

Corporate & Financial Weekly Digest

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Banking Regulators Propose Margin and Capital Requirements for Covered Swap Entities

On April 12, federal banking regulators (Agencies) proposed regulations, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, requiring certain large participants in the OTC swaps market (“covered swaps entities”) to collect margin from other covered swaps entities. This proposed regulations would impose initial margin and variation margin requirements on covered swaps entities for uncleared swaps. This would require covered swaps entities to calculate and collect initial margin and variation margin from all swap counterparties. The amount of margin that would be required would vary based on the relative risk of the counterparty and the swap. The proposed regulations would also impose existing regulatory capital rules on covered swaps entities. These initial margin, variation margin and capital standards are intended, according to the Agencies, to offset the risk to swap entities and the financial system arising from the use of swaps that are not cleared.

The proposed regulations would require commercial end users to comply with the margin requirements noted above only if their exposure is above a predefined level calculated by the seller of the swap; commercial end users of derivatives would not be required to post margin unless their activity exceeds the risk limits of the entity with which they are transacting. According to the Agencies, low-risk financial end users, including most community banks, would not be required to post margin unless their activity exceeds substantial thresholds or the risk limits of the entity with which they are transacting.

The proposal establishes minimum quality standards for acceptable margin collateral. It also establishes minimum safekeeping standards for collateral posted by covered swap entities to ensure that collateral is available to support the trades and not housed in a jurisdiction where it is not available if defaults occur.

Comments to these proposed rules are being solicited through June 24. New trades would not be subject to the proposed requirements until after the proposed effective date, which is currently planned for six months after the federal banking regulators issue the final version of these proposed requirements.

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