

CLIENT ALERT

CFTC Proposes Amendments to Uncleared Swap Margin Rules

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The Commodity Futures Trading Commission has proposed amendments to its rules governing margin requirements for uncleared swaps, including an amendment to the definition of “eligible master netting agreement.” The CFTC’s proposal is intended to ensure that agreements that have been amended to comply with new U.S. prudential regulator rules governing qualified financial contracts (“**QFCs**”) entered into by systemically important banking institutions continue to be considered eligible master netting agreements for purposes of calculating net margin requirements. Comments on the CFTC’s proposal are due by July 23, 2018.¹

CFTC Margin Rules for Uncleared Swaps

In January 2016, the CFTC adopted rules generally requiring the collection and posting of initial and variation margin for uncleared swaps (“**Covered Swaps**”) to which CFTC-regulated swap dealers and major swap participants (each, a “**Covered Entity**”) are a party (the “**CFTC Margin Rules**”).² Under these rules, in cases in which a Covered Entity enters into multiple uncleared swaps with a single counterparty, the Covered Entity generally may calculate the required margin in respect of any Covered Swaps and any “legacy swaps” in the same “netting portfolio” by measuring its exposure to such swaps on an aggregate net basis, rather than on a gross basis, provided that the swaps are entered into under a single master netting agreement that satisfies the definition of “eligible master netting agreement” (“**EMNA**”) under the CFTC Margin Rules.

¹ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants; Proposed Rule, 83 Fed. Reg. 23842 (May 23, 2018).

² Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016).

CFTC Proposes Amendments to Uncleared Swap Margin Rules

An EMNA must create a single legal obligation for all individual transactions covered by the agreement upon an event of default. The current EMNA definition allows for the limited stay of default rights under specified circumstances (e.g., in connection with the resolution of the Covered Entity's counterparty under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**") or the Federal Deposit Insurance Act (the "**FDIA**"). The definition currently does not, however, recognize the restrictions on the exercise of cross-default rights that are required under the QFC rules.

QFC Rules of U.S. Prudential Regulators

The U.S. Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation each recently adopted rules addressing the exercise of default rights under QFCs with U.S. systemically important banking institutions, their subsidiaries and certain other large OCC-supervised national banks and federal savings associations ("**Covered Banks**").³ The new QFC rules became effective on January 1, 2018 with a phased-in compliance period.

Generally, the QFC rules establish restrictions on, and requirements for, uncleared QFCs of Covered Banks. Among other things, the rules require QFCs to include provisions that limit default rights or restrictions on transfer consistent with Title II of Dodd-Frank and the FDIA, thereby reducing the risk of challenge by non-U.S. courts. In addition, the QFC rules generally preclude a Covered Bank from being party to a QFC that permits the exercise of any cross-default rights related to the entry into resolution of an affiliate of the Covered Bank. Covered Banks that are parties to existing QFCs, including QFCs with Covered Entities that are subject to the CFTC Margin Rules, are expected to amend their agreements to conform to the requirements of the QFC rules.

Proposed Amendments to CFTC Margin Rules

As noted above, the definition of EMNA for purposes of the CFTC Margin Rules currently does not include agreements containing restrictions on the exercise of cross-default rights as required under the QFC rules. As a result, Covered Entities that have to amend their master netting agreements to comply with the QFC rules would not be permitted to calculate their exposure to Covered Swaps on an aggregate net basis for purposes of determining required margin amounts under the CFTC Margin Rules.

In light of the foregoing, the CFTC is proposing to amend the definition of EMNA to provide that a master netting agreement that reflects the provisions required under the QFC rules, including restrictions on cross-default rights, may still

³ See Mandatory Contractual Stay Requirements for Qualified Financial Contracts, 82 Fed. Reg. 56630 (Nov. 29, 2017) (OCC final rule); Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 Fed. Reg. 42882 (Sept. 12, 2017) (Federal Reserve final rule); and Restrictions on Qualified Financial Contracts of Certain FDIC-Supervised Institutions; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 Fed. Reg. 50228 (Oct. 30, 2017) (FDIC final rule).

CFTC Proposes Amendments to Uncleared Swap Margin Rules

qualify as an EMNA. The CFTC is also proposing to amend the CFTC Margin Rules with respect to legacy swaps (*i.e.*, uncleared swaps entered into prior to the applicable compliance date). Under the CFTC Margin Rules, a legacy swap that is amended following the applicable compliance date may become a Covered Swap as a result of the amendment and, therefore, subject to the requirements of the CFTC Margin Rules with respect to initial and variation margin. The proposal would ensure that parties could amend legacy swaps for purposes of conforming with the QFC rules without subjecting them to regulation under the CFTC Margin Rules.

The CFTC's proposed amendments are consistent with recently proposed amendments to uncleared swap margin rules applicable to market participants that are subject to regulation by the U.S. prudential regulators.⁴

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⁴ See Margin and Capital Requirements for Covered Swap Entities; Proposed Rule, 83 Fed. Reg. 7413 (Feb. 21, 2018).