Simpson Thacher

Memorandum

CFTC Issues Six-Month No-Action Transition for Variation Margin Requirements with March 1, 2017 Compliance Date

February 14, 2017

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 providing relief until September 1, 2017 (the "CFTC Time Limited Relief") to registered swap dealers for non-compliance with CFTC variation margin requirements for uncleared swaps that have a compliance date of March 1, 2017[1] (the "March 1 VM Requirements").

I. Regulatory Background for the March 1 VM Requirements

Pursuant to the requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act, certain U.S. prudential regulators[2] (collectively, the "Prudential Regulators") and the CFTC separately adopted final rules requiring the posting and collection of initial and variation margin by swap dealers and major swap participants registered with the CFTC (collectively, "swap entities") in respect of uncleared swaps. The margin rules adopted by the Prudential Regulators apply to swap entities for which there is a Prudential Regulator.[3] The margin rules adopted by the CFTC apply to swap entities not regulated by any Prudential Regulator (such swap entities, "CFTC Swap Entities").

The March 1 VM Requirements are a part of the CFTC margin rules that require each CFTC Swap Entity to post and collect variation margin in respect of uncleared swaps entered into on or after March 1, 2017 where its counterparty under such swap is either a financial end-user[4] or a swap entity.[5] The uncleared swaps

[1] Commission Regulation 23.153. See 17 CFR § 23.153.
[2] The Federal Deposit Insurance Corporation, the Department of the Treasury (the Office of the Comptroller of the Currency), the Board of Governors of the Federal Reserve System, the Farm Credit Administration and the Federal Housing Finance Agency.
[3] As of the date of this memorandum, the Prudential Regulators have not issued any similar no-action relief for failure to timely comply with the variation margin rules adopted by the Prudential Regulators.
[4] See 17 CFR § 23.151.
[5] See 17 CFR § 23.153.

covered by such requirement include, among other derivative products, fixed-for-floating interest rate swaps, interest rate caps, non-deliverable FX swaps and forwards and FX options.

II. Conditions and Limitations to the No-Action Relief

The CFTC Time Limited Relief is available to a swap dealer ("SD") if the following conditions are satisfied –

1. the non-compliance is solely due to the SD, in good faith, needing more time to complete necessary credit support documentation or implement necessary operational processes;
2. the SD continues to use its best efforts to comply with the March 1 VM Requirements as soon as possible;
3. until it is able to comply with the March 1 VM Requirements, the SD continues to post and collect variation margin with counterparties under pre-existing variation margin arrangements; and
4. the SD complies with the March 1 VM Requirements no later than September 1, 2017.

In the no-action letter, the DSIO emphasizes that SDs are expected to make "continual, consistent and quantifiable progress" toward compliance during the no-action period and the DSIO intends to monitor the process of SDs who will rely on the no-action letter. The DSIO also notes that the no-action letter does not postpone the March 1, 2017 compliance date; it merely provides market participants with a six-month grace period to come into compliance.

For the avoidance of doubt, the no-action letter has no effect on the variation margin requirements with the September 1, 2016 compliance date which apply to uncleared swaps between certain entities who have covered swaps with average daily notional amount for March, April and May of 2016 exceeding $3 trillion.

For more information about any of the foregoing, please contact the following members of the Firm's Derivatives Group: Joyce Y. Xu (jxu@stblaw.com); Shimeng Cheng (Shimeng.Cheng@stblaw.com).

Simpson Thacher Worldwide

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
900 G Street, NW
Washington, D.C. 20001
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3901 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
25th Floor, West Tower
Mirae Asset Center 1
26 Eulji-ro 5-Gil, Jung-Gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000