Proposed Rules Regarding Margin for Uncleared Swaps

The Commodity Futures Trading Commission (CFTC) is proposing rules to implement section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposed rules would address margin requirements for uncleared swaps entered into by swap dealers (SDs) or major swap participants (MSPs). The rules would apply to SD and MSPs that are not subject to regulation by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration or the Federal Housing Finance Agency (collectively the prudential regulators).

The CFTC consulted with the prudential regulators as well as with the Securities and Exchange Commission in developing the proposed rules. The CFTC and the prudential regulators have attempted to make their respective proposals comparable to the maximum extent practicable.

Market Participants

The rules would apply to SDs and MSPs that are not subject to oversight by prudential regulators. The rules would not impose margin requirements on commercial end users, defined under the proposed rules as non-financial entities.

The margin requirements under the proposed rules would vary by counterparty. In this regard, the rules would distinguish between financial entities and non-financial entities. The definition of financial entity is based on section 2(h)(7)(C) of the Commodity Exchange Act, which addresses the exemption from mandatory clearing.

For trades between SD/MSPs and other SD/MSPs, the rules would require paying and collecting initial and variation margin for each trade. Similarly, for trades between SD/MSPs and financial entities, the rules would require the SD/MSP to collect, but not pay, initial and variation margin for each trade, subject in certain circumstances to permissible thresholds.

By contrast, the rule would not require SD/MSPs to pay or collect initial or variation margin from non-financial entities. The rule would simply require SD/MSPs to enter into credit support arrangements with their counterparties and to abide by those arrangements.

Products

The rules would apply to uncleared swaps entered into after the effective date of the regulation. The proposal would not apply retroactively.

Initial Margin Calculation

Initial margin could be calculated using a model that is approved by the Commission and (i) is used by a derivatives clearing organization for clearing swaps, (ii) is used by an entity subject to oversight by a prudential regulator or (iii) made available for licensing to any market participant by a vendor. If no such model is available, initial margin...
would be calculated by selecting a comparable cleared swap or futures contract and applying a multiplier set forth in the rule. All initial margin must cover 99% of 10-day price moves.

### Variation Margin Calculation

Variation margin would be calculated to cover the current exposure arising from changes in the market value of the swap since the trade was executed or the previous time the position was marked to market. Rules previously proposed for SDs and MSPs would require that documentation include agreement on the methods, procedures, rules, and inputs for determining the value of each swap at any time from execution to the termination, maturity, or expiration of the swap.

### Forms of Margin

SD/MSPs would be required to accept only certain specified assets as initial or variation margin from other SD/MSPs or from financial entities. Appropriate haircuts are specified in the proposed rule.

By contrast, in cases where non-financial entities posted collateral, they would be permitted to post non-traditional forms of collateral in accordance with their individually-negotiated agreements.

### Location of Margin

Collateral for trades between SD/MSPs and other SD/MSP would be required to be held at third-party custodians and could not be rehypothecated. SDs and MSPs would be required to offer non-SD/MSPs the opportunity to have any initial margin segregated.