



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and
Intermediary Oversight

Division of
Clearing and Risk

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CFTC Letter 16-71
No-Action
August 23, 2016
Division of Swap Dealer and Intermediary Oversight
Division of Clearing and Risk

Ms. Mary P. Johannes
Senior Director
International Swaps and Derivatives Association
1101 Pennsylvania Ave NW Suite 600
Washington, DC 20004

RE: Request to Include Security-Based Swaps in Product Set for Initial Margin for Uncleared Swaps

Dear Ms. Johannes:

This is in response to your letter dated June 3, 2016, as supplemented by email correspondence on July 22, 2016 (together the “Letter”), to Christopher Kirkpatrick, Secretary of the Commodity Futures Trading Commission (“Commission”). In the Letter, the International Swaps and Derivatives Association (“ISDA”) requests that the Commission issue an interpretation of its rules on margin for uncleared swaps permitting a covered swap entity (“CSE”) to include security-based swaps in the product set for initial margin. You have stated that allowing security-based swaps to be included in the same product set as swaps for the calculation of initial margin is appropriate for risk management purposes and for consistency with the rules of the Prudential Regulators (“PRs”).

Based on the facts presented and the representations ISDA has made, the Division of Clearing and Risk and the Division of Swap Dealer and Intermediary Oversight (together the “Divisions”) will not recommend that the Commission take enforcement action against a CSE, as defined in Commission Regulation 23.151, that collects and posts margin on a portfolio basis for

swaps and security-based swaps pursuant to Commission Regulations 123.150-161, subject to the following conditions:

1. The swaps and security-based swaps shall be subject to the same eligible master netting agreement and netting portfolio thereunder;
2. The swaps and security-based swaps shall be in the same broad risk category consistent with the requirement for swaps under Commission Regulation 23.154(b)(2)(v);
3. All security-based swaps in the netting set shall be included in the margin calculation on a continuous and consistent basis (i.e., the parties may not “cherry pick” individual security-based swaps, netting sets, or the time periods for inclusion of security based swaps);
4. The security-based swaps shall be treated as if they were swaps for all applicable provisions of Commission Regulations 23.150 – 161. For example, each CSE acting pursuant to this letter shall maintain records identifying (i) the positions held pursuant to the permitted treatment; (ii) the amount of initial margin held pursuant to the permitted treatment; (iii) the method by which that initial margin was calculated; and (iv) the counterparty for each position held pursuant to the permitted treatment;
5. Upon request by the Commission and/or the National Futures Association (“NFA”), each CSE acting pursuant to this letter shall provide any of the information required by Commission Regulations 23.150 through 23.161 as well as any additional information necessary for the Commission or NFA in connection herewith;
6. If the CSE has obtained or is in the process of obtaining approval from NFA to use a model to compute its initial margin for uncleared swaps under Commission Regulation 23.154(b) (Approved IM Model), the Commission shall permit the CSE to include security-based swaps in the Approved IM Model, provided that the conditions of this letter are met.¹ Additionally, the CSE must notify NFA that it intends to post and collect margin on a portfolio basis for swaps and security-based swaps and the CSE must submit any documentation in the time frame, form and manner required by NFA to extend the approval to security-based swaps; and

¹ The Commission has deferred to NFA the responsibility of reviewing margin models for swaps positions submitted by CSEs for approval. The Commission recognizes that NFA may incur both overhead and direct costs in reviewing the revised models for security-based swaps, and understands that NFA may seek to recover such costs from the CSEs.

7. If the CSE ultimately does not obtain approval to include security-based swaps in the Approved IM Model, the CSE may post and collect margin on a portfolio basis for swaps and security based swaps, provided the CSE uses the standardized initial margin schedule in Regulation 23.154(c) to calculate the initial margin for swaps and security based swaps, including those swaps and security-based swaps where the CSE used an approved IM model under condition 6.

The position taken herein concerns enforcement action only and does not represent a legal conclusion with respect to the applicability of any provision of the Commodity Exchange Act (“CEA”) or the Commission’s regulations. As with all no-action relief, the Divisions retain the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

The position taken herein is limited to enforcement action under the CEA. It does not affect the applicability of requirements under the rules of the PRs, the Securities and Exchange Commission, or the Financial Industry Regulatory Authority.

This letter is based upon the representations of ISDA and applicable laws and regulations in their current form; any new, different, or changed material facts or circumstances might render this letter void. Moreover, this letter represents the position of the Divisions only and does not necessarily represent the views of the Commission or those of any other division or office of the Commission. Should you have any questions, please contact John C. Lawton, Deputy Director, Division of Clearing and Risk, at (202) 418-5480 or Rafael Martinez, Senior Financial Risk Analyst, Division of Swap Dealer and Intermediary Oversight, at (202) 418-5462.

Very truly yours,

Eileen T. Flaherty
Director
Division of Swap Dealer and Intermediary Oversight

Jeffrey M. Bandman
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Ms. Mary P. Johannes
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cc: Jamila A. Piracci, OTC Derivatives
National Futures Association, New York