

Statement by FDIC Chairman Jelena McWilliams on the Notice of Proposed Rulemaking: Margin and Capital Requirements for Covered Swap Entities

September 17, 2019

In the aftermath of the financial crisis of 2008, Congress mandated that regulators establish capital and margin requirements for non-cleared swaps. In 2015, the banking agencies adopted regulations implementing these requirements. The agencies' swap margin rule generally requires banks that are covered swap entities to exchange margin with counterparties for non-cleared swaps.

In addition to requiring the exchange of initial and variation margin with unaffiliated counterparties, the banking agencies' swap margin rule also requires that insured depository institutions (IDIs) collect initial and variation margin from affiliates. The international framework agreed to in Basel in 2013 deferred on this issue to individual jurisdictions,¹ but foreign jurisdictions generally do not require initial margin for transactions with affiliates.

After careful review, the agencies have put together a proposal to repeal the requirement that IDIs collect initial margin from affiliates while retaining the requirement that IDIs exchange variation margin with affiliates. The proposal does not change the margin requirements for transactions with unaffiliated counterparties. In other words, the proposal covers only transactions between an IDI and its affiliates.

Exchanging initial margin with unaffiliated counterparties is an important protection for IDIs against the risk of counterparty default. However, inter-affiliate transactions, conducted among entities that are part of the same banking organization, are often used by banks for internal risk management purposes. When an IDI collects initial margin, the financial collateral is locked up, frozen, and available only in the event that the affiliate fails – a scenario that has become much less likely as a result of the issuance of total loss-absorbing capacity (TLAC) and the implementation of the single point of entry resolution strategy, along with other structural reforms. At the same time, the collateral is not available as liquidity to meet outflows at affiliates, undercutting the affiliates' resilience. Additionally, as the amount of inter-affiliate initial margin has increased as more covered swap entities have come into scope, the banking agencies have observed banking organizations borrowing increasing amounts of cash to fund eligible collateral to post as margin.

It is important to note that removing the initial margin requirement for inter-affiliate transactions does not mean that there are no longer any rules or limitation for those transactions. As mentioned, the rules would still require the exchange of variation margin, and the requirements

¹ Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions (September 2013), "Margin requirements for non-centrally cleared derivatives," at p. 21. Available at <https://www.bis.org/publ/bcbs261.pdf>. The report noted, "extending the initial margin requirements to [inter-affiliate] transactions would likely create additional liquidity demands for firms engaging in such transactions."

of sections 23A and 23B of the Federal Reserve Act will continue to apply to affiliate transactions, including derivatives positions.

The largest banking organizations remain subject to many layers of oversight, including year-round on-site examination from multiple regulators, standardized and advanced risk-based capital standards, market-risk capital standards, global systemically important bank (G-SIB) capital surcharges, leverage ratios, supplementary leverage ratios, enhanced supplementary leverage ratios, liquidity coverage ratios, long-term debt requirements, stress testing, mandatory clearing requirements, and restrictions on proprietary trading, among other regulations and mandates.

The proposal also makes several other important changes. The proposed rule addresses the Libor (London Interbank Offered Rate) transition as it relates to derivative contracts by ensuring that legacy derivatives will maintain their legacy status under the swap margin rule if amendments are made to contracts in the context of the Libor transition.

The proposal would also provide significant burden relief to counterparties with small derivatives portfolios. The amount of compliance infrastructure that small counterparties need to complete to be ready for the margin regime is substantial. In order to provide them more time to undertake the necessary steps to comply with the margin requirements, the proposal would delay mandatory compliance for counterparties with small derivative portfolios until September 2021.

I support this proposal. It is our responsibility to look for ways to improve our regulatory framework where possible while maintaining robust standards that help support the safe and sound functioning of the over-the-counter derivatives market. I would like to thank the staffs at the five agencies who worked on this proposed rulemaking, and in particular I would like to thank the staff of the FDIC for all of their hard work.