

Memorandum

The Federal Reserve and the Office of the Comptroller of the Currency Clarified Position Re Potential Delay in Compliance with Swap Margin Requirements with March 1, 2017 Compliance Date

February 28, 2017

On February 22, 2017, the Board of Governors of the Federal Reserve System (the “Federal Reserve”) issued a statement specifying its position regarding potential delayed compliance by covered swap entities¹ prudentially regulated by the Federal Reserve with the variation margin requirements for uncleared swaps that will become applicable on March 1, 2017 (the “PR March 1 VM Requirements”). On February 23, 2017, the Office of the Comptroller of the Currency (“OCC”) issued a similar statement specifying its expectations for compliance with the PR March 1 VM Requirements by covered swap entities subject to OCC’s supervisory oversight.

I. Regulatory Background for the PR March 1 VM Requirements

Pursuant to the requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Prudential Regulators² adopted final margin rules on October 22, 2015 (the “PR Margin Rules”), requiring the posting and collection of initial and variation margin by covered swap entities in respect of uncleared swaps and uncleared security-based swaps.³

The PR March 1 VM Requirements are a part of the PR Margin Rules that require each covered swap entity

¹ CFTC-registered swap dealers, security-based swap dealers, major swap participants and major security-based swap participants that are regulated by a Prudential Regulator. See PR Reg. __.2.

² The Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency.

³ In respect of uncleared swaps, the CFTC also adopted final rules requiring the posting and collection of initial and variation margin by swap dealers and major swap participants registered with the CFTC that are not regulated by any Prudential Regulator. We previously published a memorandum regarding the CFTC no-action letter providing relief until September 1, 2017 to registered swap dealers for non-compliance with CFTC variation margin requirements for uncleared swaps that have a compliance date of March 1, 2017.

to post and collect variation margin in respect of uncleared swaps and uncleared security-based swaps entered into on or after March 1, 2017 where its counterparty under such transaction is either a financial end-user⁴ or a covered swap entity.

II. Expectations of the Federal Reserve and OCC Regarding Compliance with the PR March 1 VM Requirements

Both the Federal Reserve and OCC have expressed the following expectations in their respective statements:

1. Good Faith and Governance Process Requirements: Each covered swap entity shall make good faith efforts to comply with the March 1 VM Requirements in a timely manner and shall have governance processes that assess and manage their current and potential future credit exposure to non-cleared swap counterparties and other market risks.
2. Priority and Timing: Covered swap entities shall prioritize their efforts according to the size and risk inherent in the credit and market risk exposures presented by each counterparty. Covered swap entities are expected to achieve full compliance with respect to counterparties that present significant exposures by March 1, 2017. For other counterparties, covered swap entities are expected to make good faith efforts to comply in a timely manner, and in no case later than September 1, 2017.
3. Focuses of the Examiners and Factors for Consideration: During initial examinations for compliance with PR March 1 VM Requirements, the examiners at the regulator shall evaluate a covered swap entity's management systems and programs. The examiners shall consider the covered swap entity's implementation plan, including actions taken to update documentation, policies, procedures, and processes, as well as its training program for staff on how to handle technical problems or other implementation challenges.⁵

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).

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⁴ See PR Reg. __.2.

⁵ The European Supervisory Authorities have also issued statements acknowledging the operational challenges in meeting the deadline of March 1, 2017 for exchanging variation margin under the margin rules of the European Union. Their statement expresses the expectation that participants will document the steps taken toward full compliance and put in place alternative arrangements to ensure that the risk of non-compliance is contained.



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