month-end aggregate of notional amount (''month-end AANA'') of non-cleared derivatives, including forex forwards and swaps, during the period of March, April, and May of the current year, to exchange IM beginning on September 1 of each year.

In contrast, under the CFTC Margin Rule, a CSE must exchange IM with an FEU that has MSE with respect to uncleared swaps entered into between the parties beginning in the last phase of compliance, which starts on September 1, 2022. The MSE for the FEU is to be determined on September 1, 2022, based on the FEU's daily average AANA during the period of June, July, and August of the prior year. After the last phase of compliance, the MSE for the FEU is to be determined on January 1 of each calendar year based on its daily average AANA during the June, July, and August period of the prior year, with application of the IM requirements, if the FEU has MSE, required to begin on January 1 of each year.

The BCBS/IOSCO Framework was originally promulgated in September 2013,[19] and then revised in 2015.[20] The 2015 version of the BCBS/IOSCO Framework changed the calculation period of June, July, and August, with an annual implementation date of December 1, to March, April, and May of each calendar year, with an annual implementation date of September 1. The CFTC Margin Rule incorporated the earlier 2013 version of the BCBS/IOSCO Framework by adopting the June, July, and August calculation period for the annual calculation of MSE. As a result, the Commission's existing regulations do not reflect the calculation period of March, April, and May set forth in the revised BCBS/IOSCO Framework published in March 2015.

The Commission also departed from BCBS/IOSCO's month-end AANA calculation for determining whether an entity is subject to the IM requirements. The Commission decided to adopt instead daily AANA averaging to determine whether an FEU has MSE, the finding of which requires a CSE to exchange IM with the FEU, to gather a more comprehensive assessment of the FEU's participation in the swaps market, and to address the possibility that a market participant might ''window dress'' its exposure on an as-of date such as year-end, in order to avoid the Commission's margin requirements.[21]

As a result, the Commission's current method for the annual calculation of MSE, which was adopted in coordination with the U.S. prudential

[9] IM or initial margin is the collateral (calculated as provided by Regulation 23.154) that is collected or posted in connection with one or more uncleared swaps pursuant to Regulation 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.

[10] VM or variation margin, as defined in Regulation 23.151, is the collateral provided by a party to its counterparty to meet the performance of its obligations 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.

[11] *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 through 23.159, 23.161. In May 2016, the Commission amended the CFTC Margin Rule to add 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).

[12] *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 85 FR 71246 (Nov. 9, 2020) (extending the phased compliance schedule for the CFTC's IM requirements for uncleared swaps to September 1, 2022).

[13] The schedule also addresses the VM requirements under the CFTC Margin Rule, providing a compliance period of September 1, 2016, through March 1, 2017. *See* 17 CFR 23.161(a). The compliance period (including a six-month extension to September 1, 2017, through no-action relief) has long expired and all eligible entities are required to comply with the VM requirements.

[14] The term ''covered counterparty'' is defined in Regulation 23.151 as a financial end user with material swaps exposure or a swap entity, including an SD or MSP, that enters into swaps with a CSE. *See* 17 CFR 23.151.

[15] Regulation 23.151 provides that MSE for an entity means that the entity and its margin affiliates have an average daily aggregate notional amount of uncleared swaps, uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps with all counterparties for June, July, or August of the previous calendar year that exceeds $8 billion, where such amount is calculated only for business days. A company is a ''margin affiliate'' of another company if: (i) Either company consolidates the other on a financial statement prepared in accordance with U.S. Generally Accepted Accounting Principles, the International Financial Reporting Standards, or other similar standards; (ii) both companies are consolidated with a third company on a financial statement prepared in accordance with such principles or standards; or (iii) for a company that is not subject to such principles or standards, if consolidation as described in paragraph (i) or (ii) of this definition would have occurred if such principles or standards had applied. 17 CFR 23.151.

[16] The determination of MSE requires computing AANA, calculated on a daily basis, of covered products over June, July and August of the previous calendar year. For simplicity purposes, this formulation will be referred to as ''daily average AANA'' to contrast with month-end AANA, which is used for the calculation of AANA under the BCBS/IOSCO Framework.

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

[18] The U.S. adopted the BCBS/IOSCO threshold, but replaced the 8 billion euro figure with a dollar amount of $8 billion. As a result, there is a small disparity in the threshold amounts given the continuing fluctuation of the dollar-euro exchange rate. The Final Rule does not address this issue.

[19] *See generally* BCBS/IOSCO, Margin requirements for non-centrally cleared derivatives (Sept. 2013), *https://www.bis.org/publ/bcbs261.htm.*

[20] *See generally* BCBS/IOSCO, Margin requirements for non-centrally cleared derivatives (March 2015), *https://www.bis.org/bcbs/publ/d317.htm.*

[21] 81 FR at 645. The potential for mutual funds to alter their portfolios prior to disclosure (''window dressing'') has been documented in the financial economics literature. *See, e.g.,* Musto, D. (1999). ''Investment decisions depend on portfolio disclosures.'' *Journal of Finance* 54, 935–952, or Agarwal, V., Gay G. and Ling, L. (2011). ''Window dressing in mutual funds.'' *Review of Financial Studies,* 27, 3133–3170.

regulators and is similar to the U.S. prudential regulators' method of calculation, is not consistent with the most recent version of the BCBS/IOSCO Framework. Nor is it consistent with requirements in other major market jurisdictions, most of which adopted the 2015 BCBS/IOSCO Framework's month-end AANA calculation using the period of March, April, and May for the purposes of determining whether an entity is subject to the IM requirements beginning in the last phase of implementation.[22]

In a report prepared by a subcommittee established by the CFTC's Global Markets Advisory Committee (''GMAC''), discussed in more detail below, the subcommittee reported that the differences in the methods for determining when an entity comes within the scope of the IM requirements and the timing of compliance after the last phase of compliance may impose an undue burden on market participants' efforts to comply with the CFTC's margin requirements.[23] The report stated that entities have to account for different compliance schedules and set up and maintain separate processes for determining when they meet the thresholds for IM compliance.[24]

B. No-Action Letter No. 19–29 Concerning the Calculation of IM

The Commission's Division of Swap Dealer and Intermediary Oversight[25] issued CFTC No-Action Letter 19–29 in July 2019 in response to a request for relief submitted by Cargill Incorporated (''Cargill''), a CFTC-registered SD and CSE.[26] Cargill sought no-action relief to be able to use the risk-based model calculation of IM of a counterparty that is an SD to determine the amount of IM to be collected from the counterparty. Cargill stated that while its swap activity primarily involved physical agricultural commodities with non-SD counterparties seeking to mitigate commercial risk, it maintained positions that required the collection of IM from SDs. Given the highly specialized and discrete nature of its swaps business, mainly focusing on commodities, Cargill opted to rely on the standardized IM table to calculate IM rather than develop a risk-based model. Because the use of the standardized table could generate higher amounts of IM than a risk-based model, requiring its SD counterparties to post higher amounts of IM, Cargill stated that SD counterparties might choose not to trade with it.

Based on Cargill's representations, MPD stated that it would not recommend enforcement action, subject to specified conditions, if Cargill used the risk-based model calculation of IM of a counterparty that is a CFTC-registered SD as the amount of IM that Cargill was required to collect from the SD and to determine whether the IM threshold amount of $50 million (''IM threshold amount'')[27] had been exceeded, which would trigger the requirement for documentation concerning the posting, collection, and custody of IM collateral.

C. Market Participant Feedback

As previously mentioned, the CFTC's GMAC established a subcommittee of market participants in January 2020 to consider issues raised by the implementation of margin requirements for non-cleared swaps, identify challenges associated with forthcoming implementation phases, and prepare a report with recommendations. The subcommittee issued the Margin Subcommittee Report and submitted the Report to the GMAC.[28] The GMAC adopted the Report and recommended to the Commission that it consider adopting the Report's recommendations.

Among other things, the Margin Subcommittee Report recommended the alignment of the CFTC Margin Rule with the BCBS/IOSCO Framework with respect to the method for calculating AANA for determining whether an entity comes within the scope of the IM requirements and the timing of compliance after the end of the phased compliance schedule.[29] The Report also recommended the codification of Letter 19–29.[30]

In response to feedback from market participants, in particular the GMAC subcommittee's recommendations, the Commission issued a notice of proposed rulemaking (''Proposal''), published in the **Federal Register** on September 23, 2020, proposing amendments to the CFTC Margin Rule. The Commission proposed to align the CFTC Margin Rule with the BCBS/IOSCO Framework with respect to the method for calculating AANA for determining whether certain entities come within the scope of the IM requirements and the timing of compliance after the end of the phased compliance schedule, noting that BCBS/IOSCO is the global standard setter for margin requirements for non-centrally cleared derivatives and that the proposed amendments would promote international harmonization in the application of the IM requirements. The Commission stated that the disjunction between the CFTC and BCBS/IOSCO concerning the calculation of AANA and the timing of compliance with the IM requirements does not further any regulatory purpose, noting, in particular, the foreseeability of calculation errors resulting from differences in the calculation methods.[31]

The Commission also proposed to amend the CFTC Margin Rule to permit CSEs to use the risk-based IM calculation of a counterparty that is a

[22] *See, e.g.,* 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 28(1), *https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R2251&from=EN.* Financial Services Agency of Japan (JFSA) Cabinet Office Ordinance on Financial Instruments Business (Cabinet Office Ordinance No. 52 of August 6, 2007), as amended (March 31, 2016), Article 123(11)(iv); Office of the Superintendent of Financial Institutions Canada (OSFI) Guideline No. E–22, Margin Requirements for Non-Centrally Cleared Derivatives (April 2020), Section 5, 71, *https://www.osfi-bsif.gc.ca/Eng/Docs/e22.pdf.*

[23] *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, May 2020 at, 48–54, *https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download* (''Margin Subcommittee Report'' or ''Report'').

[24] *Id.*

[25] Pursuant to a Commission plan of reorganization, the Division of Swap Dealer and Intermediary Oversight was renamed Market Participants Division (''MPD'') effective November 8, 2020. The Division is referred to as MPD hereinafter.

[26] CFTC Letter No. 19–29, Request for No-Action Relief Concerning Calculation of Initial Margin (Dec.19, 2019) (''Letter 19–29''), *http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/19-29.pdf.*

[27] Under Regulation 23.154(a)(3), SDs and MSPs subject to the Commission's regulations are not required to post or collect IM until the initial margin threshold amount has been exceeded. *See* 17 CFR 23.154(a)(3). The term ''initial margin threshold amount'' is defined in Regulation 23.151 to mean an aggregate credit exposure of $50 million resulting from all uncleared swaps between an SD and its margin affiliates (or an MSP and its margin affiliates) on the one hand, and the SD's (or MSP's) counterparty and its margin affiliates on the other. *See* 17 CFR 23.151.

[28] *See supra* note 23.

[29] *See* Margin Subcommittee Report at 48–54.

[30] *See* Margin Subcommittee Report at 34–36.

[31] The possibility of calculation errors may be mitigated by substituted compliance, as described in Regulation 23.160, if the parties are non-U.S. entities and substituted compliance is available, as the parties may be able to avail themselves of the rules in the foreign jurisdiction and may therefore not face the concern about different calculation methods. However, while the changes to the method of calculation of AANA under the Final Rule will align the CFTC's method of calculation with BCBS/IOSCO's approach, the Commission acknowledges that the changes will result in a divergence from the U.S. prudential regulators' approach, which may increase the potential for calculation errors for entities located in the United States.

CFTC-registered SD or MSP, in line with the terms of Letter 19–29. The Commission stated that this amendment would promote legal certainty and clarity, facilitating efforts by market participants to take the application of the Commission's regulations into account in planning their uncleared swaps business, without undermining the effectiveness of the CFTC Margin Rule.

The Commission stated that the more widespread availability of the relief provided by Letter 19–29 would promote efficient risk hedging by smaller CSEs that offer swaps services to smaller entities that are neither SDs nor MSPs. The Commission further noted that having the ability to use the risk-based IM calculation of a counterparty that is an SD or MSP would allow smaller CSEs to engage SDs and MSPs that otherwise might be disincentivized from trading with the CSEs. That is because for such CSEs, the single method of IM calculation available may be the standardized IM table, as the CSEs, given the discrete and limited nature of their swaps business, may find it uneconomical to develop and maintain a proprietary model. As a result, swap entity counterparties may be required to post higher amounts of IM to the CSEs, as the table-based method of calculation does not account for portfolio composition, diversification and hedges.

In the preamble to the Proposal, the Commission sought comment from the public on the proposed amendments.[32] The comment period for the Proposal closed on October 23, 2020, and nine comment letters were received: one from an SD in the gas and electric power industry;[33] one from an SD in the oil and gas industry;[34] one from a life insurance trade association;[35] one from a group of swaps and financial industry advocates;[36] one from a futures industry group representing members active in the physical commodities markets;[37] one from a managed fund industry group;[38] one from a regulated funds association;[39] one from a representative of the asset management industry;[40] and one from a group of commercial firms in the energy industry.[41]

II. Final Rule, Summary of Comments and Commission Response

The Commission is adopting revisions to the method for calculating AANA for determining whether an FEU has MSE and the timing for compliance with the IM requirements after the end of the last phase of compliance to align these aspects of the CFTC Margin Rule with the BCBS/IOSCO Framework, as proposed. The Commission is also amending Regulation 23.154(a), consistent with the terms of Letter 19–29, and thus allowing CSEs to use the risk-based model calculation of IM of counterparties that are CFTC-registered SDs or MSPs (''swap entities'')[42] to determine the amount of IM to be collected from such counterparties.

All the comment letters received on the Proposal generally expressed support for the proposed amendments[43] and the Commission's efforts to identify and address challenges in the implementation of the CFTC's margin requirements as the phased compliance schedule nears conclusion.[44] Commenters expressed support for the Proposal even in the absence of parallel action by the U.S. prudential regulators, while urging the CFTC to continue coordination with the prudential regulators and encourage corresponding amendments to the prudential regulators' margin rules so that prudentially regulated SDs and MSPs and their counterparties are not disadvantaged by requirements that are neither globally nor domestically harmonized.[45]

A. Regulation 23. 151—Amendments to MSE Definition

As noted above, a CSE must exchange IM with respect to uncleared swaps with a counterparty that is an FEU that has MSE beginning in the last phase of the phased compliance schedule, which will start on September 1, 2022.[46] Regulation 23.151 provides that an entity has MSE if it has more than $8 billion in AANA, calculated on a daily basis, during June, July, and August of the prior year.[47] An FEU that has MSE based on the calculation of AANA over June, July, and August of 2021 would come within the scope of the IM requirements beginning on September 1, 2022. In subsequent calendar years after September 1, 2022, however, because the base year for calculating AANA is the prior year, the annual determination of MSE, which triggers the applicability of the IM requirements, would be January 1 of each year,[48] using the

[32] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 85 FR 59702 (Sept. 23, 2020). The comment letters for the Proposal are available at: *https://comments.cftc.gov/PublicComments/CommentList.aspx?id=4157*.

[33] Letter from Jennifer Minnis, BP Energy Company (Oct. 23, 2020) (BPEC 10/23/2020 Letter).

[34] Letter from Scott Earnest, Shell Trading Risk Management, LLC (Oct. 23, 2020) (STRM 10/23/2020 Letter).

[35] Letter from Michael Lovendusky, American Council of Life Insurers (Oct. 23, 2020) (ACLI 10/23/2020 Letter).

[36] Letter from Tara Kruse, James Kemp, and Kyle Brandon for International Swaps and Derivatives Association (ISDA), Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association, and Securities Industry and Financial Markets Association, respectively, (collectively, ''Associations'') (Oct. 22, 2020) (Associations 10/22/2020 Letter).

[37] Letter from Allison Lurton, Financial Industry Association (Oct. 22, 2020) (FIA 10/22/2020 Letter).

[38] Letter from Jennifer W. Han, Managed Funds Association (Oct. 22, 2020) (MFA 10/22/2020 Letter).

[39] Letter from Sarah A. Bessin, Investment Company Institute (Oct. 22, 2020) (ICI 10/22/2020 Letter).

[40] Letter from Jason Silverstein, Asset Management Group of the Securities Industry and Financial Markets Association (Oct. 22, 2020) (SIFMA AMG 10/22/2020 Letter).

[41] Letter from Alexander S. Holtan, Commercial Energy Working Group (Oct. 22, 2020) (Working Group 10/22/2020 Letter).

[42] Regulation 23.151 defines the term ''swap entity'' as a person that is registered with the Commission as an SD or MSP under the CEA.

[43] *See* ACLI 10/23/2020 Letter at 1; Associations 10/22/2020 Letter at 1; BPEC 10/23/2020 Letter at 2; FIA 10/22/2020 Letter at 2–3; ICI 10/22/2020 Letter at 1; MFA 10/22/2020 Letter at 1; SIFMA AMG 10/22/2020 Letter at 1; STRM 10/23/2020 Letter at 1; Working Group 10/22/2020 Letter at 3. A commenter stated that the Proposal reflects the realities of the marketplace and further aligns the U.S. regulations with the global regulators. *See* ACLI 10/23/2020 Letter at 2. Other commenters stated that the Proposal would enable the implementation of the IM requirements in a practical and efficient manner, as market participants prepare for forthcoming compliance dates, reducing complexity and burden associated with implementation and would foster greater liquidity and contribute to the lowering of hedging costs, particularly in the last phases of the compliance schedule. *See* BPEC 10/23/2020 Letter at 2; MFA 10/22/2020 Letter at 2.

[44] While expressing support for the Proposal, commenters asked the Commission to consider other issues raised by the CFTC Margin Rule, including whether to exclude commodity swaps from the CFTC's uncleared margin requirements, the need to harmonize the definition of financial entity under section 2(h)(7) of the CEA and the definition of financial end user under the CFTC Margin Rule, whether treasury affiliates of an SD should be exempt from the CFTC's uncleared margin requirements, and other topics raised in prior communications to the Commission. *See* FIA 10/22/2020 Letter at 2; MFA 10/22/2020 Letter at 2. The commenters also asked the Commission to consider other recommendations from the Margin Subcommittee Report not addressed in the Proposal. *See* ACLI 10/23/2020 Letter at 2; Associations 10/22/2020 Letter at 1; SIFMA AMG 10/22/2020 Letter at 4. The Commission will not currently act on these additional matters as they fall outside the scope of the Proposal. The Commission is aware of these issues and will continue to consider them and monitor pertinent developments to determine whether further Commission action concerning these matters is appropriate in the future.

[45] ACLI 10/23/2020 Letter at 1; Associations 10/22/2020 Letter at 4; MFA 10/22/2020 Letter at 2.

[46] *See* 17 CFR 23.161(a)(7) (requiring CSEs to comply with the CFTC's IM requirements with respect to uncleared swaps with counterparties that are FEUs with MSE beginning on September 1, 2022).

[47] For definition of MSE, *see supra* note 15.

[48] January 1 is not explicitly set out in the Commission's regulations as the determination date for MSE after the last phase of compliance. However, absent the Final Rule, Regulation

AANA for June, July, and August of the prior year. If the FEU has MSE on January 1 of a given year, the FEU would come within the scope of the IM requirements on January 1 of such year. As such, a CSE would be required to exchange regulatory IM beginning on such January 1 for its uncleared swaps with such FEU.

As proposed, the Commission is amending the definition of MSE in Regulation 23.151 by replacing ''June, July and August of the previous calendar year'' with ''March, April and May of that year.'' The period for calculating AANA for determining whether an FEU has MSE will thus be March, April, and May of ''that year.'' ''That year'' will be understood to mean the year the MSE status for an FEU is assessed for the purpose of determining whether a CSE that enters into uncleared swaps with the FEU is required to exchange IM with the FEU.

The Commission is also amending the definition of MSE to set ''September 1 of any year'' as the determination date for MSE. Under the current requirements, absent a rule change, the MSE for an FEU would have to be determined first on September 1, 2022, which would begin the last phase of compliance under the phased compliance schedule, and subsequently, after the end of the phased compliance schedule, on January 1 of each year. Under the Final Rule, the date for the determination of MSE after the end of the phased compliance schedule will shift from January 1 to September 1. The change in the MSE determination date to September 1 of each year effectively sets the timing for compliance with the IM requirements on September 1 after the end of the phased compliance schedule with respect to uncleared swaps entered into by a CSE and an FEU with MSE.

The shift of the MSE determination date from January 1 to September 1 may defer for nine months to September 1, 2023, the obligation to exchange IM for a firm that absent the rule change would have been subject to the IM requirements on January 1, 2023. Uncleared swaps entered into by the firm during the nine-month deferral period will be deemed legacy swaps, or uncleared swaps exempt from the IM requirements.[49] As a result, in 2023, less collateral may be collected for uncleared swaps, which could render uncleared swap positions riskier and increase the risk of contagion and systemic risk. The Commission, however, notes that because the deferral period will affect entities with lower AANAs than entities brought into scope in earlier phases of the IM compliance schedule, the potential uncollateralized risk would be mitigated, becoming a lesser concern, particularly because the proposed change in the MSE determination date will draw the Commission's rules closer to BCBS/IOSCO's approach, promoting international harmonization.

Conversely, the change in the MSE determination date could also result in requiring certain entities to post and collect IM that otherwise would not have been required to do so. This could occur when an FEU meets the MSE threshold in the last phase of compliance beginning on September 1, 2022, but falls below the threshold by January 1, 2023, because the AANA for June, July, and August of the prior year (*i.e.* 2022) is below $8 billion. In such case, under the current rule, a CSE would no longer be required to exchange IM with such FEU beginning on January 1, 2023. However, the change in the MSE determination date to September 1, as adopted, will require the CSE to continue to exchange IM with the FEU through September 1, 2023, as no determination of MSE status will be required between September 1, 2022, and September 1, 2023, and, as a result, the CSE will be required to exchange IM with the FEU for nine months longer than the January 1, 2023 MSE determination date would have required.

These amendments to the definition of MSE will have the effect of reducing the time frame that FEUs and their CSE counterparties will have to prepare for compliance with the IM requirements. Under the current rule being amended, CSEs would have been required to exchange regulatory IM with counterparties that are FEUs with MSE beginning on September 1, 2022, which starts the last phase of the phased compliance schedule. The MSE for the FEU would have been determined using the AANA for June, July, and August of the prior year (*i.e.,* 2021). As a result, for the last phase of compliance in 2022, a CSE and FEU would have had at least twelve months to prepare for compliance with the IM requirements. By contrast, under the Final Rule, a CSE and FEU, for the last phase of compliance in 2022, will have only 3 months to prepare for IM compliance because MSE will be required to be determined using the AANA for March, April, and May of the current year (*i.e.,* 2022).

Also, under the Final Rule, after the last phase of compliance under the phased compliance schedule, the date for determining MSE for an FEU will be September 1 of each year, and the AANA calculation period for determining whether an FEU has MSE will be March, April, and May of such year. As a result, an FEU with MSE and its CSE counterparty will have three months to prepare in advance of compliance with the IM requirements, whereas under the current rule being amended, such parties would have had four months because MSE would have been required to be determined on January 1 based on the AANA for June, July, and August of the prior year.

In its Margin Subcommittee Report, the GMAC subcommittee acknowledged that the change in the period for the calculation of AANA and the change in the MSE determination date from January 1 to September 1 would reduce the time frame for preparing for compliance with the IM requirements.[50] Nevertheless, the subcommittee expressed support for the changes, noting that the changes would align the CFTC's margin requirements with the BCBS/IOSCO Framework.[51]

The Commission is also amending the definition of MSE to replace ''average daily aggregate notional amount,'' or daily average AANA, with ''average month-end aggregate notional amount,'' for calculating AANA to determine whether an entity has MSE. In adopting the CFTC Margin Rule, the Commission acknowledged that month-end AANA averaging for the calculation of AANA would be consistent with BCBS/IOSCO's approach. Nonetheless, the CFTC, along with the U.S prudential regulators, decided to adopt daily AANA averaging for the calculation of AANA to determine MSE. In the preamble to the CFTC Margin Rule, the

23.161(a)(7) (addressing the last phase of compliance and the timing of compliance going forward) and the definition of MSE in Regulation 23.151 can be reasonably read together to set January 1 as the MSE determination date. *See* 17 CFR 23.151; 17 CFR 23.161(a)(7).

[49] Pursuant to Regulation 23.161, the compliance dates for the IM and VM requirements under the CFTC Margin Rule are staggered across a phased schedule that extends from September 1, 2016, to September 1, 2022. The compliance period for the VM requirements ended on March 1, 2017 (though the CFTC and other regulators provided guidance permitting a six-month grace period to implement the requirements following the implementation date), while the IM requirements continue to phase in through September 1, 2022. An uncleared swap entered into prior to an entity's IM compliance date is a ''legacy swap'' that is not subject to the IM requirements. *See* CFTC Margin Rule, 81 FR at 651 and Regulation 23.161. 17 CFR 23.161.

[50] *See* Margin Subcommittee Report at 49.

[51] *Id.* (The GMAC subcommittee stated that the divergence between the U.S. and international requirements ''creates complexity and confusion, and leads to additional effort, cost and compliance changes for smaller market participants that are generally subject to margin requirements in multiple global jurisdictions.'').

Commission explained that daily average AANA would provide a more comprehensive assessment of an FEU's participation in the swaps market in determining whether the FEU has MSE and would address the possibility of window dressing of exposures by market participants that might seek to avoid the CFTC's margin requirements.[52]

In its Report, the GMAC subcommittee stated that the use of daily average AANA for the calculation AANA entailed more work for smaller counterparties and that such method of calculation was only used in the United States, noting that in the United States, daily AANA averaging over the three-month calculation period for Phase 5 [53] required 64 observations while global determinations based on month-end AANA required only three observations.[54] The Report further stated that month-end AANA averaging over the three-month calculation period, by accounting for three periodic dates on which AANA would be calculated, would mitigate the risk that market participants would adjust exposures to avoid the CFTC's margin requirements, and that it would be neither practicable nor financially desirable for parties to tear-up their positions on a recurring basis prior to each month-end AANA calculation, as it would interfere with their hedging strategies and cause them to incur realized profit and loss.[55]

The Commission notes that the adoption of a month-end AANA methodology for the calculation of AANA to determine MSE will align the CFTC's approach with the BCBS/IOSCO Framework and the approach adopted by other major market jurisdictions. The Commission does acknowledge that such methodology for calculating AANA could raise the risk that market participants that are counterparties to CSEs may ''window dress'' their exposures by adjusting their exposures as they approach the month-end date. By doing so, an FEU would no longer have to post and collect IM with all CSEs for all its uncleared swaps for at least twelve months from the date on which compliance with the IM requirements would have been initially required.[56]

To address this concern, the Commission has determined to revise the proposed rule text to include anti-evasion language prohibiting activities not carried out in the ordinary course of business and willfully designed to circumvent the month-end AANA calculation by, for example, altering swap book composition to evade meeting the definition of MSE and thus coming within the scope of the CFTC's IM requirements. In addition, the Commission points to the availability of other tools to address the risk of ''window dressing.'' Regulation 23.402(a)(ii) requires CSEs to have written policies and procedures to prevent their evasion, or participation in or facilitation of an evasion, of any provision of the CEA or the Commission's regulations.[57] Also, section 4b of the CEA prohibits any person entering into a swap with another person from cheating or defrauding or willfully deceiving or attempting to deceive the other person.[58]

The Commission further notes that replacing daily average AANA with month-end AANA for determining MSE could result in an AANA calculation that is not fully representative of an entity's participation in the swaps markets. Under the current definition of MSE, AANA must be calculated counting uncleared swaps, uncleared security-based swaps, foreign exchange forwards, or foreign exchange swaps. Under the Final Rule, which provides for the calculation of AANA by averaging month-end AANA during the three-month calculation period, some of the financial products that are required to be included in the calculation, because of their terms, such as tenure and time of execution, may be undercounted or excluded.[59]

The Commission believes that the notional amount associated with products that may be excluded from the AANA calculation, as a result of the change to month-end AANA averaging for the calculation of AANA, may be relatively low and that the products' contribution to the AANA calculation for the purpose of determining MSE may be insignificant. In this regard, in an analysis undertaken by the Commission's Office of the Chief Economist (''OCE'') on a sample of days, the OCE estimated (setting aside the window dressing issue) that calculations based on end-of-month AANA would yield fairly similar results as calculations based on the current daily average AANA approach. Based on 2020 swap data, the OCE estimated that 492 entities of the 514 entities that would have come into scope in the last phase of the IM compliance schedule (with AANA between $8 and $50 billion) based on the current daily AANA calculation methodology would also come into scope under the month-end AANA calculation methodology being adopted herein. Put differently, all but 22 of the entities that would be above MSE under the existing methodology would also be above MSE under the month-end AANA methodology. In addition, there are 20 entities that would be in scope under the month-end AANA methodology, but would not be in scope under the existing methodology, so that the aggregate number of entities under the two methodologies differs only by two.

In the aggregate, the two methodologies capture quite similar sets of entities. In addition, the entities that fall out of scope applying the month-end AANA methodology tend to be among the smallest coming into IM compliance in the last phase of compliance. That is, entities that would have been in-scope under the current daily average AANA methodology but not the month-end AANA methodology average $6.95 billion in AANA, compared to $20 billion for all entities coming into scope in the last phase of compliance.[60]

Based on the OCE analysis discussed above, in the Commission's view, switching from daily average AANA to month-end AANA for the purpose of determining MSE would likely have a limited impact on the protections provided by the CFTC Margin Rule. In addition, the Commission believes that the anti-evasion language being incorporated into the rule text by this Final Rule mitigates the window dressing concerns.[61]

---

[52] *See supra* note 21.

[53] As used in the Margin Subcommittee Report, Phase 5 meant the phase of compliance with the CFTC's IM requirements that started on September 1, 2020, comprising covered swap entities and covered counterparties with AANA between $750 billion and $50 billion. Since the issuance of the Report, the IM compliance schedule has been revised to defer the beginning of Phase 5 to September 1, 2021. *See* 17 CFR 23.161(a)(6).

[54] Margin Subcommittee Report at 52.

[55] *Id.*

[56] Under the Final Rule, the MSE calculation will be made annually on September 1 of each year and will be in effect for the next twelve months after that date.

[57] 17 CFR 23.402(a)(ii).

[58] 7 U.S.C. 6b.

[59] For example, the Commission observes that certain physical commodity swaps, such as electricity and natural gas swaps, are products for which a month-end AANA calculation might not provide a comprehensive assessment of the full scope of an FEU's exposure to those products.

[60] Note that the OCE calculation excludes commodity swaps, and the examples of products that end-of-month calculations may undercount tend to be commodity swaps, such as natural gas and electricity swaps. Overall, commodity swaps tend to represent less than 1% of all swap trades. *See* BIS Statistic Explorer, Global OTC derivatives market (July 30, 2020), *https://stats.bis.org/statx/srs/table/d5.1?f=pdf.*

[61] The prudential regulators have not indicated whether they intend to amend their margin requirements consistent with the BCBS/IOSCO

Commenters expressed strong support for the amendments to the MSE definition in Regulation 23.151 to align the method for calculating AANA and the timing of compliance with the IM requirements after the end of the last phase of compliance with the BCBS/IOSCO Framework.[62] Commenters stated that the amendments would help smaller market participants overcome unnecessary operational challenges. [63] The commenters also stated that the amendments would help entities that conduct swaps business across jurisdictions.[64] A commenter stated that the differences in the AANA calculation methods and the timing of compliance burden market participants, such as asset managers, in determining whether clients are in scope in the later phases of the compliance schedule and create a complex and confusing ongoing monitoring process.[65]

Another commenter noted that the U.S. is the only jurisdiction that requires using the three-month period of June, July and August of the preceding year for the calculation of AANA, and the only jurisdiction besides Brazil that requires AANA to be calculated using daily averaging rather than month-end averaging over the three-month period.[66] The commenter stated that a jurisdiction-specific approach creates additional effort for smaller counterparties coming into scope in the later phases of the compliance schedule, which need to run separate AANA calculations using different time periods and methods and need to provide separate notifications to their counterparties concerning the application of the IM requirements.[67] The commenter stated that according to its estimates, 775 counterparties with a total of 5,443 relationships could come into the scope of global IM requirements in the last phase of compliance beginning September 1, 2022, and that over 74% of those counterparties will qualify for the IM requirements with less than EUR 25 billion AANA and therefore may be in a position to recalculate their AANA each year to affirm the continued application of the IM requirements.[68] In addition, hundreds of other counterparties that do not initially breach the $8 billion threshold will need to conduct annual AANA calculations to confirm whether they have come into scope of the IM requirements in one or more jurisdictions.[69] The commenter concluded by stating that jurisdictional differences are difficult to track and manage, leading to inadvertent errors or omissions in the calculations and the application of IM requirements, and that the differences could interfere with the ability to apply substituted compliance, since a party may become subject to the IM requirements under the CFTC Margin Rule on a different date in the U.S. as they will in other global jurisdictions.[70]

Addressing concerns that the month-end AANA methodology for determining MSE may result in window dressing, a commenter stated that it was not a realistic risk, as it would take considerable effort for parties to unwind their positions and then reestablish the position on a recurring basis over the three-month period, which would interrupt their hedging strategies and require the counterparties to absorb the cost of realized profit and loss changes.[71] Another commenter echoed these arguments, noting that tearing up positions may interfere with hedging and cause portfolios to incur realized profit and loss changes.[72] A commenter, speaking on behalf of the managed fund industry, stated that adjustments to swaps positions to benefit from the month-end AANA methodology would be contraindicated in the case of an investment adviser to a regulated fund because the investment adviser is a fiduciary to the fund that is legally obligated to manage the fund's assets in accordance with that fund's investment strategy, policies, and limitations.[73] Adjusting swap exposures over the course of three periodic dates solely to avoid IM could impose transaction costs and inhibit a fund's ability to manage its portfolio risk, which may be inconsistent with the adviser's duty to act in the best interest of its clients.[74] Another commenter representing the life insurance industry stated that the proposed changes to the calculation of AANA would be unlikely to change the life insurers' market behavior given that life insurers are subject to significant state regulation of their derivatives activities.[75]

While recognizing that practical considerations, as discussed by the commenters, may reduce the risk of window dressing, the Commission believes that it should seek to remove any potential incentives that may lead to the manipulation of swaps exposures to avoid meeting the definition of MSE and thus coming within the scope of the margin requirements. Accordingly, as discussed further above, the Commission is revising the proposed rule text to incorporate an anti-evasion provision prohibiting activities willfully designed to avoid the month-end AANA calculation.

With respect to the divergence between the CFTC and the U.S. prudential regulators regarding the method for calculating AANA for determining whether an entity has MSE and the timing of compliance after the last phase of the compliance schedule, commenters stated that the CFTC should proceed with the amendments even if the prudential regulators do not make corresponding changes to their margin rules while also encouraging the prudential regulators to align with the global standards.[76] A commenter further noted that given that most affected FEUs belong to a corporate group that has to calculate AANA for multiple jurisdictions, a deviation between the CFTC and prudential regulators would not increase the regulatory burden for most FEUs as they would already be calculating AANA under the CFTC/prudential regulator approach and the BCBS/IOSCO approach.[77]

After reviewing the comments, the Commission has confirmed the rationale articulated for proposing the amendments to the definition of MSE in Regulation 23.151 and is therefore adopting the amendments as proposed, subject to the change to the proposed rule text to add the anti-evasion provision discussed in more detail above. The Commission believes, as discussed in the preamble to the Proposal, that the amendments will eliminate the need to maintain separate schedules and processes for the computation of AANA and reduce the burden and cost of compliance with the

Framework and the amendments to the definition of MSE discussed herein. Also of note, the U.S. Securities and Exchange Commission ("SEC") has adopted a different approach that does not use MSE for identifying entities that come within the scope of the SEC margin requirements. *See* Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers, 84 FR 43872 (Aug. 22, 2019).

[62] *See* ACLI 10/23/2020 Letter at 1; Associations 10/22/2020 Letter at 2; FIA 10/22/2020 Letter at 4; MFA 10/22/2020 Letter at 1; SIFMA AMG 10/22/2020 Letter at 2; Working Group 10/22/2020 Letter at 3.

[63] SIFMA AMG 10/22/2020 Letter at 1; ACLI 10/23/2020 Letter at 2.

[64] *Id.*

[65] *Id.*

[66] Associations 10/22/2020 Letter at 2.

[67] *Id.*

[68] *Id.*

[69] *Id.*

[70] *Id.*

[71] *Id.*

[72] SIFMA AMG 10/22/2020 Letter at 3.

[73] ICI 10/22/2020 Letter at 5.

[74] *Id.*

[75] ACLI 10/23/2020 Letter at 2.

[76] SIFMA AMG 10/22/2020 Letter at 3; Working Group 10/22/2020 Letter at 2.

[77] Working Group 10/22/2020 Letter at 3.

IM requirements.[78] In addition, section 752(a) of the Dodd-Frank Act calls on the CFTC to ''consult and coordinate'' with respect to the establishment of consistent international standards.[79] As such, the Commission believes that amending the definition of MSE, as proposed, is appropriate to harmonize its compliance schedule with that of BCBS/IOSCO and, for entities engaging in swaps with CSEs, eliminates a disjunction that could risk calculation errors and may hinder compliance with the IM requirements.

B. Regulation 23.154—Alternative Method of Calculation of IM

As originally adopted, the CFTC Margin Rule requires CSEs to collect and post IM with covered counterparties, including CFTC-registered SDs or MSPs.[80] Regulation 23.154(a) directs CSEs to calculate, on a daily basis, the IM amount to be collected from covered counterparties.[81] CSEs have the option to calculate the IM amount by using either a risk-based model or the standardized IM table set forth in Regulation 23.154(c)(1).[82] For a CSE that elects to use a risk-based model to calculate IM, Regulation 23.154(b)(1) requires the CSE to obtain the written approval of the Commission or a registered futures association[83] to use the model to calculate IM required by the Commission's margin requirements for uncleared swaps.[84]

After reviewing the comments on the Proposal, the Commission is adopting the amendment to Regulation 23.154(a) as proposed, subject to some clarifications further discussed below. More specifically, the Commission is amending Regulation 23.154(a) by adding new paragraph (a)(5). Paragraph (a)(5) permits a CSE that enters into uncleared swaps with a CFTC-registered SD or MSP, or a swap entity, to use the swap entity's risk-based model calculation of IM to determine the amount of IM that must be collected from such counterparty and to determine whether the IM threshold amount has been exceeded, which would require documentation concerning the posting, collection, and custody of IM.

This amendment to Regulation 23.154(a) modifies, consistent with Letter 19–29, the requirement that CSEs calculate the amount of IM to be collected from a swap entity counterparty by giving CSEs the option to rely on such counterparty's risk-based IM calculation. The Commission acknowledges that as a result, some CSEs may forgo the adoption of a risk-based model to avoid the cost and burden associated with developing and maintaining such a model. The Commission notes that without a model to compute its own IM, a CSE may lack reasonable means to verify the IM amount provided by its counterparty or may fail to recognize shortfalls in the IM calculation or flaws in the counterparty's risk-based model. As such, the CSE may collect insufficient amounts of IM to offset counterparty risk. In addition, the Commission acknowledges the swap entity's potential conflict of interest in calculating IM for the CSE,[85] as it may be biased in favor of calculating and posting lower amounts of IM to the CSE.

Based on the foregoing concerns, the Commission is adopting, as part of the new paragraph (5) in Regulation 23.154(a), two of the conditions set forth in Letter 19–29.[86]

First, consistent with Letter 19–29, paragraph (a)(5) requires that the risk-based model used by the CSE's swap entity counterparty for the calculation of IM satisfy the requirements of Regulation 23.154(b) (requiring the approval of the use of the model by either the Commission or the NFA), or that the model be approved by a prudential regulator.[87]

Second, paragraph (a)(5) permits CSEs to use the risk-based model calculation of IM of a swap entity counterparty only if the uncleared swaps for which IM is calculated are entered into for the purpose of hedging the CSE's own risk. The risk to be hedged is understood to be the risk that a CSE would incur when entering into swaps with non-swap entity counterparties. By limiting the application of this alternative method of calculation of IM to only uncleared swaps entered into for the purpose of hedging risk arising from swaps entered into with non-swap entities, the Commission ensures the narrow application of this method of calculation.

The Commission contrasts the risk of customer-facing swaps with the risk that CSEs incur when entering into a swap in a dealing capacity ''to accommodate the demand'' of a swap entity counterparty.[88] The Commission believes that it would be inappropriate to allow a CSE to use the IM calculation of the swap entity counterparty in this latter case. The Commission notes that the latter case (*i.e.,* where the CSE is acting in a dealing capacity for a counterparty that is itself calculating IM) would occur in the inter-dealer market for swaps. The Commission believes that a CSE participating in the inter-dealer market in a dealing capacity should have the capacity to develop, implement, and use an approved risk-based model.

The Commission expects that new paragraph (a)(5) would be relied upon by CSEs that opt not to develop and obtain approval to use a risk-based model for the calculation of IM but instead elect to use the table-based calculation described in Regulation 23.154(c) for swaps with non-swap entity counterparties. Such CSEs, in the course of their uncleared swaps business, would enter into uncleared swaps mostly with end-user, non-swap entity counterparties, and hedge the risk of those swaps with other uncleared swaps entered into with swap entity counterparties. The CSEs would exchange IM with the swap entity counterparties for the uncleared swaps entered into for their own hedging, as the swaps would be subject to the CFTC

[78] The Commission acknowledges that the burdens on market participants will not be fully eliminated, and in fact, may increase, for those entities that enter into uncleared swaps with SDs and MSPs that are subject to the U.S. prudential regulators' margin requirements for uncleared swaps and come within the scope of the prudential regulators' margin regime, as the prudential regulators have not revised their rules consistent with the rule changes being adopted herein. Any further discussion in this Final Rule of the benefits of not needing to maintain separate schedules and processes is limited to entities not also undertaking swaps with U.S. prudentially regulated SDs.

[79] *See s*ection 752(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

[80] *See* 17 CFR 23.152.

[81] *See* 17 CFR 23.154(a).

[82] *See id.*

[83] *See* 17 CFR 23.154(b)(1)(i). In this context, the term ''registered futures association'' refers to the National Futures Association (''NFA''), which is the only futures association registered with the Commission.

[84] *See* 17 CFR 23.154(b)(1)(i).

[85] The Commission, however, notes that the potential for conflict may be mitigated as the swap entity, as a CFTC-registered SD or MSP, would be subject to Regulation 23.600, which requires SDs and MSPs to establish a risk management program for the management and monitoring of risk, including credit and legal risk, associated with their swap activities. *See* 17 CFR 23.600.

[86] As previously discussed, Letter 19–29 permits Cargill to use the risk-based IM calculation of a counterparty that is a CFTC-registered SD to determine the amount of IM to be collected from such counterparty, subject to specified conditions discussed in more detail below.

[87] The prudential regulators have not amended their margin requirements for uncleared swaps consistent with the amendment to Regulation 23.154(b) discussed herein. As such, the CFTC's margin requirements will diverge from the prudential regulators' approach.

[88] *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, 30608 (May 23, 2012) (noting that a distinguishing characteristic of swap dealers is being known in the industry for their availability to accommodate demand for swaps).

IM requirements.[89] Because maintaining a risk-based model imposes a disproportionate burden on the CSEs relative to the discrete and limited nature of their uncleared swap activities, the CSEs would generally not have a model for the calculation of IM, and thus new paragraph (a)(5) will permit them to use the risk-based model calculation of their swap entity counterparties to determine the amount of IM to be collected from such counterparties.

Letter 19–29, in addition to the foregoing conditions, requires that Cargill, prior to using the risk-based model calculation of IM of a swap entity counterparty, agree with its counterparty in writing that the IM calculation be provided to Cargill in a manner and time frame that would allow Cargill to comply with the CFTC Margin Rule and other applicable Commission regulations, and that the calculation be used to determine the amount of IM to be collected from the counterparty and to determine whether the IM threshold amount has been exceeded, which would require documentation addressing the posting, collection, and custody of IM. While the Commission acknowledges that the application of the alternative method of calculation of IM adopted herein could potentially result in the miscalculation or underestimation of IM, it believes that the safeguards in Part 23 of the Commission's regulations, such as the documentation requirements in Regulations 23.158 and 23.504, address this concern.

Regulation 23.158(a) requires CSEs to comply with the documentation requirements set forth in Regulation 23.504.[90] Regulation 23.504(b)(4)(i) requires CSEs to have written documentation reflecting the agreement with a counterparty concerning methods, procedures, rules, and inputs for determining the value of each swap at any time from execution to the termination, maturity, or expiration of such swap for the purposes of complying with the margin requirements under section 4s(e) of the Act and regulations under this part.[91] Regulation 23.504(b)(3)(i) also provides that the documentation shall include credit support arrangements, including initial and variation margin requirements, if any.[92]

Letter 19–29 also sets forth two conditions that are designed to ensure that Cargill will undertake adequate risk management with respect to its uncleared swaps. The Commission notes that the availability of the alternative method of calculation of IM may lead some CSEs to forgo the adoption of a proprietary risk-based model for the calculation of IM. Without a proprietary risk-based model, CSEs may not be able to precisely calculate IM, or the potential future exposure of uncleared swaps, which could undercut a CSE's ability to adequately manage the risk of its swaps. However, the Commission believes that CSEs' risk management obligations under the CEA and the Commission's regulations provide adequate safeguards to address this concern. In this regard, the Commission notes that section 4s(j)(2) of the CEA requires SDs and MSPs, including CSEs, to establish robust and professional risk management systems adequate for the management of their day-to-day swaps business [93] and that Regulation 23.600, consistent with the mandate under the CEA, requires SDs and MSPs to establish and maintain a risk management program to monitor and manage risk associated with their swap activities.[94]

To obtain relief under Letter 19–29, Cargill also must ''keep track of exceedances'' [95] and ''[if] the exceedances indicate that the Approved IM Calculation Method fails to meet the relevant regulators' standards, [Cargill] must take appropriate steps to ensure compliance with its risk management obligations and address exceedances with its SD counterparty.'' [96] The purpose of this requirement is to ensure that Cargill monitors, identifies, and addresses potential shortfalls in the amount of IM generated by the counterparty. Cargill must also report to the CFTC ''any adjustments and enhancements . . . applied to the amount of IM calculated pursuant to the Approved IM Calculation Method to ensure [Cargill's] collection of adequate amounts of IM.''

The Commission notes that if a CSE declines to adopt a proprietary model to calculate IM, a CSE may be unable to verify whether the amounts of IM calculated by its counterparty are sufficient. The Commission, however, believes that Regulation 23.600 addresses this concern by requiring SDs and MSPs to account for credit risk in conducting their risk oversight and to ensure compliance with the CFTC margin requirements. In the case of a CSE relying on new paragraph (a)(5), as adopted, adequate risk oversight will include steps by the CSE to monitor, identify, and address potential shortfalls in the amounts of IM generated by the counterparty on whose IM model the CSE is relying. While the Commission does not prescribe the CSE's oversight process, it believes that a risk management program that is unable to identify or to address shortfalls in IM will be insufficient to comply with Regulation 23.600.

Moreover, Regulation 23.600 requires SDs and MSPs to furnish to the Commission risk exposure reports setting forth credit risk exposures and any other applicable risk exposures relating to their swap activities. Here again, the Commission believes that an adequate risk exposure report pursuant to Regulation 23.600 will require a CSE to identify any adjustments and enhancements to the amount of IM calculated pursuant to the risk-based model of its swap entity counterparty to ensure the CSE's collection of adequate amounts of IM.

Commenters generally supported the proposed amendment to Regulation 23.154(a) to permit CSEs to rely on their swap entity counterparties' risk-based model calculation of IM.[97] A commenter stated that the proposed alternative method of IM calculation would greatly reduce the complexity and burden associated with the implementation of the margin requirements, in particular in the last phases of compliance, thus fostering greater liquidity and contributing to lowering the hedging costs of end-users.[98] Another commenter discussed the competitive disadvantage that smaller SDs might experience absent the alternative method of IM calculation.[99] This commenter noted that large SDs may be

[89] *See generally* 17 CFR 23.152 (requiring CSEs to exchange IM with swap entity counterparties for their uncleared swaps).

[90] 17 CFR 23.158(a).

[91] 7 U.S.C. 6s(e);17 CFR 23.504(b)(4)(i).

[92] Regulation 23.504(b)(1) further provides that the documentation should include all terms governing the trading relationship between an SD or MSP and its counterparty, including without limitation, terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, valuation, and dispute resolution. 17 CFR 23.504(b)(1).

[93] 7 U.S.C. 6s(j)(2).

[94] *See* 17 CFR 23.600.

[95] Exceedances are price movements above the amount of IM computed using a risk-based model that complies with the Commission's regulations.

[96] Letter 19–29 at 4.

[97] Associations 10/22/2020 Letter at 4; BPEC 10/23/2020 Letter at 2; FIA 10/22/2020 Letter at 4; STRM 10/23/2020 Letter at 1; Working Group 10/22/2020 Letter at 3. In addition to the comments addressing the alternative method of calculation of IM, as proposed, two commenters requested broadening the Proposal to permit CSEs to use the risk-based model of calculation of IM of financial end user counterparties. BPEC 10/23/2020 Letter at 9; Associations 10/22/2020 Letter at 4. In the Commission's view, this matter falls outside the scope of the Proposal. Accordingly, the Commission will not express a view or act on this matter.

[98] BPEC 10/23/2020 Letter at 2.

[99] FIA 10/22/2020 Letter at 5.

disincentivized from trading uncleared swaps with such SDs since doing so would require large SDs to manage risk-based model calculations with some entities and table-based calculation with smaller SDs.[100] Further, this commenter stated that table-based IM calculations, which do not take into account a firm's specific portfolio composition, including diversification and hedges, might produce more conservative results requiring the posting and collection of margin that is inappropriately high given the actual level of risk involved in a typical transaction.[101]

Another commenter representing a group of commercial firms in the energy industry stated that allowing smaller SDs to rely on their SD counterparties' approved IM model calculation would allow them to continue to play a crucial role in certain discrete swaps markets, like the energy swaps markets, in an economic and cost effective manner.[102] The commenter noted that the use of the table-based method for the calculation of IM by smaller SDs and IM modeling by larger SDs resulted in a mismatch in calculation methods that could lead to worse pricing for smaller SDs, as the table-based method would likely cause their counterparties to post more IM than they would under a model-based approach, with the cost of that margin being reflected in a higher price provided to the smaller SDs.[103]

Notwithstanding these expressions of support, many commenters objected to the provision in the Proposal that limits the application of the alternative method of calculation of IM to uncleared swaps entered into by a CSE and a swap entity counterparty to hedge the risk of customer-facing swaps undertaken by the CSE, namely the hedging limitation.[104] A commenter stated that it would be difficult, if not impossible, to ensure that all transactions to which the alternative method of calculation could apply are entered into for hedging purposes given that the concept of hedging is difficult to administer.[105] The commenter pointed to questions that may arise, including what standard should be used to determine whether a given swap is in fact a ''hedge.'' [106] The commenter asked whether each swap with a large SD must be matched one-by-one with a swap with a non-swap entity counterparty,[107] and whether it would be feasible for an entity to undertake portfolio hedging or dynamic hedging in that context.[108] The commenter also asked what would happen if the underlying swap transaction with a non-swap entity counterparty had been terminated, and whether anticipatory hedges could be counted as hedging.[109] The commenter noted that because the swaps markets are dynamic, the character of swaps may change over time and tagging a swap as hedging and non-hedging may be impractical.[110] The commenter concluded that given the uncertainty as to what constitutes hedging, CSEs may be reluctant to apply the alternative method of calculation.[111]

Another commenter raised similar concerns regarding difficulties in applying the concept of hedging, illustrated by the position limits rule recently adopted after many attempts by the Commission to implement the Dodd-Frank Act, noting that at the core of the rule lies the concept of hedging.[112] The commenter stated that the concept of hedging is difficult to quantify and that there are many instances when ''hedging'' is virtually indistinguishable from speculation.[113] In the absence of a definition in the Final Rule, the commenter stated, counterparties could be left guessing and may be reluctant to rely on the alternative method of calculation for fear of violating the hedging limitation.[114] A commenter also noted that proposed Regulation 23.154(a)(5) does not define the term hedging and suggested replacing the term with the phrase ''hedge or mitigate commercial risk.'' [115]

Another commenter stated that many CSEs do not separate hedging from dealing on a transaction-by-transaction basis since CSEs often manage hedging on a portfolio basis and, as a result, to implement the hedging limitation, CSEs would need to undertake a significant amount of analysis and legal review to make hedging determinations, making the relief provided by the alternative method of IM calculation impracticable.[116] Similarly, another commenter stated that if a CSE must be able to demonstrate that each swap is a hedge of a transaction with a non-SD, then the CSE would not be able to engage in portfolio hedging if the portfolio includes risk related to a speculative swap with another SD.[117] Consequently, in the commenter's view, the hedging limitation would limit the flexibility and efficacy of a CSE's risk management program.[118]

In line with these comments, another commenter stated that if a commercial CSE's portfolio includes non-hedging transactions, the opportunity to rely on the IM calculations of its SD counterparty may not be useful since they would need to calculate separately IM for the non-hedging transactions, which would reduce the benefits of netting or diversification offered by the Standardized IM Model (''SIMM'').[119] As a result, the commenter noted, the amount of IM is likely to be higher, disadvantaging commercial CSEs and their SD counterparties in a way that would not apply to CSE portfolios with non-SDs.[120]

Commenters also noted that CSEs and their counterparties typically transact both hedging and dealing swaps under a single ISDA Master Agreement or credit support annex, with many relationships put in place years ago, and calculate IM at the relationship or master contract level rather than the transaction level.[121] A commenter stated that if CSEs are required to add additional representations confirming that a given transaction is a ''hedging'' transaction, the existing documentation would need to be updated.[122] The commenter further stated that IM would also need to be administered on the basis of hedging and non-hedging transactions which would make the

[100] *Id.*

[101] *Id.* at 5.

[102] Working Group 10/22/2020 Letter at 3.

[103] *Id. See also* STRM 10/23/2020 Letter at 2.

[104] Associations 10/22/2020 Letter at 4; BPEC 10/23/2020 Letter at 2; FIA 10/22/2020 Letter at 6; Working Group 10/22/2020 Letter at 4.

[105] BPEC 10/23/2020 Letter at 5.

[106] *Id.* at 4.

[107] *Id. See also* STRM 10/23/2020 Letter at 4 (stating that classifying individual transactions with other SDs as hedges and tying the hedges to particular client-facing transactions would impose a material compliance burden that could nullify any benefit offered by the relief in proposed Regulation 23.154(a)(5)).

[108] BPEC 10/23/2020 Letter at 4.

[109] *Id.*

[110] *Id.*

[111] *Id.* at 5.

[112] FIA 10/22/2020 Letter at 7.

[113] *Id.*

[114] *Id.*

[115] STRM 10/23/2020 Letter at 4.

[116] BPEC 10/23/2020 Letter at 5.

[117] Working Group 10/22/2020 Letter at 4.

[118] *Id.*

[119] Associations 10/22/2020 Letter at 4. This commenter, along with another commenter, also argued that SIMM, whose use must be approved by a regulator prior to its utilization in the calculation of regulatory IM, is a robust framework that obviates the need for a safeguard, such as the hedging limitation, to ensure the calculation of sufficient amounts of IM. *See* Associations 10/22/2020 Letter at 5; FIA 10/22/2020 Letter at 9. While recognizing the value of standardization, the Commission believes that SIMM on its own does not offer the safeguards necessary to address the concerns raised by the application of the alternative method of IM calculation. That is because SIMM is a tool that must be tailored to fit each firm's portfolio and risk profile, and must be subject to ongoing oversight to ensure adequate calibration.

[120] Associations 10/22/2020 Letter at 4.

[121] *See generally* Associations 10/22/20 Letter at 4; BPEC 10/23/2020 Letter at 6; FIA 10/22/2020 Letter at 7–8.

[122] FIA 10/22/2020 Letter at 8.

netting of all transactions under a single ISDA Master Agreement impossible.[123] As a result, the implementation of the hedging limitation would be extremely complex and result in potentially added operational risk, and certain swap entity counterparties, given the added market and bankruptcy risk, may shy away from undertaking swaps with CSEs that rely on the alternative method of calculation of IM.[124]

A commenter also pointed out that having to use the table-based method of calculation for determining IM in some circumstances and a counterparty's IM model in other circumstances would be operationally complex for a CSE, potentially to the point of being unworkable, and may result in the CSE being forced to choose between entering into transactions in the inter-dealer market or using the alternative method of calculation.[125] The commenter further stated that the hedging limitation could have negative implications for liquidity in certain markets, as some CSEs with unique insights and risk profiles that are best situated to assume customer risk from other SDs may opt not to trade with such SDs to avoid the burden associated with the hedging limitation.[126] Another commenter stated that costs associated with the hedging limitation, including operational and documentation burdens, could lead small CSEs to cease providing risk mitigation services to end-user counterparties, leaving end-users with unhedged risks.[127]

The concerns raised in the foregoing comments hinge on two ideas: (i) CSEs undertake hedging and speculative swaps with swap entity counterparties; and (ii) there is no clear standard for determining which swaps are entered into for hedging purposes. Commenters assert that because CSEs undertake both hedging and speculative swaps with swap entity counterparties, the implementation of the hedging limitation would add further complexity to the transactions and would be burdensome as swaps are generally managed on a portfolio basis and may be under a single master netting agreement or credit support annex, making the separation of hedging and non-hedging transactions challenging, if not impossible.[128]

In response to these concerns, the Commission acknowledges the potential burdens associated with the implementation of the hedging limitation. However, the Commission points out that the proposed addition of a method of calculation of IM that would enable a CSE to rely on a swap entity counterparty's model calculation of IM provides an alternative to the two existing methods of calculation of IM. The alternative method provides flexibility to address a particular situation illustrated in Letter 19–29. As such, it is intended for use by CSEs whose core swaps business is with non-swap entities but that occasionally enter into swaps with a few swap entity counterparties to offset the risk of customer-facing swaps. Given the limited swaps business with swap entity counterparties, it is uneconomical for the CSEs to develop, adopt, and maintain a proprietary risk-based model for the sole purpose of engaging such counterparties.

In light of the intended use for the alternative method of IM calculation, the Commission incorporated in the Proposal, in line with Letter 19–29, the hedging limitation restricting the application of the proposed alternative method of IM calculation to uncleared swaps entered into by a CSE to hedge the CSE's customer-facing risk. The Commission noted in the Proposal that the incorporation of the hedging limitation would also have the effect of limiting the use of the proposed method of IM calculation. While the proposed alternative method of IM calculation was intended to make the alternative method set forth in Letter 19–29 more widely available, the Commission stated that its application raised some concerns that would be mitigated, in part, by limiting the use of the alternative method of calculation to hedging transactions. More specifically, the Commission expressed the concern that in calculating the amount of IM to be used by the CSE to determine the amount to be collected from the swap entity counterparty, the swap entity counterparty could miscalculate the amount of IM or may be motivated to underestimate the amount of IM in order to post lesser IM amounts to the CSE. In turn, the CSE, without a proprietary model to calculate IM, would have no meaningful way to verify whether the amounts generated by the swap entity counterparty were correct or to contest the amounts, potentially resulting in the CSE collecting insufficient amounts of margin to mitigate the risk of its swaps.

The Commission notes that there are other safeguards in the Commission's regulations, such as risk management requirements applicable to both CSEs and their swap entity counterparties, that could address the potential miscalculation or underestimation of IM; however, the Commission believes that these safeguards do not obviate the need for the hedging limitation. Rather, in the Commission's view, the hedging limitation will work together with such other measures to provide effective protections to address the concerns raised by the application of the alternative method of calculation of IM.

Accordingly, the Commission has decided to retain the hedging limitation. The Commission expects that counterparties that engage in both hedging and speculative transactions would engage in such a small number of speculative transactions that the complexity and burden of separating speculative and hedging transactions and operationally implementing the hedging limitation would be rather low. On the other hand, if the speculative activity between the CSE and the swap entity counterparty is so robust as to complicate the use of the alternative method of calculation, the CSE should be able to carry out its own calculation of IM by either adopting a proprietary model for the calculation of margin or using the table-based method of calculation. It follows that if the CSE adopts a proprietary model of calculation for its speculative swaps, the CSE should be likewise able to adopt a model or use the same model for calculating IM for its hedging swaps, thus obviating the need to rely on its counterparty's IM calculation.

Regarding comments asserting a lack of a clear standard to differentiate between hedging and non-hedging swaps, the Commission believes that the existing standard set out in section 4a(c)(2)(B) of the CEA [129] to define ''bona fide hedging transaction or position'' provides a suitable framework for determining which swaps are hedges for the purpose of applying the alternative method of calculation. By referring to section 4a(c)(2)(B) for this purpose, the Commission is setting forth a principles-based approach, not requiring strict adherence to all the terms of the statute, as the statute addresses physical markets and products not pertinent in this context, and pertains to issues (*i.e.,* speculation in the physical markets) outside the scope of this Final Rule. Key principles derived from section 4a(c)(2)(B) that should be taken into account in determining whether a swap between a CSE and a swap entity counterparty has been entered into for hedging purposes include: (a) Whether the swap reduces

[123] *Id.*

[124] *See* Associations 10/22/20 Letter at 4; BPEC 10/23/2020 Letter at 6; FIA 10/22/2020 Letter at 8.

[125] Working Group 10/22/2020 Letter at 4.

[126] *Id. See also* STRM 10/23/2020 Letter at 5.

[127] FIA 10/22/2020 Letter at 8.

[128] *See* BPEC 10/23/20 Letter at 6; FIA 10/22/2020 Letter at 8.

[129] 7 U.S.C. 6a(c)(2).

risk attendant to another swap undertaken between the CSE and a non-swap entity counterparty; and (b) whether such other swap (i) was executed by the non-swap entity counterparty as a substitute for transactions made or to be made, or for positions taken or to be taken at a later time, in a commercial enterprise; (ii) is economically appropriate to the reduction of risk in the conduct and management by the non-swap entity counterparty of a commercial enterprise; and (iii) arises from the potential change in value of the non-swap entity counterparty's assets, liability or services. To determine whether the criteria in (b) above have been satisfied, the CSE, in accordance with Regulation 23.402(d), would be able to rely on a written representation from the non-swap entity counterparty, unless the CSE has information that would cause a reasonable person to question the accuracy of the representation.[130]

By using this framework, the Commission believes that many of the questions raised by the commenters in connection with the application of the hedging limitation would be addressed. For example, commenters asked whether swaps entered into by a CSE and an end-user and the offsetting swaps undertaken by the CSE and a swap entity counterparty must match one-to-one.[131] The framework provides some flexibility permitting CSEs as part of the hedging strategy to match a set of customer-facing swaps with one or more hedging swaps undertaken with a swap entity counterparty. Commenters also asked what would happen if the customer-facing swaps were terminated, and whether anticipatory hedging would be deemed hedging in the context of the alternative method of calculation.[132] Consistent with the framework set forth above, swaps undertaken by a CSE and a swap entity counterparty as part of a hedging strategy to offset the risk of customer-facing swaps—including swaps that are ultimately terminated and swaps that may be entered into in the future—would be deemed to be hedges for the purposes of the alternative method of IM calculation.

The Commission confirms, consistent with the statutory framework set forth in section 4a(c)(2)(B), that both the underlying swap between the CSE and the end-user counterparty, and the offsetting swap between the CSE and the swap entity counterparty must be entered into for hedging purposes. More specifically, the swap between the CSE and the end-user counterparty must be entered into to hedge risk attendant in a commercial enterprise. In connection with this position, a commenter stated that the burden of compliance with the hedging limitation would be borne not only by the CSE and the swap entity counterparty, but also by end-users that are counterparties to the CSE, as they too would need to make an assessment of whether their swaps are for ''hedging'' purposes and would need to update their documentation accordingly.[133] Given that the alternative method of calculation is expected to be used in the limited circumstances described herein, the Commission believes that the chance that end-users may be burdened would be greatly reduced.

A commenter also stated that the hedging limitation may not only burden small CSEs but also their swap entity counterparties.[134] Another commenter noted that a swap entity counterparty may be reluctant to trade with a CSE fearing the CSE's misrepresentation or mischaracterization of its swaps as hedges, which could lead the swap entity counterparty to violate its obligations under the CFTC Margin Rule.[135] In this regard, the Commission notes that Regulation 23.402(d) permits a swap entity counterparty with respect to swaps with a CSE to rely on the CSE's representations to satisfy its due diligence obligations unless the swap entity counterparty has any reason to question the CSE's representations.[136] The Commission believes that Regulation 23.402(d) mitigates swap entity counterparties' concerns regarding a CSE's potential misrepresentation or mischaracterization of its swaps as hedges.

Two commenters suggested replacing the hedging limitation with a $750 billion threshold, whereby CSEs with AANA below the threshold would be able to use the alternative method of IM calculation without imposing conditions on the business of CSEs that could have adverse market impact.[137] In the Commission's view, another threshold to determine the applicability of the CFTC's margin requirements would add further complexity to the rules. In addition, the Commission believes that the hedging limitation as adopted and further discussed above is adequately designed to advance the Commission's goals.

III. Administrative Compliance

A. Regulatory Flexibility Act

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.[138] As discussed in the Proposal, the amendments being adopted herein only affect SDs and MSPs that are subject to the CFTC Margin Rule and their covered counterparties, all of which are required to be eligible contract participants (''ECPs'').[139] The Commission has previously determined that SDs, MSPs, and ECPs are not small entities for purposes of the RFA.[140] Therefore, the Commission believes that the Final Rule will not have a significant economic impact on a substantial number of small entities, as defined in the RFA.

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

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (''PRA'') [141] 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

[130] 17 CFR 23.402(d) (providing that an SD or MSP may rely on the written representations of a counterparty to satisfy its due diligence requirements under subpart H of Part 23 of the Commission's regulations, which sets forth business conduct standards for SDs and MSPs to be applied in their dealings with counterparties). *See also* Position Limits for Derivatives (approved Oct. 15, 2020) (defining ''bona fide hedging transaction or position'' to include pass-through swaps, as described in section 4a(c)(2)(B) of the CEA, undertaken to offset the risk of other swaps entered into to hedge commercial risk, and noting that a counterparty may rely on its counterparty's written representations confirming that such counterparty is executing the pass-through swap to hedge another swap undertaken to offset commercial risk).

[131] FIA 10/22/2020 Letter at 7; BPEC 10/23/2020 Letter at 4.

[132] *Id.*

[133] FIA 10/22/2020 Letter at 8.

[134] BPEC 10/23/2020 Letter at 5.

[135] FIA 10/22/2020 Letter at 8.

[136] *See* 17 CFR 23.402(d) (allowing SDs or MSPs to rely on the written representations of a counterparty to satisfy its due diligence requirements concerning swaps entered into with the counterparty, unless the SD or MSP has information that would cause a reasonable person to question the accuracy of the representation).

[137] STRM 10/23/2020 Letter at 5; Working Group 10/23/2020 Letter at 5.

[138] 5 U.S.C. 601 *et seq.*

[139] Each counterparty to an uncleared swap must be an ECP, as the term is defined in section 1a(18) of the CEA, 7 U.S.C. 1a(18) and Regulation 1.3, 17 CFR 1.3. *See* 7 U.S.C. 2(e).

[140] *See* Registration of Swap Dealers and Major Swap Participants, 77 FR 2613, 2620 (Jan. 19, 2012) (SDs and MSPs) and Opting Out of Segregation, 66 FR 20740, 20743 (April 25, 2001) (ECPs).

[141] 44 U.S.C. 3501 *et seq.*

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 Office of Management and Budget control number. The Final Rule, as adopted, contains no requirements subject to the PRA.

C. Cost-Benefit Considerations

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA.[142] 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 is amending the CFTC Margin Rule to revise the method for calculating AANA for determining whether an FEU has MSE and the timing of compliance with the IM requirements after the end of the phased compliance schedule (''timing of post-phase-in compliance''). These amendments align the CFTC Margin Rule with the BCBS/IOSCO Framework with respect to these matters. The Commission is also amending Regulation 23.154(a), consistent with Letter 19–29, to allow CSEs to use the risk-based model calculation of IM of a counterparty that is a swap entity.[143]

With respect to these rule amendments, the Commission considered the costs and benefits resulting from its discretionary determinations with respect to section 15(a) considerations, and sought comments from interested persons regarding the nature and extent of such costs and benefits. In response to its request for comment, as noted earlier, the Commission received nine comment letters.[144] All the comment letters generally expressed support for the Proposal.[145] One commenter noted that it reflects the realities of the marketplace and further aligns the U.S. regulations with the global regulators.[146] Other commenters stated that the Proposal would enable the implementation of the IM requirements in a practical and efficient manner and reduce the complexity and burden associated with the implementation of those requirements.[147] The commenters added that the Proposal would foster greater liquidity and contribute to the lowering of hedging costs, particularly in the last phases of the compliance schedule.[148]

The baseline against which the benefits and costs associated with the Final Rule is compared is the uncleared swaps markets as they exist today and the currently applicable timing for compliance with the IM requirements after the expiration of the phased compliance schedule. Concerning the amendment to Regulation 23.154(a), the Commission believes that to the extent market participants may have relied on Letter 19–29, the actual costs and benefits of the amendment, as realized by the market, may not be as significant at a practical level. With respect to the amendments to align aspects of the CFTC Margin Rule with the BCBS/IOSCO Framework, the Commission notes that the Dodd-Frank Act calls on the CFTC to ''consult and coordinate on the establishment of consistent international standards'' with respect to the regulation of swaps.[149] The amendments therefore advance the Congressional direction towards harmonization of the CFTC's requirements with international standards, thereby removing a regulatory impediment that might hinder the competitiveness of the U.S. swaps industry.[150]

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 following discussion of costs and benefits refers to the effects of the Final Rule on all activity subject to the Final Rule, whether by virtue of the activity's physical location in the United States or by virtue of the activity's connection with activities in, or effect on, U.S. commerce under section 2(i) of the CEA.[151]

1. Benefits

By harmonizing the CFTC's method for calculating AANA for determining MSE and the timing of post-phase-in compliance with the BCBS/IOSCO Framework, the Final Rule will create a benefit because it will reduce complexity—for example, the month-end AANA calculation method being adopted will require consideration of only three observation dates rather than daily AANA averaging over the three-month calculation period—and the potential for confusion in the application of the margin requirements. Some entities will no longer need to undertake separate AANA calculations using different calculation periods, nor will they need to conform to two separate compliance timings, varying according to the location of their swap counterparties and jurisdictional requirements applicable to the counterparties.

The Final Rule will affect FEUs with AANA between $8 billion and $50 billion that come into the scope of compliance with the IM requirements under the CFTC Margin Rule in the last compliance phase beginning on September 1, 2022, as well as those entities that come into scope after the end of the last compliance phase. The Commission believes that the Final Rule will benefit some of these entities, which, given their level of swap activity, pose a lower risk to the uncleared swaps market and the U.S. financial system in general than entities that came into scope in earlier phases. The OCE has estimated that there are approximately 514 of such entities representing 4% of total AANA across

[142] 7 U.S.C. 19(a).

[143] For the definition of the term ''swap entity,'' *see supra* note 42.

[144] *See* ACLI 10/23/2020 Letter; Associations 10/22/2020 Letter; BPEC 10/23/2020 Letter; FIA 10/22/2020 Letter; ICI 10/22/2020 Letter; MFA 10/22/2020 Letter; STRM 10/23/2020 Letter; SIFMA AMG 10/22/2020 Letter; Working Group 10/22/2020 Letter.

[145] *See* ACLI 10/23/2020 Letter at 1; Associations 10/22/2020 Letter at 1; BPEC 10/23/2020 Letter at 2; FIA 10/22/2020 Letter at 2–3; ICI 10/22/2020 Letter at 1; MFA 10/22/2020 Letter at 1; STRM 10/23/2020 Letter at 1; SIFMA AMG 10/22/2020 Letter at 1; Working Group 10/22/2020 Letter at 3.

[146] *See* ACLI 10/23/2020 Letter.

[147] *See generally* BPEC 10/23/2020 Letter; MFA 10/22/2020 Letter.

[148] *Id.*

[149] *See supra* note 79.

[150] A starting point in determining the potential benefit of alignment with the BCBS/IOSCO Framework is various statutory provisions where the U.S. Congress has called on the CFTC and other financial regulators to align U.S. regulatory requirements with international standards. For example, the Commodity Futures Modernization Act of 2000 (''CFMA'') focused on the potential threat to competitiveness of the U.S. industry where there is divergence with international standards. In particular, section 126 of the CFMA provides that regulatory impediments to the operation of global business interests can compromise the competitiveness of United States businesses. *See* CFMA section 126(a), Appendix E of Pub. L. 106–554, 114 Stat. 2763 (2000).

[151] 7 U.S.C. 2(i).

all phases.[152] This means that the Final Rule addresses entities that tend to engage in less uncleared swap trading activity and, and in the aggregate, pose less systemic risk than entities in previous phases. Because these entities are smaller, they presumably have fewer resources to devote to IM compliance and hence will benefit from the alignment of the method of calculation of AANA across jurisdictions without contributing substantially to systemic risk.

For entities with AANA between $8 billion and $50 billion that will begin collecting IM on September 1, 2022, moving the calculation period from June, July, and August 2021 to March, April, and May 2022 will better align with current practices. While the Commission cannot anticipate exactly how the June–August 2021 period will differ from the March–May 2022 period, based on comparable past experience, the OCE estimates that approximately 75–100 entities will come into scope, and a similar number will fall below the threshold by virtue of moving the calculation period. The adjusted calculation period will reduce the regulatory burden for firms that have reduced their MSE below the $8 billion threshold while requiring the collection of margin for those firms that have increased their swaps business above the threshold. While aggregate AANA for firms that fall into or out of scope is small relative to the overall market (less than one percent of total aggregate AANA), moving the calculation period close to the compliance date may have a significant impact on entities that have reduced their MSE.

The Commission also notes that the benefits of alignment with the BCBS/IOSCO Framework will continue to accrue in future years, as the determination of MSE for an FEU under the CFTC Margin Rule is an annual undertaking, triggered by the entry into an uncleared swap between the FEU and a CSE counterparty and the need to determine whether the FEU has MSE, which triggers the application of the IM requirements and the exchange of regulatory IM between a CSE and an FEU for their uncleared swap transactions.

With respect to the amendment to Regulation 23.154(a), the Commission believes that the uncleared swap markets will benefit from the extension of the targeted relief provided to Cargill, the requester in Letter 19–29, to a wider group of CSEs with similar unique swaps business models. In taking a no-action position, MPD took account of Cargill's representation that its swap trading activity primarily involved physical agricultural commodities and certain other asset classes and that it ''may maintain positions that require collection of IM from SDs.'' Cargill further stated that given the highly specialized and discrete nature of its swaps business, risk-based modeling would impose a disproportionate burden.

The more widespread availability of the alternative method of calculation of IM provided by Regulation 23.154(a), as amended by the Final Rule, may incentivize some market participants to expand their swaps business. In particular, given that certain market participants will have the option to forgo the cost of risk-based modeling, this potential reduction in compliance costs may encourage certain entities to increase their swaps trading. By increasing the pool of potential swap counterparties, the Final Rule could enhance competition, increase overall liquidity, and facilitate price discovery in the uncleared swaps markets.

2. Costs

While the Final Rule will have the effect of creating efficiencies for market participants, the Commission acknowledges that the rule changes being adopted will also give rise to some costs. Among other things, the change of the CFTC's AANA calculation period for determining MSE to align it with BCBS/IOSCO's AANA calculation period will reduce the time frame for determining whether an FEU is subject to the IM requirements and for preparing for compliance with the requirements during the final phase-in period of 2022.

Under the current margin requirements, in the period leading to the final phase-in date of September 1, 2022, FEUs would have a full year to prepare, as MSE for an FEU would be determined using the AANA for June, July and August of the prior year. However, under the Final Rule, entities will have only a three-month advance notice in 2022, as AANA will be calculated using the March, April and May period of that year. Entities will have a shorter time frame to engage in preparations to comply with IM requirements, including, among other things, procuring rule-compliant documentation, establishing processes for the exchange of regulatory IM, and setting up IM custodial arrangements. Because the Final Rule aligns the AANA calculation for determining MSE with BCBS/IOSCO's approach and the compliance date remains unchanged, the Commission believes that the cost will be mitigated. In particular, the Commission notes that commenters confirmed,[153] as reported in the Margin Subcommittee Report, that the differences in the U.S. regulations could create complexity and confusion and lead to additional effort, cost and compliance challenges for smaller market participants that are generally subject to margin requirements in multiple global jurisdictions.[154]

The Commission further notes that the amendment to the timing of post-phase-in compliance, as proposed, will defer compliance with the IM requirements with respect to uncleared swaps entered into by a CSE with an FEU that comes into the scope of IM compliance after the end of the last compliance phase. Under the current rule being amended, FEUs with MSE as measured in June, July, and August 2022 would have come into the scope of compliance post-phase-in beginning on January 1, 2023. On the other hand, under the Final Rule, FEUs with MSE as measured in March, April, and May 2023 will come into scope, post-phase-in compliance, beginning on September 1, 2023. As a result, for FEUs with MSE in both periods, less collateral for uncleared swaps may be collected given that the Final Rule changes the beginning of post-phase-in compliance from January 1, 2023, to September 1, 2023, rendering uncleared swap positions entered into between January 1, 2023, and September 1, 2023, riskier, as no IM will be required to be collected during that period, which could increase the risk of contagion and the potential for systemic risk. The Commission, however, notes that under the Final Rule, a CSE may be required to exchange IM with an FEU that comes into scope in the last phase of compliance beginning on September 1, 2022, but falls below the MSE level by January 1, 2023, for nine months longer than otherwise would have been the case, as post-phase-in, no assessment of MSE status will be required until September 1, 2023.

With respect to the adoption of a month-end AANA methodology for the calculation of AANA for determining MSE, as proposed, the Commission acknowledges that there are potential costs. The utilization of month-end

[152] Using March-May of 2020 as the calculation period. The methodology for calculating AANA is described in Richard Haynes, Madison Lau, & Bruce Tuckman, *Initial Margin Phase 5,* at 4 (Oct. 24, 2018), *https://www.cftc.gov/sites/default/files/About/Economic%20Analysis/Initial%20Margin%20Phase%205%20v5_ada.pdf.*

[153] *See* ACLI 10/23/2020 Letter at 2; Associations 10/22/2020 Letter at 3; FIA 10/22/2020 Letter at 4; SIFMA AMG 10/22/2020 Letter at 3; Working Group 10/22/2020 Letter at 2.

[154] Margin Subcommittee Report at 49.

AANA could result in an AANA calculation that is not representative of a market participant's participation in the swaps markets. As previously discussed, an AANA calculation based on month-end AANA may result in the exclusion or undercounting of certain financial contracts that are required to be included in the calculation (*e.g.,* uncleared swaps, uncleared security-based swaps, foreign exchange forwards, or foreign exchange swaps) because of certain combinations of tenure and time of execution, such as those often present in some intra-month natural gas and electricity swaps.[155] The Commission also notes the potential that market participants might ''window dress'' their exposures to avoid MSE status and compliance with the CFTC's margin requirements. At the same time, it is possible that the month-end methodology, which uses only three data points, could result in some entities having an AANA calculation on the three end-of-month dates that is uncharacteristically high relative to their typical positions.

If products are excluded from the AANA calculation, or if exposures are ''window dressed,'' the month-end calculation may have the effect of deferring the time by which market participants meet the MSE classification resulting in additional swaps between market participants and CSEs being deemed legacy swaps that are not subject to the IM requirements.[156] This may increase the level of counterparty credit risk to the financial system. While potentially meaningful, this risk will be mitigated because the legacy swap portfolios will be entered into with FEUs that engage in lower levels of notional trading.

In addition, many larger SDs are under the jurisdiction of the U.S. prudential regulators, and these entities and their counterparties will apparently be required to continue to use the current AANA calculation methodology. Entities that trade with both SDs that are under the jurisdiction of the U.S. prudential regulators and CSEs that are under the CFTC's jurisdiction will be required to undertake separate AANA calculations using different calculation periods, varying according to the regulator of their swap counterparty. Hence, entities that trade in other jurisdictions and that trade with SDs subject to the prudential regulators' jurisdiction will be required to continue to undertake separate AANA calculations using different calculation periods and two separate compliance timings. In fact, an entity that only trades in the U.S. will now be required to conduct separate AANA calculations using different calculation periods and timings. While we received no quantification of the number of such entities, SDs regulated by U.S. prudential regulators represent a sizable share of swap trading.

Recognizing the potential for costs to increase for this reason, all of the comments received by the Commission noted the benefits of alignment with the BCBS/IOSCO Framework, and none mentioned the costs associated with any potential misalignment with the U.S. prudential regulators. Further, some commenters stated that the CFTC should proceed with the amendments even if the prudential regulators do not make corresponding changes to their margin rules.[157]

In addition, the Commission notes that, in the aforementioned OCE exercise utilizing a sample of days, the OCE estimated that calculations based on end-of-month AANA would yield fairly similar results as the calculations based on the current daily average AANA approach (setting aside the window dressing issue). Based on 2020 swap data, the OCE estimated that approximately 492 entities of the 514 entities that would have come into scope in the last phase of the phased compliance schedule, based on the existing methodology, would also come into scope based on the methodology being adopted under the Final Rule. Put differently, all but 22 of the entities that would be above MSE under the existing methodology would also be above MSE under the Final Rule's methodology. In addition, there are 20 entities that would be in scope under the Final Rule's methodology, but would not have been under the existing methodology, so that the aggregate number of entities differs only by two. In aggregate, the two methodologies capture quite similar sets of entities. In addition, the entities that fall out of scope when one changes methodology tend to be among the smallest of entities coming into scope in the last phase of compliance. That is, entities that would have been in-scope under the current methodology but not the Final Rule's methodology average $6.95 billion in AANA, compared to $20 billion for all entities coming into scope in the last phase of compliance.[158]

Taking account of the relatively small percentage of aggregate AANA represented by FEUs that will have MSE for the first time in the near future, and thus be subject to the Commission's IM requirements under the Final Rule, the Commission believes that the potential exclusion of certain financial products in determining MSE will have a limited impact on the effectiveness of the CFTC Margin Rule. In addition, with respect to the potential that a market participant might ''window dress'' its exposure, the Commission believes that the anti-evasion language being incorporated into the rule text by this Final Rule, discussed in more detail above, would reduce the risk that swap exposures or positions might be manipulated to evade the CFTC's IM requirements. The Commission also notes that it has authority, including anti-fraud authority under section 4b of the CEA,[159] to take appropriate enforcement actions against any market participant that may engage in deceptive conduct with respect to the AANA calculation, and that CSEs, under the Commission's regulations, must have written policies and procedures in place to prevent evasion or the facilitation of an evasion by an FEU counterparty.[160]

Roughly 514 entities, as estimated by the OCE, will come into the scope of the IM requirements beginning on September 1, 2022, and will be affected by the Final Rule. In advance of the September 1, 2022 compliance date, many of these entities may have engaged in planning and preparations relating to the exchange of regulatory IM. With the revision of the AANA method of calculation, these entities may need to adjust their systems to reflect changes in the calculation and update related financial infrastructure arrangements. However, the Commission believes that the resulting increased costs will be negligible, and the amendments being adopted will likely be cost-reducing for those impacted firms.

Regarding the amendment to Regulation 23.154(a), there may be associated costs, as CSEs will be able to rely on the risk-based model calculation of IM computed by a swap entity counterparty. The safeguard provided by the requirement that both the CSE and its SD counterparty maintain a risk-based IM model for any swap transaction for which they do not use the table-based method to calculate IM will be eliminated. A CSE that relies on a counterparty's risk-based model calculations may forgo the adoption of a risk-based model and thus avoid the rigorous Commission requirements

[155] *See supra* note 59.

[156] For explanation of legacy swaps, *see supra* note 49.

[157] SIFMA AMG 10/22/2020 Letter at 3; Working Group 10/22/2020 Letter at 2.

[158] *See supra* note 60.

[159] 7 U.S.C. 6b.

[160] *See* 17 CFR 23.402(a)(ii).

relating to risk-based modeling,[161] which may undercut the effectiveness of the CSE's risk oversight.[162]

In addition, the safeguard of private market discipline that is inherent in having each counterparty develop its own IM model, and therefore the ability for the parties to scrutinize each other's IM model and output, will not be present given that under the Final Rule, a CSE will be permitted to rely on the risk-based model calculation of a swap entity counterparty. As such, there is the potential that insufficient amounts of IM will be generated by the swap entity counterparty, which may be attributable to a deficiency in the model or the fact that the swap entity may be inherently conflicted and interested in generating lower IM collectable by the CSE.[163] Without a model, the CSE will lack adequate means to verify the amount of IM produced by the swap entity counterparty and will not be capable to contest it. As a result, insufficient amounts of IM may be collected by the CSE to protect itself against the risk of default by the swap entity counterparty, increasing the risk of contagion and the potential for systemic risk.

The Commission, however, believes that these costs are mitigated by the Final Rule, because it reflects the narrow terms of Letter 19–29, which extends no-action relief only with respect to uncleared swaps entered into for the purpose of hedging. In addition, the Commission notes that there are other requirements in the Commission's regulations that address the monitoring of exposures and swap risk.

3. Section 15(a) Considerations

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

(a) Protection of Market Participants and the Public

The Final Rule aligns the CFTC's method for calculating AANA for determining MSE and the timing of post-phase-in compliance with the BCBS/IOSCO Framework. By aligning these aspects of the CFTC Margin Rule with the international standard, the Final Rule will reduce the potential for complexity and confusion that can result from using different AANA calculation methods and different compliance schedules for some market participants that may be subject to margin requirements in multiple jurisdictions, which could result in errors in determining whether a particular entity comes within the scope of the CFTC Margin Rule, and, in turn, the failure to exchange requisite margin if the entity is mistakenly determined to be out of scope.

The Final Rule may result in FEUs having less time between the calculation of AANA to determine whether they reach the MSE level, and the date on which CSEs would be required to exchange IM with the FEUs should the FEUs reach the MSE level. This may make it more difficult for such FEUs to prepare for the exchange of IM for their uncleared swaps with CSEs and to timely post IM, increasing the risk of their swap positions.

More specifically, under the existing CFTC Margin Rule, beginning on September 1, 2022, FEUs would have been required to look back to the June-August 2021 period to determine whether they have MSE and come within the scope of the IM requirements. The firms would have had at least twelve months to engage in preparations for the exchange of regulatory IM, by, among other things, procuring rule-compliant documentation, establishing processes and systems for the calculation, collection and posting of IM collateral, and setting up custodial arrangements. Under the Final Rule, which changes the AANA calculation period for determining MSE to March-May of the current year, such firms will have only a three-month window to engage in preparations to exchange IM. Nevertheless, the Commission notes that, under the current rule being amended, after the end of the phased compliance schedule, firms would have had only four months in subsequent years between calculation and required compliance since the calculation period for determining MSE status would have been June through August of the prior year, with compliance starting January 1 of the following year. In addition, because the Final Rule requires the averaging of three month-end dates rather than all business days during the three-month calculation period, the potential burdens of a shorter preparatory period may be offset by the adoption of the BCBS/IOSCO Framework's less onerous calculation method for some entities.

Moreover, the Final Rule shifts the timing of post-phase-in compliance to September 1 of each year. As such, some entities that otherwise would have been required to exchange IM beginning January 1, 2023, will be able to defer compliance to September 1, 2023.[164] As a result, less collateral for uncleared swaps may be collected between January 1, 2023, and September 1, 2023, rendering the parties' positions riskier during that nine-month period, which could raise the risk of contagion and increase the potential for systemic risk. Firms that would have fallen out of scope by January 1, 2023, will also be subject to compliance for an additional nine months.

The amendment to Regulation 23.154(a), as proposed, will allow a CSE to use the risk-based model calculation of IM of a counterparty that is a swap entity. As a result, the CSE may forgo the adoption of a risk-based model, avoiding the cost and burden associated with the development and maintenance of a model. Without a model, the CSE may not be able to challenge the amounts generated by the swap entity counterparty, which may be insufficient because of model error or malfunction or because the swap entity, given the inherent conflict of interest, may be biased in favor of calculating and posting lower amounts of IM to the CSE. Hence, the CSE may collect insufficient amounts of IM to offset the risk of counterparty default, increasing the risk of contagion and the potential for systemic risk.

The Commission believes that these risks may be mitigated by the Final Rule, which is narrowly tailored to permit reliance on a swap entity counterparty's risk-based model calculation only with respect to uncleared swaps entered into for the purpose of hedging. In addition, Regulation 23.600, which requires SDs and MSPs to adopt a robust risk management program for the monitoring and management of risk related to their swap activities, imposes an additional safeguard by requiring the monitoring of exposures and swap risk.

[161] *See generally* 17 CFR 23.154(b).

[162] *But cf.* 17 CFR 23.600 (requiring SDs and MSPs to establish a robust risk management program for the monitoring and management of their swap activities).

[163] *But cf.* 17 CFR 23.600 (requiring swap entities to have a risk management program for the management and monitoring of risk associated with their swaps, which may reduce the risk that such entities may act in a conflicted manner).

[164] This would apply to entities that meet the MSE level based on their AANA during the June, July, and August 2022 period, and continue to have MSE in the March, April, and May 2023 period. Of course, changing the calculation period to the March, April, and May 2023 period may lead to the inclusion of entities whose AANA is below MSE in the June, July, and August 2022 period, but rises to the MSE level or above by the March, April, and May 2023 period. The OCE estimated that approximately 75–100 entities typically move from one side of the MSE threshold to the other between measurement periods.

(b) Efficiency, Competitiveness, and Financial Integrity of Markets

The Final Rule aligns the CFTC Margin Rule's AANA calculation method for determining MSE and the timing of post-phase-in compliance with the BCBS/IOSCO Framework. The Final Rule will thus reduce the need, at least for entities not also undertaking swaps with U.S. prudentially regulated SDs, to undertake separate AANA calculations accounting for different calculation methods and to conform to separate compliance timings, varying according to the location of swap counterparties and jurisdictional requirements applicable to the counterparties.[165] As such, the Final Rule may promote market efficiency and may level the playing field for CSEs, fostering competitiveness and reducing the incentive for market participants to engage in regulatory arbitrage by identifying more accommodating margin frameworks.

The amendment to Regulation 23.154(a), as proposed, will allow CSEs to rely on a swap entity counterparty's IM risk-based model calculation. This will generally result in lower IM than if IM were calculated using the standardized IM table. As such, the amendment may allow CSEs to more effectively compete in providing swaps to end-users. The Final Rule may thus promote efficiency in the uncleared swaps market by increasing the pool of swap counterparties and fostering competition.

Potential costs may arise because, without its own model, a CSE may lack effective means to verify its counterparty's IM calculations. As a result, if there are shortfalls in the output, the CSE may collect less IM collateral to offset the risk of default by the counterparty, which could increase the risk of contagion, threatening the integrity of the U.S. financial markets. The Commission, however, believes that the Final Rule is sufficiently targeted to mitigate these risks. The Final Rule will apply only when uncleared swaps are entered into for hedging, thus limiting widespread use and the potential for uncollateralized uncleared swap risk.

(c) Price Discovery

By aligning the CFTC Margin Rule and the BCBS/IOSCO Framework with respect to the AANA calculation method for determining MSE and the post-phase-in compliance timing, the Final Rule may reduce the burden and confusion inherent in implementing separate measures and processes to address compliance in different jurisdictions for some entities. The Final Rule may thus incentivize more firms to enter into uncleared swap transactions, increasing liquidity and leading to more robust pricing that reflects market fundamentals.

The amendment to Regulation 23.154(a), as proposed, may relieve certain CSEs from having to adopt a risk-based margin model to calculate IM or use the standardized IM table, by allowing them to rely on a counterparty's risk-based model calculation of IM. Relative to the alternatives, being able to have IM calculated in this manner may lower the costs of trading for such entities, and they may increase their trading in uncleared swaps, which in turn may increase liquidity and enhance price discovery. On the other hand, the Final Rule may encourage entities to shift their trading from swaps that can be cleared, potentially reducing liquidity and price discovery in those markets.

(d) Sound Risk Management

The Final Rule may reduce the need for some firms to undertake separate AANA calculations using different methods and to conform to separate compliance timing, allowing firms to engage in sound risk management by focusing on more substantive requirements.

Under the current rule, after the last phase of compliance, CSEs that enter into uncleared swaps with FEUs with MSE would have been required to exchange IM with such FEUs beginning on January 1, 2023. Under the Final Rule, CSEs will not be required to exchange IM with an FEU with MSE until September 1, 2023. As such, one effect of adopting the Final Rule is that uncleared swaps entered into between January 1, 2023, and September 1, 2023, by a CSE and FEU with MSE may now be uncollateralized. Given that less collateral may be collected during that nine-month period, positions created during that period may be riskier, increasing the risk of contagion and systemic risk. Conversely, because the existing January 1, 2023 compliance date would have required reassessment of MSE status on such date, certain FEUs that came into scope in the last phase of compliance may have come out of scope post-phase-in, resulting in the collection of less collateral for such entities than under the Final Rule. The Commission therefore believes that balancing the additional firms that will not be required to exchange IM until September 2023, against the possibility that some firms would have come out of scope under the existing requirements, the impact of the rule change with respect to the exchange of required collateral is likely to be relatively small.

Also, it is possible that FEUs trading certain financial products may not meet the MSE threshold because month-end positions in these financial products are not reflective of their typical position, so that their month-end AANAs may be uncharacteristically low.[166] As result, CSEs and such FEUs may not exchange IM for their uncleared swaps and their swaps may be insufficiently collateralized, increasing the risk of contagion and systemic risk. Conversely, because more than 96% of FEUs are unlikely to have MSE and come within the scope of the IM requirements, as estimated by the OCE, the exclusion of such products will have a limited impact on the effectiveness of the Commission's IM requirements.

Having only three observations to evaluate an entity's typical position may lead to less precision in determining which entities are most likely to contribute to systemic risk. However, absent ''window dressing'' issues, the effect of having fewer observations is unlikely to be substantial. Based on 2020 trading, OCE estimates that the sets of firms that will meet MSE under either measure are largely the same, and the set of entities that meet one criterion and not the other tends to consist of the smallest entities.

In regard to ''window dressing,'' AANA calculations based on month-end AANA compared to the currently required daily AANA averaging may be more susceptible to manipulation and less conducive to sound risk management. FEUs may manage their exposures as they approach the month-end date during the three-month calculation period to avoid MSE status. The Commission, however, believes that the anti-evasion language being incorporated into the rule text by this Final Rule, discussed in more detail above, would reduce the risk of window dressing. In addition, the Commission notes that it has authority, including anti-fraud authority under section 4b of the CEA, to take appropriate enforcement actions against any market participant that may engage in deceptive conduct with respect to the AANA calculation, and that CSEs, under the Commission's regulations, must have written policies and procedures in place

[165] As noted above, for entities that only trade in the U.S., the Final Rule may result in separate compliance timings and AANA calculations.

[166] As noted in footnote 60 infra, the month-end calculation may tend to undercount positions in certain physical energy swaps.

to prevent evasion or the facilitation of an evasion by an FEU counterparty.[167]

As proposed, the Final Rule allows CSEs to use the risk-based model calculation of a swap entity counterparty to calculate the amount of IM to be collected from such counterparty, consistent with Letter 19–29. As a result, CSEs may no longer be incentivized to adopt a proprietary risk-based model. If a CSE uses a counterparty's IM model calculation without developing its own model, the CSE may lack reasonable means to verify the IM provided by its counterparty, recognize shortfalls in the IM calculation, and identify potential flaws in the swap entity counterparty's risk-based model. As such, insufficient amounts of IM may be collected by the CSE to protect itself against the risk of default by the swap entity counterparty, increasing the risk of contagion and the potential for systemic risk. The Commission, however, believes that these risks are mitigated because, under the Final Rule, CSEs are able to use a counterparty's risk-based model IM calculation only with respect to uncleared swaps entered into for the purpose of hedging. In addition, the Commission notes that there are other requirements in the Commission's regulations that address the monitoring of exposures and swap risk.

(e) Other Public Interest Considerations

The Commission believes that the Final Rule, by aligning the CFTC Margin Rule with the BCBS/IOSCO Framework, will promote harmonization with international regulatory requirements and may reduce the potential for regulatory arbitrage. However, given that the U.S. prudential regulators have not amended their margin requirements in line with the Final Rule, the possibility exists that certain firms may undertake swaps with particular SDs based on which U.S. regulatory agency is responsible for setting margin requirements for such SDs.

D. Antitrust Laws

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 objectives of the CEA, as well as the policies and 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.[168]

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requested comment on whether the Proposal implicated any other specific public interest to be protected by the antitrust laws and received no comments.

The Commission has considered the Final Rule to determine whether it is anticompetitive, and has identified no anticompetitive effects. The Commission requested comment on whether the Proposal was anticompetitive and, if it was, what the anticompetitive effects were, and received no comments.

Because the Commission has determined that the Final Rule is not anticompetitive and has no anticompetitive effects, the Commission has not identified any less competitive means of achieving the purposes of the Act.

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 amends 17 CFR part 23 as follows:

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, revise the definition of ''Material swaps exposure'' to read as follows:

§ 23.151 Definitions applicable to margin requirements.

* * * * *

Material swaps exposure for an entity means that, as of September 1 of any year, the entity and its margin affiliates have an average month-end aggregate notional amount of uncleared swaps, uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps with all counterparties for March, April, and May of that year that exceeds $8 billion, where such amount is calculated only for the last business day of the month. Activities not carried out in the regular course of business and willfully designed to circumvent calculation at month-end to evade meeting the definition of material swaps exposure shall be prohibited. An entity shall count the average month-end aggregate notional amount of an uncleared swap, an uncleared security-based swap, a foreign exchange forward, or a foreign exchange swap between the entity and a margin affiliate only one time. For purposes of this calculation, an entity shall not count a swap that is exempt pursuant to § 23.150(b) or a security-based swap that qualifies for an exemption under section 3C(g)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78c–3(g)(4)) and implementing regulations or that satisfies the criteria in section 3C(g)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78–c3(g)(4)) and implementing regulations.

* * * * *

■ 3. In § 23.154, add paragraph (a)(5) to read as follows:

§ 23.154 Calculation of initial margin.

(a) * * *

(5) A covered swap entity would be deemed to calculate initial margin as required by paragraph (a)(1) of this section if it uses the amount of initial margin calculated by a counterparty that is a swap entity and the initial margin amount is calculated using the swap entity's risk-based model that meets the requirements of paragraph (b) of this section or is approved by a prudential regulator, provided that initial margin calculated in such manner is used only with respect to uncleared swaps entered into by the covered swap entity and the swap entity for the purpose of hedging the covered swap entity's swaps with non-swap entity counterparties.

* * * * *

Issued in Washington, DC, on December 11, 2020, by the Commission.

Christopher Kirkpatrick,

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.

[167] *See* 17 CFR 23.402(a)(ii).

[168] 7 U.S.C. 19(b).

Appendix 2—Statement of Support of Commissioner Brian D. Quintenz

I vote in favor of today's final rule that first, amends a key definition used to determine whether a financial end-user must comply with the Commission's uncleared swap margin regulations when trading with a swap dealer,[1] and second, codifies no-action relief providing additional flexibility for swap dealers to use the risk-based calculation of initial margin.[2] With regard to the adjustment to the definition of material swap exposure, I support the fact that the rulemaking further aligns the Commission's rules to the framework agreed upon by the international framework established by BCBS–IOSCO. However, I continue to take issue with the reliance on notional value as the defining metric for determining whether a firm should be subject to the uncleared margin regulations. The philosophy behind such a framework is that firms with small levels of swaps can have outsized impacts on the financial system. Further, the fact that we, as an agency and as international regulators, continue to embrace a metric as useless, biased, and arbitrary as notional value is something I have long opposed, and I have never, not once, heard an acceptable or even rationale defense for doing so.

[1] Definition of material swap exposure under reg. 23.151(a).

[2] CFTC Letter 19–29.

Appendix 3—Statement of Support of Commissioner Dawn D. Stump Overview

I am pleased to support the final rulemaking that the Commission is adopting with respect to the definition of ''material swaps exposure'' and an alternative margin calculation method in connection with the Commission's margin requirements for uncleared swaps.

This 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 rulemaking we are adopting makes two changes to the Commission's uncleared margin rules. These changes have much to commend them—indeed, we did not receive any comment letters opposing them. These rule changes further objectives that I have commented on before:

- The imperative of harmonizing our margin requirements with those of our international colleagues in order to facilitate compliance and coordinated regulatory oversight; and
- the benefits of codifying relief that has been issued by our Staff and re-visiting our rules, where appropriate.

Background: 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, most systemic, and interconnected financial institutions for their uncleared swap transactions with one another. Today, these institutions and transactions are subject to uncleared margin requirements that have taken effect since the rules were adopted.

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—will soon be coming into scope of the margin rules. It is only now, as we enter 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 thoughtfully consider whether the regulatory parameters that we have designed for the largest financial institutions in the earlier phases of margin implementation need to be tailored to account for the practical and 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.

International Harmonization To Enhance Compliance and Coordinated Regulation

The first rule change we are adopting would revise the calculation method for determining whether financial end-users come within the scope of the initial margin (''IM'') requirements, and the timing for compliance with the IM requirements after the end of the phased compliance schedule. These changes would align certain timing and calculation issues under the Commission's margin rules with both the BCBS/IOSCO Framework and the manner in which these issues are handled by our regulatory colleagues in all other major market jurisdictions.

Swap dealers must exchange IM with respect to uncleared swaps that they enter into with a financial end-user counterparty that has material swaps exposure (''MSE''). The Commission's margin rules currently provide that after the last phase of compliance, MSE is to be determined on *January 1,* and that an entity has MSE if it has more than $8 billion in average aggregate notional amount (''AANA'') during *June, July, and August* of *the prior year.* By contrast, under the BCBS/IOSCO Framework and in virtually every other country in the world, an entity is determined to come into scope of the IM requirement on *September 1,* and an entity has MSE if it has the equivalent of $8 billion in AANA[3] during *March, April, and May* of *that year.*

The reason the United States is out-of-step with the rest of the world on these timing and calculation issues is not because of any reasoned policy determination. Rather, it is the result of a quirk that the U.S. margin rules were adopted based on the BCBS/IOSCO Framework that was in effect at the time—but the BCBS/IOSCO Framework was revised two years later.

In a further disconnect, the Commission's margin rules look to the *daily average* AANA during the three-month calculation period for determining MSE, whereas the BCBS/IOSCO Framework and other major market jurisdictions base the AANA calculation on an *average of month-end dates* during that period. Yet, as noted in the rulemaking release, the Commission's Office of the Chief Economist has estimated that calculations based on end-of-month AANA generally would yield similar results as calculations based on the Commission's current daily AANA approach. It has been suggested that this rule change theoretically might incentivize a firm to ''window dress'' its swap exposures as the month-end approaches in order to avoid margin requirements. But the GMAC Margin Subcommittee observed that it would be neither practicable nor financially desirable for parties to tear-up their positions on a recurring basis prior to the month-end calculation,[4] because doing so would interfere with hedging strategies and cause the firm to incur realized profit and loss.[5]

Accordingly, the Commission is amending these timing and calculation provisions of its uncleared margin rules to harmonize them with the BCBS/IOSCO Framework and the approach followed by our international colleagues. Given the global nature of the derivatives markets, we should always seek international harmonization of our

[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) (''Margin Subcommittee Report''), available at *https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download.*

[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] The MSE threshold under the BCBS/IOSCO Framework is stated in euros rather than dollars.

[4] Margin Subcommittee Report at 52.

[5] Commenters made this same point. *See, e.g.,* Joint Letter from ISDA, SIFMA, and GFXD at 3 (month-end window dressing is not a realistic risk since unwinding and then reestablishing positions on a recurring basis over the three-month period would take considerable effort, interrupt hedging strategies, and require counterparties to absorb the costs of realized profit and loss changes); Letter from SIFMA Asset Management Group at 3 (it would be neither practicable nor financially desirable for parties to tear-up positions on a recurring basis prior to each month end); Letter from Investment Company Institute at 5–6 (for regulated funds, adjusting swap exposures over the course of three periodic dates solely to avoid IM could impose transaction costs and inhibit a fund's ability to manage its portfolio risk, which may be inconsistent with the investment adviser's fiduciary duty to act in the best interest of its client). Comment letters available at *https://comments.cftc.gov/PublicComments/CommentList.aspx?id=4157.*

regulations unless a compelling reason exists not to do so—which is not the case here.

Indeed, in the Dodd-Frank Act, Congress specifically directed the Commission, ''[i]n order to promote effective and consistent global regulation of swaps,'' to ''consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation . . . of swaps [and] swap entities. . . .'' [6] And when the G–20 leaders met in Pittsburgh in the midst of the financial crisis in 2009, they, too, recognized that a workable solution for global derivatives markets demands coordinated policies and cooperation.[7]

Our rule change regarding MSE is true to the direction of Congress in the Dodd-Frank Act, and honors the commitment of the G–20 leaders at the Pittsburgh summit. Differences between countries in the detailed timing and calculation requirements with respect to uncleared margin compel participants in these global markets to run multiple compliance calculations—for no particular regulatory reason. This not only forces market participants to bear unnecessary costs, but actually hinders compliance with margin requirements because of the entirely foreseeable prospect of calculation errors in applying the different rules.

As noted above, now is the time to address this disconnect in MSE timing and calculation requirements because the financial end-users to which the MSE definition applies are coming into scope of the margin rules. During the unfortunate events of the financial crisis, we learned that coordination among global regulators, working towards a common objective, is essential. That lesson remains true today, and we are reminded that disregarding this reality has the potential to weaken, rather than strengthen, the effectiveness of our oversight and the resilience of global derivatives markets.

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

The second rule change that we are adopting would codify existing Staff no-action relief in recognition of market realities. The Commission's 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.[8] 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.'' [9]

This second rule change would codify the alternative IM calculation method set out in Staff no-action Letter No. 19–29.[10] It would provide that a swap dealer may use the risk-based model calculation of IM of a counterparty that is a CFTC-registered swap dealer as the amount of IM that the former must collect from the latter. The release states the Commission's expectation that this alternative method of IM collection will be used by swap dealers with a discrete and limited swap business consisting primarily of entering into uncleared customer-facing swaps with end-user counterparties, and then hedging the risk of those swaps with uncleared swaps entered into with a few other swap dealers.

Simply put, not all swap dealers are created equal. It is therefore appropriate to tailor our uncleared margin regime accordingly. Letter No. 19–29 recognized this reality and smoothed the rough edges of our otherwise one-size-fits-all uncleared margin rules, and it is appropriate to codify that result.

Yet, under the rule amendments being adopted, this alternative method is subject to the condition that the uncleared swaps for which a swap dealer uses the risk-based model calculation of IM of its swap dealer counterparty are entered into for the purpose of hedging the former's own risk from entering into customer-facing swaps with non-swap dealer counterparties. This is a departure from the GMAC Margin Subcommittee, which did not recommend such a condition.

I am concerned by comments we received suggesting that this condition may cause this rule change to prove unworkable in practice.[11] I am encouraged that the rulemaking release addresses some of these comments by, among other things, confirming: (1) The flexibility of swap dealers as part of their hedging strategy to match a set of customer-facing swaps with one or more hedging swaps undertaken with swap dealer counterparties; and (2) that customer-facing swaps entered into through anticipatory hedging or that are subsequently terminated would be deemed hedges for purposes of the alternative method of IM calculation. Nevertheless, if over time, market participants find that the hedging condition causes this rule change to fail to fulfill its intended purpose, I urge them to alert the Commission so that it can consider appropriate adjustments.

There Remains Unfinished Business

While I am pleased with the steps the Commission is taking, there remains unfinished business in the implementation of uncleared margin requirements. As an initial matter, U.S. prudential regulators with oversight authority over bank swap dealers have not adopted the same rule changes. As a result, although commenters expressed support for the Commission proceeding with these rule changes even in the absence of parallel action by the U.S. prudential regulators, the operational difficulties confronting market participants that are coming into scope of the margin rules will not be fully addressed when they enter into uncleared swaps with bank swap dealers. I look forward to continuing the dialogue with our regulatory colleagues at other U.S. agencies to support addressing these challenges.

In addition, the report of the GMAC Margin Subcommittee recommended several actions, beyond those that we are adopting, to address the hurdles associated with the application of uncleared margin requirements to end-users. Having been present for the development of the Dodd-Frank Act, I recall that the concerns expressed by many lawmakers at the time focused on the application of the new requirements to end-users. The unique challenges with respect to 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. As the calendar turns into the new year, I look forward to continuing to work together to address the other recommendations included in the GMAC Margin Subcommittee's report regarding applying the uncleared margin rules to financial end-users. The need to do so will

[6] *See s*ection 752(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, Title VII, 124 Stat. 1376 (2010) (''Dodd-Frank Act'').

[7] *See* Leaders' Statement from the 2009 G–20 Summit in Pittsburgh, Pa. at 7 (September 24–25, 2009) (''We are committed to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage''), available at *https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf.*

[8] *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.*

[9] 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.*

[10] CFTC Letter No. 19–29, Request for No-Action Relief Concerning Calculation of Initial Margin (December 19, 2019), available at *https://www.cftc.gov/LawRegulation/CFTCStaffLetters/letters.htm?title=&field_csl_letter_types_target_id%5B%5D=636&field_csl_divisions_target_id%5B%5D=596&field_csl_letter_year_value=2019&=Apply.*

[11] *See, e.g.,* Letter from BP Energy Company at 5 (given the uncertainty as to what constitutes hedging, swap dealers may be reluctant to rely on the alternative method of IM calculation) and 6 (limiting relief to hedge transactions may diminish its utility); Letter from Futures Industry Association at 8 (complexity and added risk of hedging condition will make the alternative method of IM calculation impractical as counterparties will shy away from undertaking swaps with swap dealers that rely on the alternative method of calculating IM; also, cost, operational and documentation burdens associated with hedging condition could lead small swap dealers to cease providing risk management services to end-user counterparties, leaving end users with unhedged risks).

only become more urgent as time marches on.

Conclusion

To be clear, these amendments to the 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, they reflect a thoughtful refinement of our rules to align them with the rest of the international regulatory community, and to take account of specific circumstances in which the rules impose substantial practical and operational challenges (*i.e.,* they are not workable) when applied to financial end-users that are now coming within the scope of their mandates.

I am very appreciative of the many people whose efforts have contributed to bringing this rulemaking to fruition. First, the members of the GMAC, and especially the GMAC Margin Subcommittee, who devoted a tremendous amount of time to provide us with a high-quality report on complex margin issues during the turmoil at the start of the pandemic. Second, Chairman Tarbert and my fellow Commissioners for working with me on these important issues. And finally, the Staff of the Market Participants Division, whose tireless efforts have enabled us to advance these initiatives to assure that our uncleared margin rules are workable for all and are in line with international standards, thereby enhancing compliance consistent with our oversight responsibilities under the Commodity Exchange Act.

Appendix 4—Statement of Commissioner Dan M. Berkovitz

I. Introduction

I support today's two final rules that make tailored amendments to the CFTC's Margin Rule.[1] The Margin Rule requires swap dealers (''SDs'') and major swap participants (''MSPs'') for which there is no prudential regulator to post and collect, each business day, initial and variation margin for uncleared swap transactions with each counterparty that is an SD, MSP, or a financial end user with material swaps exposure (''MSE'').[2] The Margin Rule is a lynchpin of the Dodd-Frank reforms for swaps markets, and critical to mitigating risks in the financial system that might otherwise arise from uncleared swaps.[3] I support the final rules because they provide targeted, operational improvements to the Margin Rule; include backstops to deter any potential abuse; and are unlikely to increase risk to the U.S. financial system.

The two final rules address: (1) The definition of MSE and an alternative method for calculating initial margin (''MSE and Initial Margin Final Rule''); and (2) the application of the minimum transfer amount (''MTA'') for initial and variation margin (''MTA Final Rule''). The final rules align Commission requirements with international frameworks developed by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (''BCBS/IOSCO''),[4] and incorporate recommendations made to the CFTC's Global Markets Advisory Committee.[5] The final rules also build off existing CFTC staff no-action letters that in some cases have been in place since 2017, and that have operated with no apparent detrimental effects.

II. MSE and Initial Margin Final Rule

The MSE and Initial Margin Final Rule amends the definition of MSE to align it with the BCBS/IOSCO framework, including the method for calculating the average daily aggregate notional amount (''AANA'') of swaps. The final rule provides for calculations based on the average of the last business day in each month of a three-month period. The Commission previously raised concerns that this method of AANA calculation could potentially become less representative of an entity's true AANA and swaps exposure, potentially through the use of ''window dressing'' to artificially reduce AANA during the measurement period.[6]

The MSE and Initial Margin Final Rule includes an important new provision to address this issue. The final rule explicitly prohibits any ''[a]ctivities not carried out in the regular course of business and willfully designed to circumvent calculation at month-end to evade meeting the definition of material swaps exposure . . . .''[7] The addition of this language to the final rule's regulatory text will help ensure that CFTC efforts at international harmonization will not come at the expense of the safety and soundness of the U.S. financial system.[8] I thank the Chairman and the CFTC staff for working with my office to include this provision.

The MSE and Initial Margin Final Rule will also allow SDs and MSPs for which there is no prudential regulator (''Covered Swap Entities'' or ''CSEs'') to rely on the initial margin calculations of the more sophisticated counterparties with whom they transact swaps to manage their risks. This flexibility is limited to circumstances where a CSE enters into uncleared swaps with an SD, MSP, or swap entity to hedge its customer-facing swaps. This amendment to the Commission's existing rules could help promote liquidity and competition in swaps markets by increasing choice for end-users that are CSE customers.

The MSE and Initial Margin Final Rule provides helpful direction regarding the scope of hedging swaps for purposes of relying on a CSE counterparty's initial margin calculations. As set forth in the preamble to the final rule, a hedging swap must be consistent (although not identical) with the statutory definition of ''bona fide hedging transaction or position'' in CEA section 4a(c)(2)(B).[9] The final rule also makes clear that existing Commission regulations require a CSE that relies on its counterparty's initial margin calculations to also take steps to ''monitor, identify, and address potential shortfalls in the amounts of [initial margin] generated by the counterparty on whose [initial margin] model the CSE is relying.''[10]

III. MTA Final Rule

To reduce operational burdens associated with de minimis margin transfers, the Margin Rule provides that a CSE is not required to collect or post margin until the combined amount of initial margin and variation margin that is required to be collected or posted and that has not been collected or posted with respect to the counterparty exceeds $500,000—the MTA.[11] This MTA level, in part, helps limit the amount of a counterparty's uncollateralized, uncleared swaps exposure and mitigate any systemic risk arising from such swaps.

The MTA Final Rule addresses the application of the $500,000 MTA level to a counterparty's ''separately managed accounts,'' as well as the use of separate MTAs for initial and variation margin.[12] The MTA Final Rule codifies separate treatment for separately managed accounts and permits an MTA of $50,000 for each such account of a counterparty. This approach responds to practical limits on the ability of asset managers, for example, to aggregate initial and variation margin obligations across multiple separately managed accounts owned by the same counterparty. The MTA Final Rule also provides that if certain entities agree to separate MTAs for initial margin and variation margin, the respective amounts of MTA must be reflected in their required margin documentation.

These new provisions balance concerns over operational inefficiencies and practical challenges in the Commission's MTA rules against concerns that they may result in the exchange of less total margin than would be the case under the Commission's current

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

[2] Although addressed in the final rules, there are currently no registered MSPs.

[3] Section 4s(e) of the Commodity Exchange Act (''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.

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

[5] 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 (Apr. 2020), available at *https://www.cftc.gov/media/3886/GMAC_051920MarginSubcommitteeReport/download.*

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

[7] MSE and Initial Margin Final Rule at new § 23.151 (defining ''Material Swaps Exposure'').

[8] The preamble to the MSE and Initial Margin Final Rule also notes an analysis by the CFTC's Office of the Chief Economist indicating that the new month-end AANA calculation method captures substantially the same entities and total number of entities as the Commission's previous daily AANA calculation method. As with any rulemaking, the Commission is free in the future to periodically review its data and confirm that the new AANA calculation method is performing as expected.

[9] 7 U.S.C. 6a(c)(2).

[10] MSE and Initial Margin Final Rule at section II(B).

[11] 17 CFR 23.151.

[12] Both aspects of the MTA Final Rule were the subject of CFTC staff no-action letters issued in 2017 and 2019, respectively.

requirements. Comments in response to the proposed rule noted the difficulties that would be associated with creating numerous separately managed accounts solely to evade the comparatively low $50,000 MTA for separately managed accounts. The MTA Final Rule also defines separately managed account so that the swaps of such account are not subject to a netting of initial or variation margin obligations. This potentially provides further disincentive to create separately managed accounts solely for the purpose of evading the $50,000 MTA level for such accounts.

IV. Conclusion

Mitigating systemic risk to the U.S. financial system was a primary objective of the Dodd-Frank Act in 2010, and of subsequent Commission rulemakings to implement Dodd-Frank, including the Margin Rule adopted in 2016. The Commission must remain committed to the Margin Rule and vigilant for any large pool of uncollateralized, uncleared swaps exposure. Today's targeted final rules, which codify existing practices, include embedded backstops, and provide tailored operational enhancements to the Margin Rule, are unlikely to present systemic risks.

I thank staff of the Market Participants Division for their work on these final rules.

[FR Doc. 2020–27736 Filed 1–4–21; 8:45 am]

BILLING CODE 6351–01–P

AGENCY FOR INTERNATIONAL DEVELOPMENT

22 CFR Part 212

RIN 0412–AB00

Procedures for the Review and Clearance of USAID's Guidance Documents

AGENCY: U.S. Agency for International Development (USAID).

ACTION: Final rule.

SUMMARY: This final rule amends USAID's regulations to implement Executive Order (E.O.) 13891, *Promoting the Rule of Law Through Improved Agency Guidance Documents.* This rule sets forth processes and procedures for USAID to issue guidance documents as defined in the E.O. in a manner consistent with the requirements of Federal law applicable to all employees involved in inherently governmental deliberative decision-making on policy and employees involved in related administrative processes.

DATES: This final rule is effective January 5, 2021.

FOR FURTHER INFORMATION CONTACT: Tyrone K. Brown, Guidance Mailbox, (202) 355–7450, *tybrown@usaid.gov.*

SUPPLEMENTARY INFORMATION:

Background

On October 9, 2019 (84 FR 55235), President Trump issued Executive Order (E.O.) 13891, *Promoting the Rule of Law Through Improved Agency Guidance Documents.* The E.O. asserts that, except as mandated by applicable law or incorporated into a binding contract or agreement, Federal Departments and Agencies should treat guidance documents as non-binding on outside entities both in law and practice. To further the principle that Federal guidance should be transparent and made readily available to the public, Section 3 of the E.O. requires that Departments and Agencies make guidance documents available on a single, searchable, indexed public website. Section 3 also requires that Departments and Agencies review their guidance documents and, consistent with applicable law, rescind those that should no longer be in effect. Lastly, Section 4 requires that each Department and Agency put in place processes and procedures for issuing guidance documents as defined by the E.O.

In accordance with that direction, to codify our processes and procedures for guidance documents, the U.S. Agency for International Development (USAID) is amending our Automated Directives System (ADS) to update ADS Chapter 501, which governs the clearance process for reviewing and issuing Agency policy documents, to include guidance documents as defined by the E.O. USAID's formal clearance process ensures that all guidance documents receive legal review and, when appropriate, review and approval from USAID's Regulatory Reform Officer, who is the Agency's Deputy Administrator.

Before the Agency issues guidance documents as defined by E.O. 13891, we must review them to ensure they are written in plain language and do not impose any substantive legal requirements above and beyond statute or regulation. If a guidance document purports to describe, approve, or recommend specific conduct not required by existing laws, statutes, and regulations, then it must include a clear and prominent statement that the contents of the guidance document do not have the force and effect of law and are not meant to bind the public in any way, and that the guidance document is intended only to provide clarity to the public regarding existing requirements under the law or internal Agency policies and procedures applicable to our staff.

According to E.O. 13891, guidance documents shall also be subject to notice-and-comment procedures. The E.O. mandates that Departments and Agencies shall publish a notice in the **Federal Register** to announce that a draft of the proposed guidance document is publicly available; shall post the draft guidance document on the guidance portal of the Department or Agency; shall invite public comment on the draft document for a minimum of 30 days; and shall prepare and post a public response to major concerns raised in the comments, as appropriate, on its guidance portal, when the Department or Agency finalizes and issues the guidance document. Consistent with E.O. 13891, USAID proposes procedures to allow the public to petition for the modification or withdrawal of an active guidance document posted on the Agency's guidance portal. USAID's guidance portal will provide clear and specific instructions on how to request the modification or withdrawal of an active guidance document.

The Office of the General Counsel (GC) at USAID has determined that the Agency has no ''guidance documents'' as defined under E.O. 13891. USAID's internal guidance materials do not qualify as ''guidance documents'' under the E.O., nor do grant and contract solicitations and awards; *Country and Regional Development Cooperation Strategies;* Agency programmatic Policies and *Strategies;* and purely internal Agency policies not intended to have substantial effect on the behavior of regulated parties, such as Chapters of our ADS. The procedures contained in this final rule apply to all guidance documents, which USAID defines as any statement of Agency policy or interpretation that concerns a statute, regulation, or technical matter within the jurisdiction of the Agency that is intended to have general applicability and future effect on the behavior of regulated parties, but which is not intended to have the force or effect of law in its own right and is not otherwise required by statute to satisfy the rulemaking procedures of the *Administrative Procedure Act.*

Notice and Comment Not Required

This rule relates to internal Agency management. Therefore, pursuant to Section 553(a)(2) of Title 5 of the United States Code (U.S.C.), notice of proposed rulemaking and opportunity to comment are not required.

Procedural Requirements

The Office of Management and Budget (OMB) has determined that this regulatory action does not meet the criteria for significant regulatory action