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LATHAM & WATKINS LLP

January 23, 2020

VIA EMAIL

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Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219
Email: regs.comments@occ.treas.gov

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th and C Streets NW
Washington, DC 20551
Email: regs.comments@federalreserve.gov

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
Email: comments@fdic.gov

Barry F. Mardock, Deputy Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102
Email: reg-comm@fca.gov

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AB03
Federal Housing Finance Agency
Constitution Center
400 7th St. SW
Washington, DC 20219
Email: regcomments@fhfa.gov

Re: Margin and Capital Requirements for Covered Swap Entities

Ladies and gentlemen:

Latham & Watkins LLP respectfully submits these comments in response to the proposal (“**Proposed Amendments**”) by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency (“**Prudential Regulators**”) to amend the regulations that require swap dealers and security-based swap dealers under the Prudential Regulators’ respective

jurisdictions (“**prudentially regulated CSEs**”) to exchange margin with their counterparties for swaps that are not centrally cleared (“**PR Margin Rules**”).¹ We appreciate the opportunity to comment.

We support and appreciate the affirmative steps taken by the Prudential Regulators to amend the PR Margin Rules to account for market participants’ amending their existing uncleared swap transactions to account for the industry-wide initiative to amend swaps that reference an interbank offered rate (“**IBOR**”) or other discontinued rate in connection with the industry-wide initiative to amend or replace swaps referencing such rates, to instead reference specified risk-free rates (“**RFRs**”) (“**IBOR Transition**”) and such amended or replacement swaps, “**IBOR Transition Swaps**”). In our review, we found the ability of pre-compliance date swap transactions (*i.e.*, swaps entered into prior to the relevant PR Margin Rule compliance date) to retain their legacy status as IBOR Transition Swaps under the Proposed Amendments to be quite clear. However, we are concerned that the Proposed Amendments do not clearly address existing post-compliance date uncleared swap transactions (*i.e.*, swaps entered into after the relevant PR Margin Rules compliance date) entered into between prudentially regulated CSEs and commercial end-users relying on the exemption under Section __.1(d)(1) of the PR Margin Rules (“**Exemption**”).² By its terms, the Exemption is based on an end-user’s satisfaction of either:

1. The exception to mandatory clearing under Section 2(h)(7)(A) of the Commodity Exchange Act, as amended (“**CEA**”),³ and implementing regulations (for commercial end-users);
2. The exemption from mandatory clearing under a rule, regulation or order issued by the CFTC pursuant to its authority under Section 4(c)(1) of the CEA (for certain cooperative entities);
or
3. The exception to mandatory clearing under Section 2(h)(7)(D) of the CEA and implementing regulations (for treasury affiliates);

in each case, where the end-user is entering into the uncleared swap in order to hedge or mitigate commercial risk (each, an “**End-User Exception**”).

On December 17, 2019, the Division of Clearing and Risk (“**DCR**”) of the US Commodity Futures Trading Commission (“**CFTC**”) issued no-action relief from mandatory clearing under CFTC Letter No. 19-28 where an existing uncleared swap transaction, for which the parties had previously relied upon an End-User Exception, is amended in connection with the IBOR Transition.⁴ On the same day, the CFTC’s Division of Swap Dealer and Intermediary Oversight (“**DSIO**”) similarly issued no-action relief from uncleared swap margin requirements under CFTC Letter No. 19-26⁵ where an existing uncleared swap transaction, for which the parties had previously relied upon the End-User Exception as the basis for

¹ Margin and Capital Requirements for Covered Swap Entities, 84 Fed. Reg. 59970 (proposed Nov. 7, 2019), <https://www.govinfo.gov/content/pkg/FR-2019-11-07/pdf/2019-23541.pdf>.

² See Margin and Capital Requirements for Covered Swap Entities, 81 Fed. Reg. 50605 (Aug. 2, 2016), <https://www.govinfo.gov/content/pkg/FR-2016-08-02/pdf/2016-18193.pdf>; Margin and Capital Requirements for Covered Swap Entities, 80 Fed. Reg. 74916 (Nov. 30, 2015), <https://www.govinfo.gov/content/pkg/FR-2015-11-30/pdf/2015-28670.pdf>.

³ 7 U.S.C. § 2(h)(7)(A).

⁴ CFTC No-Action Letter No. 19-28, Staff No-Action Relief from the Swap Clearing Requirement for Amendments to Legacy Uncleared Swaps to Facilitate Orderly Transition from Inter-Bank Offered Rates to Alternative Risk-Free Rates (Dec. 17, 2019), <https://www.cftc.gov/csl/19-28/download>.

⁵ CFTC No-Action Letter No. 19-26, No-Action Positions to Facilitate an Orderly Transition of Swaps from Inter-Bank Offered Rates to Alternative Benchmarks (Dec. 17, 2019), <https://www.cftc.gov/csl/19-26/download>.

their exemption from the CFTC's uncleared swap margin rules for non-prudentially regulated swap dealers ("CFTC Margin Rules"), is amended in connection with the IBOR Transition (CFTC Letter No. 19-26 and CFTC Letter No. 19-28, collectively referred to herein as the "CFTC Letters").⁶ The CFTC staff posits that, in connection with the IBOR Transition, the commercial end-users and cooperatives may enter into IBOR Transition Swaps which for a period of time may have a temporary mismatch in the interest rates referenced in commercial arrangements and in the swaps used to hedge the risk of such arrangements. As a result, this may lead parties to question whether the IBOR Transition Swap still qualifies as a swap used to "hedge or mitigate commercial risk" for CFTC regulatory purposes. As a result, the relief provides a transitional period until December 31, 2021 to allow commercial end-users and cooperatives to maintain their status of swaps that are "used to hedge or mitigate commercial risk" provided certain conditions are met.⁷

Because the Exemption under the PR Margin Rules is based on the end-user counterparty qualifying for an exception to mandatory clearing under the CEA and implementing CFTC regulations, we are concerned that the CFTC Letters would not be taken into account or recognized under the Exemption for purposes of determining application of the PR Margin Rules in order for previously exempt post-compliance date positions to continue to qualify for the Exemption. Specifically, the Exemption is based on an end-user's satisfaction of an End-User Exception as set forth in the CEA or formal CFTC rulemaking. Absent further clarification and recognition of CFTC staff relief issued in connection with the IBOR Transition, it remains unclear whether an end-user, which is entering into IBOR Transition Swaps with respect to post-compliance date uncleared swaps transacted with prudentially regulated CSEs, would be able to rely upon the relief provided to end-users under the CFTC Letters, which may be necessary for some end-users in order to continue to satisfy the conditions of the Exemption set forth under Section __.1(d)(1) of the PR Margin Rules. If end-users cannot rely upon the relief under the CFTC Letters for purposes of the Exemption, then they may be required to post variation margin for such post-compliance date uncleared swaps under the PR Margin Rules as a result of such IBOR Transition Swaps.

We do not believe that triggering the posting of variation margin requirements for end-users who may need the relief provided in the CFTC Letters is in the interest of the market and would be contrary to the relief and clarity that we understand the Prudential Regulators are intending to achieve with the Proposed Amendments. Further, we believe it is in the interest of all market participants to provide as much clarity as possible in order to aid with the IBOR Transition.

Accordingly, we would respectfully request that the Prudential Regulators consider amending the PR Margin Rules or otherwise providing guidance clarifying that — in determining whether or not a post-compliance date uncleared swap continues to qualify for the Exemption — regulatory actions short of a formal CFTC rulemaking (*e.g.*, interpretive guidance, staff no-action letter) related to IBOR Transition Swaps (including under the CFTC Letters) would also be considered. As a result, end-users who may for a period of time come out of compliance with the relevant End-User Exception for a short period of time (while still satisfying the conditions set forth in the CFTC Letters)⁸ would have legal certainty that they

⁶ Under the CFTC Margin Rules (as under the PR Margin Rules), qualification for an End-User Exception provides a basis for end-users to rely upon an exemption from the posting/collection requirements under the CFTC Margin Rules. *See* 17 C.F.R. § 23.150(b).

⁷ CFTC Letter No. 19-26 at 17-18; CFTC Letter No. 19-28 at 12-13.

⁸ CFTC Letter No. 19-28 relays the following example submitted by the Alternative Reference Rates Committee on behalf of its members:

may enter into IBOR Transition Swaps under the Proposed Amendments without needing to comply with posting/collection requirements under the PR Margin Rules, provided the Proposed Amendments' other conditions are met.

* * * * *

We appreciate the opportunity to provide comments in response to the Proposed Amendments. As the Prudential Regulators progress in their ongoing efforts to refine the PR Margin Rules in anticipation of the imminent IBOR Transition, we would welcome the opportunity to assist in the process. Please feel free to contact me at yvette.valdez@lw.com or +1.212.906.1797 or my colleague J. Ashley Weeks at ashley.weeks@lw.com or +1.212.906.4630.

Respectfully submitted,

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[A]s the [interest rate swap (“**IRS**”)] market transitions to RFRs, there are likely to be situations where commercial end-users and cooperatives will have to amend their swaps that reference IBORs that are subject to the CFTC’s IRS clearing requirement, but have not yet amended their IBOR-linked loan agreements, debt instruments, and other agreements or transactions to include new fallbacks or RFRs. The reverse may also be true (*i.e.*, amendments to financial agreements may be completed before the related swaps are amended).

CFTC No-Action Letter No. 19-28 at 12.