



**U.S. COMMODITY FUTURES TRADING COMMISSION**

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Market Participants  
Division

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**To: Futures Commission Merchants and Swap Dealers**

**Subject: Market Participants Division Advisory on the use of Margin Models to Calculate the Uncleared Swap Margin Amount for Purposes of Determining Minimum Capital Requirements**

The Market Participants Division (“Division”) of the Commodity Futures Trading Commission (“Commission” or “CFTC”) is issuing this advisory to clarify that a registered swap dealer (“SD”) may use a model to compute the initial margin on its uncleared swap positions for purpose of determining its minimum regulatory capital requirement under regulations 1.17 and 23.101, as applicable, without obtaining the approval of the Commission or the National Futures Association (“NFA”).<sup>1</sup> The SD’s model must comply with the standards established by the Commission for margin models in regulation 23.154(b)(2) as discussed below.

**I. Regulatory Background**

Section 4s(e) of the Commodity Exchange Act (“Act”) requires the Commission to adopt rules imposing minimum capital requirements and uncleared swap margin requirements on all SDs that are not subject to a prudential regulator.<sup>2</sup> The Commission adopted final initial and

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<sup>1</sup> Commission regulations may be found at 17 CFR Ch. I, and are available at the Commission’s website, <http://www.cftc.gov>.

<sup>2</sup> 7 U.S.C. § 6s(e). The term “prudential regulator” is defined in section 1a(39) of the Act (7 U.S.C. § 1a(39)) and Commission regulation 1.3 to mean 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, as applicable to the SD.

variation margin rules for SDs engaging in uncleared swap transactions in 2016.<sup>3</sup> The final initial and variation margin rules are set forth in regulations 23.150 through 23.161.

The Commission's margin requirements require an SD to compute, on a daily basis, the amount of initial margin that the SD must post to, and collect from, counterparties that are SDs or financial end-users that have material swaps exposure.<sup>4</sup> An SD may compute initial margin for uncleared swaps under regulation 23.154 using a standardized initial margin schedule or a risk-based model that has been approved in writing for use by the Commission or NFA.

A margin model must meet certain requirements set forth in regulation 23.154(b)(2) in order to be approved, including that the model calculates an amount of initial margin that is equal to the "potential future exposure" of the uncleared swap or netting portfolio of uncleared swaps covered by an eligible master netting agreement. The "potential future exposure" is an estimate of the one-tailed 99 percent confidence interval for an increase in the value of the uncleared swap or netting portfolio of uncleared swaps due to an instantaneous price shock that is equivalent to a movement in all material underlying risk factors, including prices, rates, and spreads over a holding period equal to the shorter of 10-business days or the maturity of the swap or netting portfolio.<sup>5</sup> Regulation 23.154 further provides that: (i) All data used to calibrate the risk-based model must be based on an equally weighted historical observation period of at least one year and not more than five years, and must incorporate a period of significant financial stress for each broad assets class that is appropriate to the uncleared swaps to which the model is applied; and (ii) The model must use risk factors sufficient to measure all material price risk inherent in the transactions for which initial margin is being calculated, and the risk categories shall include, but should not be limited to, foreign exchange or interest rate risk, credit risk, equity risk, and commodity risk, as appropriate.

The Commission also adopted revised capital requirements for entities dually-registered as futures commission merchants and SDs ("FCM/SDs") and adopted new capital requirements for entities that are solely registered as SDs ("standalone SDs.") The capital requirements were published in the Federal Register on September 15, 2020, with a compliance date of October 6, 2021.<sup>6</sup> The Commission's minimum capital requirements provide that standalone SDs may elect one of three capital approaches: (1) A bank-based approach, which requires a standalone SD to

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<sup>3</sup> See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016).

<sup>4</sup> See 17 CFR § 23.154. See also 17 CFR § 23.151 which provides that a financial end user has "material swaps exposure" if, 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.

<sup>5</sup> See 17 CFR § 23.154(b)(2).

<sup>6</sup> Capital Requirements of Swap Dealers and Major Swap Participants, 85 FR 57462 (Sept. 15, 2020).

compute its capital as if it were a bank holding company subject to the capital requirements of the Federal Reserve Board;<sup>7</sup> (2) A net liquid asset approach, which requires a standalone SD to compute its capital as if it were a security-based swap dealer subject to the capital rules of the Securities and Exchange Commission;<sup>8</sup> and (3) A tangible net worth approach, which requires a standalone SD to maintain a level of net worth that equals or exceeds \$20 million plus the market risk and credit risk of the SD's swaps that are associated with the SD's dealing activities.<sup>9</sup> The Commission's capital rules further provide that an FCM/SD is subject to amended regulation 1.17, which imposes the traditional FCM capital requirements on FCM/SDs with several revisions to more directly reflect swap and security-based swap transactions.

One component of the Commission's minimum capital requirements requires each FCM/SD or standalone SD to maintain a minimum level of regulatory capital that equals or exceeds 2% or 8%, as applicable, of the SD's "uncleared swap margin" amount.<sup>10</sup> The term "uncleared swap margin" is defined as the amount of initial margin, computed in accordance with regulation 23.154, that an FCM/SD or standalone SD would be required to collect from each counterparty for each outstanding swap position of the FCM/SD or standalone SD.<sup>11</sup> An FCM/SD or standalone SD must include all swap positions in the calculation of the uncleared swap margin amount, including swaps that are exempt or excluded from the scope of the Commission's margin regulations for uncleared swaps pursuant to regulation 23.150, exempt foreign exchange swaps or foreign exchange forwards, or netting sets of swaps or foreign exchange swaps, for each counterparty, as if that counterparty was an unaffiliated SD.<sup>12</sup> Furthermore, in computing the uncleared swap margin amount, an FCM/SD or standalone SD may not exclude the initial margin threshold amount or minimum transfer amount as such terms are defined in regulation 23.151.<sup>13</sup>

## II. Request for Guidance

The Division has received requests from market participants, including FCMs, SDs, and trade associations, for clarification whether an FCM/SD or standalone SD may, in determining

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<sup>7</sup> See 17 CFR § 23.101(a)(1)(i).

<sup>8</sup> See 17 CFR § 23.101(a)(1)(ii).

<sup>9</sup> See 17 CFR § 23.101(a)(2).

<sup>10</sup> An FCM/SD is required to maintain adjusted net capital in excess of 2% of the FCM/SD's uncleared swap margin amount (see 17 CFR § 1.17(a)(1)(i)(B)(2)). A standalone SD that elects the bank-based approach or the tangible net worth approach must maintain regulatory capital in excess of 8% of the standalone SD's uncleared swap margin amount (see 17 CFR §§ 23.101(a)(1)(i)(B) and 23.101(a)(2)(ii)(B), respectively). A standalone SD that elects the net liquid asset approach must maintain regulatory capital in excess of 2% of the standalone SD's uncleared swap margin amount (see 17 CFR 23.101(a)(1)(ii)(A)(2)).

<sup>11</sup> See 17 CFR §§ 1.17(b)(11) and 23.100 for FCM/SDs and standalone SDs, respectively.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

its minimum regulatory capital requirement under regulation 1.17 or 23.101, as applicable, use a risk-based margin model that meets the standards set forth in regulation 23.154(b)(2) to compute the uncleared swap margin amount without obtaining model approval from the Commission or NFA. In requesting clarification, market participants have noted that the Commission's capital rules require an FCM/SD or standalone SD to include in the calculation of the uncleared swap margin amount certain swaps that are not subject to the uncleared swap margin rules, such as FX forwards and FX swaps. Market participants have further noted that while NFA has approved margin models submitted by FCM/SDs and standalone SDs that meet the requirements of regulation 23.154(b)(2), NFA's reviews and approvals extend only to swaps that are within the scope of the Commission's margin requirements.

In addition, several standalone SDs have stated that they are not currently required to exchange initial margin with counterparties for uncleared swap transactions. These standalone SDs may not be subject to the Commission's uncleared swap margin requirements until September 1, 2022.<sup>14</sup> While several of standalone SDs have initiated applying for margin model approval with NFA, final approval may not be obtained prior to the October 6, 2021 capital compliance date. In addition, several standalone SDs are considering using the standardized margin schedule in regulation 23.154 to compute initial margin to be collected from SD counterparties and exchanged with financial end-user counterparties for all or certain classes of their swaps.

### **III. Division Advisory**

The Division clarifies that an FCM/SD or a standalone SD may use a model to compute the uncleared swap margin amount for purposes of determining the firm's minimum regulatory capital requirement without obtaining Commission or NFA Approval. As noted above, regulations 1.17(b)(11) and 23.100 define the term "uncleared swap margin" to mean the amount of initial margin computed in accordance with regulation 23.154 that an FCM/SD or SD would be required to collect from each counterparty for each outstanding swap position of the firm. Therefore, an FCM/SD or standalone SD is required to compute the uncleared swap margin amount in accordance with the requirements of regulation 23.154, which includes the standardized initial margin schedule or a model that meets the standards of regulation 23.154(b). The capital regulations, however, do not require Commission or NFA approval of the margin model for purposes of computing the uncleared swap margin amount. Specifically, the capital model approval requirements are set forth in regulations 1.17(c)(6)(v)(A) and 23.102(a) and apply solely to internal models used to compute market risk and credit risk capital charges, and

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<sup>14</sup> See 17 CFR § 23.161. Regulation 23.161 establishes a phased-in compliance schedule for the uncleared swap margin requirements that commenced on September 1, 2016. The last phase of the compliance schedule goes into effect on September 1, 2022, and applies to all SDs that have an average daily aggregate notional amount of uncleared swaps, uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps that exceeds \$50 million.

not to models used to compute the uncleared swap margin amount.<sup>15</sup> In addition, while regulation 23.154(b)(1) requires an FCM/SD or standalone SD to obtain the approval of the Commission or NFA to use a margin model, the regulation provides that the approval is necessary in the context of computing the initial margin to be exchanged by an SD with its counterparties on swap transactions that are within the scope of the margin rules.<sup>16</sup>

The Division also clarifies that an FCM/SD or standalone SD may use an initial margin model other than the Standardized Initial Margin Model (“SIMM”) developed by the International Swaps and Derivatives Association for the purposes of computing the uncleared swap margin amount. As noted above, Commission regulations 1.17(b)(11) and 23.100 require that the model used to compute the uncleared swap margin amount meet the standards set forth in regulation 23.154(b)(2), but do not require the FCM/SD or standalone SD to use the SIMM model or any other model used by the FCM/SD or standalone SD to compute initial margin to be exchanged with counterparties for in-scope swaps under regulation 23.154. The model also must be part of the FCM/SD’s or standalone SD’s risk management program required by regulation 23.600, including the operational risk management requirements of regulation 23.600(c)(4)(vi) and the testing and distribution requirements of regulations 23.600(e) and (f), respectively.

The Division further clarifies that an FCM/SD or a standalone SD that has obtained Commission or NFA approval to use models to compute initial margin under regulation 23.154 for certain classes or categories of swaps, but elects to use the standardized initial margin schedule for other classes or categories of swaps may use a model to compute the uncleared swap margin amount for all of its swaps positions, including the classes or categories of swaps that are subject to the standardized initial margin schedules under regulation 23.154. The Division and NFA will review an FCM/SD’s or standalone SD’s calculation of the uncleared swap margin amount using a margin model or the standardized margin schedule as part of the ongoing oversight of the firm’s compliance with the minimum capital requirements.

This advisory represents the views of the Division only and does not necessarily represent the views of the Commission or those of any other Division or office of the Commission. The staff statements herein have no legal force or effect: they do not alter or amend applicable law, and they do not create any enforceable rights or new or additional obligations for any person. Questions regarding this advisory may be directed to Tom Smith, Deputy Director, 202-418-5495 or [tsmith@cftc.gov](mailto:tsmith@cftc.gov); Rafael Martinez, Senior Financial Risk Analyst, 202-418-5462 or [rmartinez@cftc.gov](mailto:rmartinez@cftc.gov); Joo Hong, Data and Risk Analyst, 202-418-6221

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<sup>15</sup> See 17 CFR §§ 1.17(c)(6)(v)(A) and 23.102(a), which provide that an FCM/SD and standalone SD, respectively, may apply in writing to the Commission or NFA for approval to compute deductions for market risk and credit risk using internal models in lieu of the standardized deductions.

<sup>16</sup> See 17 CFR § 23.154(b)(1)(i), which provides that a SD must obtain the written approval of the Commission or NFA to use a model to calculate the initial margin required under the Commission’s margin rules in regulations 23.150 through 23.161.

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Sincerely,

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