Margin Requirements for Uncleared Swaps

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Dodd-Frank Act: Margin Requirements for Uncleared Swaps

- Section 731 of the Dodd-Frank Act requires the Commission to adopt rules for non-bank swap dealers and major swap participants for which there is not a prudential regulator –
  - imposing both initial and variation margin requirements on all swaps that are not cleared by a registered derivatives clearing organization.

Dodd-Frank Act: Use of Non-Cash Collateral

In prescribing margin requirements with respect to swap dealers and major swap participants for which there is no prudential regulator, the Commission shall permit the use of noncash collateral as it determines to be consistent with—

(i) preserving the financial integrity of markets trading swaps; and

(ii) preserving the stability of the United States financial system

Proposed Rules on Margin for Uncleared Swaps

- The proposed rules address margin requirements for uncleared swaps entered into by swap dealers (SDs) or major swap participants (MSPs).
- The rules would apply to SDs 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).

Entities Subject to the Proposed Rules

- 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.
- 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.

Requirements for Trades Between SDs/MSPs and Other Entities

- Trades between SDs/MSPs and other SDs/MSPs: rules would require paying and collecting initial and variation margin for each trade.
- Trades between SDs/MSPs and financial entities: 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.
- Trades between SDs/MSPs and non-financial entities: rules would not require the SD/MSP to pay or collect initial or variation margin from non-financial entities. The rule would simply require SDs/MSPs to enter into credit support arrangements with their counterparties and to abide by those arrangements.

Rules Would Not Apply Retroactively

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

Initial Margin

- 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

- 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

- SDs/MSPs would be required to accept only certain specified assets as initial or variation margin from other SDs/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 SDs/MSPs and other SDs/MSPs would be required to be held at third-party custodians and could not be rehypothecated.
- SDs and MSPs would be required to offer non-SDs/MSPs the opportunity to have any initial margin segregated.