THE COMMITTEE ON FUTURES AND DERIVATIVES

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Jonathan Gould
Chief Counsel
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th St., SW, Suite 3E-218
Washington, DC 20219

Submitted via regs.comments@occ.treas.gov

Re: RIN 2590-AB03/Docket ID OCC-2019-0023—Margin and Capital Requirements for Covered Swap Entities, 84 Federal Register 59970 (November 7, 2019).

Dear Mr. Gould:

We write on behalf of the Committee on Futures and Derivatives Regulation (the "Committee") of the New York City Bar Association (the "Association") to comment on the Office of the Comptroller of the Currency's ("OCC") proposed rulemaking entitled "Margin and Capital Requirements for Covered Swap Entities" (the "Proposal").[1]

I. NEW YORK CITY BAR ASSOCIATION

The Association is an organization of over 24,000 members. Most of its members practice in the New York City area. However, the Association also has members in nearly every state and over fifty countries. The Committee consists of attorneys knowledgeable about the trading of futures contracts and over-the-counter derivatives products, as well as the regulations applicable to such products and market participants. The Committee has a practice of publishing comments on legal and regulatory developments that have a significant impact on the futures and derivatives markets.

II. THE PROPOSAL

Our comments relate to each of the four elements of the Proposal: (1) Continued grandfathering of swaps[2] entered into before institution of uncleared swap margin requirements

[1] 84 Fed. Reg. 59970 (Nov. 7, 2019).

[2] Throughout, unless the context requires, references to "swaps" shall be inclusive of "security-based swaps."

("Legacy Swaps") if such swaps are amended related to certain interest rate benchmark events, reductions of notional, portfolio compression exercises, or similar occurrences;[3] (2) Repeal of inter-affiliate initial margin requirements; and (3) Extension of the initial margin compliance date and simplified initial margin documentation requirements. The Committee supports each of these regulatory initiatives. Although our comments are formally addressed to the OCC, they are for all of the Prudential Regulators[4] who have jointly proposed these rule amendments.

III. GRANDFATHERING OF LEGACY SWAPS

Currently, Legacy Swaps are exempt from uncleared swap margin requirements. However, to the extent such swaps are amended on or after the relevant compliance date, they are generally required to be subsequently included in margin calculations. This prevents evasion of margin requirements by parties who might otherwise continuously amend existing Legacy Swaps to reflect new swap exposures in lieu of entering into new swaps subject to margin requirements. However, treating non-material or other minor amendments of Legacy Swaps as triggering margin requirements has the effect of deterring parties from *bona fide* amendments that may be required for the swap to continue under reasonable terms (e.g., replacing a benchmark such as LIBOR, or reducing swaps exposure via portfolio compression).

What the OCC proposes has the dual benefit of preventing evasion of uncleared swap margin requirements while permitting *bona fide* amendments without the loss of Legacy Swap status. In particular, the OCC proposes to allow the following categories of amendments without impact to Legacy Swap status: (1) "Technical" amendments, i.e., those that do not change the underlying economics of a swap; (2) Notional reductions; (3) Changes as a result of portfolio compression exercises; and (4) Certain changes in relation to discontinuation or irrelevance of LIBOR and other interest rate benchmarks. The first of these is by nature economically immaterial, the second reduces swap exposures, the third reduces swap exposures or other risks, and the fourth is driven by an external event for which it would be imprudent to deter related amendments. Swap counterparties who enter into these amendments do not intend to evade the margin requirements by doing so and none of these amendment categories are susceptible to abuse. We support these proposed rule changes.

IV. REPEAL OF INTER-AFFILIATE MARGIN REQUIREMENTS

Uncleared swap margin requirements can be divided into "variation margin," an amount determined by calculating the net economic exposure of one party to the other in relation to the whole of the parties' swaps, and "initial margin," an amount calculated on a per trade basis, typically using a model to account for offsetting exposures. While the Commodity Futures Trading Commission ("CFTC") is responsible for the preponderance of swaps regulation, and the Securities and Exchange Commission ("SEC") is responsible for the preponderance of security-based swaps regulation, there is an exception for capital and margin. For swap and security-based swap capital and margin requirements applying to entities directly regulated by a Prudential

[3] These are the first and fourth items identified in the Proposal. For convenience, we have combined them.

[4] The Prudential Regulators, together with OCC, are the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and Federal Housing Finance Agency

Regulator, the Prudential Regulators are the rulemaking body. For all other entities, the CFTC and SEC, respectively, determine capital and margin rules.

Both the CFTC and SEC allow for an "inter-affiliate" exception to initial margin requirements.[5] In short, so long as certain baseline criteria are met, affiliated entities may enter into uncleared swaps or security-based swaps, as applicable, without exchanging initial margin.[6] European regulators have a similar exception.[7] For the purpose of harmonization with other U.S. and European regulators' swaps margin requirements, we encourage the Prudential Regulators to adopt an inter-affiliate exception to the requirement that parties to a swap exchange initial margin. Otherwise, entities regulated for swap and security-based swap capital and margin purposes by the Prudential Regulators will be at a competitive disadvantage to those regulated by the CFTC, the SEC, or European regulators with no apparent public benefit.

V. EXTENSION OF INITIAL MARGIN COMPLIANCE DATE AND SIMPLIFIED INITIAL MARGIN DOCUMENTATION REQUIREMENTS

Consistent with the 2015 recommendations of the Basel Committee on Banking Supervisions and the Board of the International Organization of Securities Commissions ("BCBS/IOSCO"), global derivatives regulators have established a phased compliance period for parties to implement initial margin requirements for uncleared swaps.[8] Establishment of a compliant initial margin relationship between counterparties is extremely time consuming legally and operationally and requires coordination with one of a handful of custodians who, by regulation, are required to hold the initial margin in segregated accounts. Phased compliance is, therefore, necessary to enable market participants to comply in an administratively orderly manner.

The phased compliance period is determined by an entity's total outstanding aggregate swap notional calculated over a specified period along with that of its margin affiliates ("AANA").[9] As of September 1, 2019, entities with an AANA at that time of $750 billion or more were required to exchange initial margin with counterparties that also had AANAs of $750 billion or more. On September 1, 2020, the AANA will drop down to $8 billion. This "big bang" will bring many more counterparties into the scope of initial margin in a very short period of time. The legal and operational resources necessary to bring relationships into compliance with this are daunting. As a result BCBS/IOSCO has recently revised its 2015 recommendation. BCBS/IOSCO now recommends that national regulators reduce the AANA requirement to $50 billion or more on

[5] Inter-affiliate swaps reduce system risk by reducing overall corporate family group credit exposure to third-parties. Also, the CFTC concluded that imposing initial margin requirements on inter-affiliate swaps "would limit the ability of U.S. companies to efficiently allocate risk among affiliates and manage risk centrally." CFTC, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 635, 673 (Jan. 6, 2016).

[6] *See* 17 C.F.R. § 50.52 and 17 C.F.R. § 240.18a-3(c)(1)(iii)(G). The parties are still required to exchange variation margin.

[7] *See* Commission Delegated Regulation (EU) 2016/2251 ch. III (Oct. 4, 2016).

[8] *See BCBS/IOSCO, Margin requirements for non-centrally cleared derivatives* 24-25 (March 2015), available at https://www.bis.org/bcbs/publ/d317.pdf. (All links in this letter were last visited on January 29, 2020).

[9] Groups without a financial entity need not exchange initial margin regardless of AANA.

September 1, 2020 and then $8 billion or more on September 1, 2021.[10] This would provide more time for market participants to negotiate and put in place the documentation and operational processes necessary for the exchange of initial margin. The OCC has proposed to adopt this BCBS/IOSCO timetable. The Committee supports this as it will reduce market disruption and make the OCC's timetable consistent with the expected timetable imposed by other regulators.[11]

Additionally, the Prudential Regulators' uncleared swap initial margin regulations seem to require that parties trading swaps and meeting the relevant AANA test have in place initial margin documents and custodial relationships. This is without regard to whether the parties actually are required to exchange initial margin. Existing Prudential Regulator rules allow parties to refrain from exchanging initial margin so long as the models calculating initial margin exposure do not result in over $50 million in initial margin being due from one party to the other on a group-to-group basis.[12]

This requirement – that parties have complex documentation and a custodial relationship in place even where neither may ever be used – would require an inefficient allocation of resources and jeopardize the ability of those who need to establish such relationships to do so in a timely and orderly manner. The OCC reasonably proposes that such documentation should be in place *only* when initial margin is actually due from one party to another. This achieves regulatory objectives while enabling market participants to focus on documenting those relationships where initial margin will be required to be exchanged.[13] Moreover, this would bring the OCC's requirements in accord with those applying in Europe and to entities regulated by the CFTC or SEC.[14] Consequently, we support this proposal.

VI. SUMMARY

The OCC's Proposal is likely to result in greater harmonization of regulatory requirements among the various regulators without compromising regulatory objectives. We support this

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[10] *See BCBS/IOSCO, Margin requirements for non-centrally cleared derivatives* 23-24 (July 2019), available at https://www.bis.org/bcbs/publ/d475.pdf.

[11] *See, e.g.*, CFTC, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 84 Fed. Reg. 56950 (Oct. 24, 2019).

[12] Technically, this $50 million must be allocated to specified bilateral pairings of entities in the two groups.

[13] As a practical matter, such an approach means that parties will have to monitor whether initial margin amounts calculated are in danger of exceeding $50 million and either put required documentation in place or cease trading and, possibly, unwind some existing trades.

[14] CFTC Letter No. 19-16 (July 9, 2019), 17 C.F.R. 18a-4(c)(1)(iii)(H)(2), and BCBS/IOSCO, statement on the final implementation phases of the margin requirements for non-centrally cleared derivatives (March 5, 2019), available at https://www.bis.org/press/p190305a.htm. In the European Union it is technically unaddressed in the regulations. *See* Commission Delegated Regulation (EU) 2016/2251 art. 2 and 3 (Oct. 4, 2016). However, the prevailing view is that initial margin documentation need only be in place when the $50 million threshold is exceeded. *See, e.g.*, Tom Mortlock and Rob Daniell, BCBS/IOSCO gives guidance on the documentation and operational burdens of regulatory initial margin (Mar. 6, 2019), available at https://blog.macfarlanes.com/post/102fg71/bcbs-iosco-gives-guidance-on-the-documentation-and-operational-burdens-of-regulat: "It remains a matter of interpretation of G-20 national law as to whether full documentation does need to be put in place where the initial margin calculation is under the €50m threshold (and arguably in the EU at least, it is an excessive interpretation of the EU requirements to suggest that this is the case)."

Proposal because it reflects careful, nuanced rulemaking using the least intrusive means to achieve the Dodd-Frank Act's policy objectives in this area and it will result in a greater level of harmonization in the related margin regulations administered by disparate regulators. This will benefit market participants globally and provide more uniformity as parties address their initial margin requirements under various regulations.

The Association thanks the Commission for this opportunity to comment on the Proposal. As always, we are available to meet with you or provide our assistance in this or other OCC efforts.

Respectfully,

Gary Edward Kalbaugh
Chair, Futures and Derivatives Committee