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CFTC no-action letters address variation margin deadline and minimum transfer amounts

On February 13, 2017, the U.S. Commodity Futures Trading Commission's ("**CFTC**") Division of Swap Dealer and Intermediary Oversight ("**DSIO**") issued a no-action letter (available here) granting limited relief relating to the CFTC's variation margin requirements until September 1, 2017. The DSIO also issued a no-action letter (available here) that grants exemptive relief related to the application of the minimum transfer amount to separately managed accounts. The relief discussed in this briefing applies only to dealers subject to the CFTC's margin rules (typically non-bank dealers) and does not apply to any swap dealer that is subject to the margin rules issued by the U.S. prudential regulators (typically bank dealers).

Grace period for variation margin compliance until September 1, 2017

The CFTC's margin rule requires swap dealers to collect and post initial and variation margin with each counterparty that is a swap dealer, major swap participant or financial end user. Swap dealers and their counterparties with the largest outstanding notional amounts of uncleared swaps have been subject to both the CFTC's initial and variation margin requirements on September 1, 2016. The second phase, which requires swap dealers to comply with the CFTC's variation margin requirements with all relevant counterparties not covered in the first phase, begins on March 1, 2017 (the "March 1 VM Requirements").

Swap dealers have been working with financial end-user customers (including life insurance companies and retirement funds) to comply with the March 1 VM Requirements by executing new or amended credit support documentation and putting in place new operational processes to settle variation margin. For various reasons, including the number and variety of entities involved, the CFTC believes that many financial end users will not be ready to meet the new requirements on March 1, 2017. As a result, it appears that many CFTC-regulated swap dealers will not be able to implement the March 1 VM Requirements by the specified compliance date without causing substantial disruptions to the uncleared swap market. According to CFTC Acting Chairman J. Christopher Giancarlo, as much as ninety percent of financial end-users are not ready to meet these requirements despite their best efforts to do so.

What is variation margin?

"Variation margin" is defined in CFTC Regulation 23.151 as "collateral provided by a party to its counterparty to meet the performance of its obligation under one or more uncleared swaps between the parties as a result of a change in the value of such obligations since the trade was executed or the last time such collateral was provided."

To avoid an abrupt cutoff in substantial swap trading activity, which could have harmful effects on the global swaps market, the DSIO has granted time-limited no-action relief regarding the March 1 VM Requirements. This relief is effective from March 1, 2017 through September 1, 2017 and does not apply to any of the CFTC's variation margin requirements that had a compliance date of September 1, 2016.

To be eligible for the grace period created by the CFTC's no-action letter with respect to a particular counterparty, swap dealers must meet the following conditions:

- The swap dealer does not comply with the March 1 VM Requirements with respect to such counterparty solely because it has not, despite good faith efforts, completed necessary credit support documentation with such counterparty or, acting in good faith, requires additional time to implement the related operational processes;
- The swap dealer uses its best efforts to continue to implement compliance with the March 1 VM Requirements;
- The swap dealer must continue to post and collect variation margin with such counterparty in accordance with any existing variation margin arrangements until such time as the swap dealer is able to comply with the March 1 VM Requirements; and
- No later than September 1, 2017, the swap dealer complies with the March 1 VM Requirements with respect to all swaps to which the March 1 VM Requirements are applicable entered on or after March 1, 2017.

Relief for separately managed accounts

DSIO staff also issued a letter granting no-action relief, subject to specified conditions, to swap dealers for meeting the minimum transfer amount requirements of CFTC Regulations 23.152(b)(3) or 23.153(c) with respect to swaps with a legal entity that enters into swaps through more than one separately managed account.

The assets of some entities are managed by several asset managers who each exercise discretion over a portion of such entity's assets. (For example, large pension funds and endowments may have dozens of asset managers, each managing a separate pool of assets.) The CFTC no-action letter calls the pool of assets that are managed by one manager a "**separately managed account**". A manager that enters into swaps for a separately managed account of a particular client will typically use a payment netting set (in the applicable ISDA agreements) that is separate from the netting sets used by other managers with the same client. Because multiple asset managers cannot collectively calculate minimum transfer amounts or move collateral in aggregate between separately managed accounts, the application of the minimum transfer amount at the client level presents significant practical challenges.

The DSIO's no-action relief addresses these practical challenges by permitting swap dealers to treat each separately managed account as a separate counterparty for purposes of applying a reduced minimum transfer amount. This relief is subject to the following conditions:

- Relevant swaps are entered into with the swap dealer by an asset manager on behalf of a separately managed account owned by the legal entity pursuant to authority granted under an investment management agreement;
- The swaps of each separately managed account are subject to a master netting agreement that does not permit netting of initial or variation margin obligations with other separately managed accounts of the same legal entity; and
- The swap dealer applies a minimum transfer amount **no greater than $50,000** to the initial and variation margin collection and posting obligations of such separately managed account.

What is the Minimum Transfer Amount?

Under the CFTC's margin rule, a covered swap entity does not need to collect or post variation margin until the combined amount of initial margin and variation margin required to be collected or posted with respect to the relevant counterparty is **greater than $500,000**. This is intended to alleviate operational burdens associated with making *de minimis* margin transfers.

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