SPEECHES & TESTIMONY

Concurring Statement of Commissioner Dan M. Berkovitz

Proposed Rule Extending Uncleared Swap Margin Deadline for Certain Financial Entities with Smaller Swap Portfolios

October 16, 2019

I concur with issuing for public comment the proposed rulemaking ("Proposal") to extend the swaps margining compliance deadline for certain financial entities that have smaller swap portfolios.

In general, I am not in favor of extending compliance deadlines when there has been a substantial lead-in period for compliance. The compliance date being extended in the Proposal was set more than four years earlier. However, in this instance, there are several factors that lead me to conclude that the Proposal will benefit hundreds of entities with smaller swap portfolios while having only a small impact on the systemic risk mitigation benefits of the initial margin requirements.

Variation and initial margin requirements for uncleared swaps reduce contagion and liquidity concerns by ensuring that collateral is available to cover swap losses if a party defaults.[1] Two types of margin are required. Variation margin covers current net exposure from day-to-day price movements for a portfolio of swaps. The Proposal does not change variation margin requirements. Initial margin covers estimated potential future exposures between the time a default occurs and when the swaps can be closed out or hedged.

A CFTC Office of the Chief Economist ("OCE") analysis indicated that approximately 40 large financial enterprises are already required to exchange initial margin for uncleared swaps under regulations adopted by the CFTC and other regulators.[2] Under the current rule, the so called "phase 5" entities, entities with average daily aggregate notional amounts ("AANA") of between $8 billion and $750 billion on a consolidated basis, are required to have various margining and custodial agreements in place by September 1, 2020. The Proposal does not change that deadline for financial end users that have an AANA greater than $50 billion. Accordingly, entities with moderately large swap portfolios would remain subject to the original compliance date. Only financial end users with relatively modest AANA levels would get an extension of the compliance deadline.

The existing implementation schedule is consistent with the original Basel Committee on Banking Supervision ("BCBS") and the Board of the International Organization of Securities Commissions ("IOSCO") international framework for margin requirements. In July 2019, BCBS and IOSCO revised the framework to effectively recommend an extension of the phase 5 deadline in recognition of likely compliance delays given the large number of entities that would need to execute margining agreements to comply with the new initial margin requirements.[3]

The Proposal follows the revisions recommended by BCBS and IOSCO. Other United States and foreign regulators have indicated they also intend to adopt extensions. Consistency with other regulators, particularly with requirements like swap margining, helps reduce the likelihood of regulatory arbitrage.

I am concurring with the Proposal because the impact on systemic risk mitigation resulting from the partial one year delay is muted while the potential impacts on the hundreds of financial end users with smaller swap portfolios might be significant if they are not able to have margining documentation in place by the original deadline. This is a data driven conclusion. While about 40 entities have had to comply through phase 4, the OCE analysis estimates that around 700 entities with 7,000 swap arrangements would be included in phase 5. Providing more time to hundreds of smaller users of swaps should help maintain the hedging capabilities of these market participants while they negotiate and establish the necessary margining arrangements.

The OCE analysis also provides critical data on the muted impact of the proposed change on systemic risk mitigation. The estimated average AANA for phase 5 entities is $54 billion compared to an average $12.71 trillion AANA for entities in phases 1, 2 and 3, and $1 trillion for entities in phase 4. The total estimated AANA for entities that would be subject to the one year extension is approximately three percent of the total AANA of entities subject to the margin rules. In my view, this data is critical to supporting a one year extension as it indicates that the likely affect in providing the extension on systemic risk mitigation will be quite limited.

For these reasons, I concur in the issuance of the Proposal.

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[1] Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions "Margin requirements for non-centrally cleared derivatives," (September 2013), available at https://www.bis.org/publ/bcbs261.pdf.

[2] *See* Initial Margin Phase 5 by Richard Haynes, Madison Lau, and Bruce Tuckman, Oct. 24, 2018 available at https://www.cftc.gov/sites/default/files/About/Economic%20Analysis/Initial%20Margin%20Phase%205%20v5_ada.pdf.

[3] See BCBS and IOSCO "Margin requirements for non-centrally cleared derivatives," (July 2019), available at https://www.bis.org/bcbs/publ/d475.pdf ("July 2019 BCBS/IOSCO Margin Framework").