



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and  
Intermediary Oversight

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**Audience: Registered Swap Dealers**

**Topic: Initial Margin Documentation Requirements**

### I. Introduction

The Division of Swap Dealer and Intermediary Oversight (“Division” or “DSIO”) of the Commodity Futures Trading Commission (“Commission” or “CFTC”) is issuing this advisory to clarify that, pursuant to CFTC regulations, the documentation governing the posting, collection, and custody of initial margin (“IM”) is not required to be completed until such time as the initial margin amount exceeds \$50 million. This advisory is issued in light of the March 5, 2019 statement by the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) with respect to the internationally agreed framework for margin requirements for non-centrally-cleared derivatives, which provides that:

[T]he framework does not specify documentation, custodial or operational requirements if the bilateral initial margin amount does not exceed the framework’s €50 million initial margin threshold. It is expected, however, that covered entities will act diligently when their exposures approach the threshold to ensure that the relevant arrangements needed are in place if the threshold is exceeded.<sup>1</sup>

Specifically, this advisory addresses inquiries concerning when swap dealers (“SDs”)<sup>2</sup> that are subject to the CFTC Margin Rule<sup>3</sup> (“covered swap entities” or “CSEs”)<sup>4</sup> are required to complete

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<sup>1</sup> *BCBS/IOSCO statement on the final implementation phases of the Margin requirements for non-centrally cleared derivatives* (March 5, 2019), <https://www.bis.org/press/p190305a.htm>.

<sup>2</sup> The guidance addresses only SDs because there are no major swap participants (“MSPs”) currently registered with the Commission.

<sup>3</sup> See *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 FR 636 (Jan. 6, 2016). The CFTC Margin Rule, which became effective April 1, 2016, is codified in part 23 of the Commission’s regulations. 17 CFR 23.150 - 23.159, 23.161. In May 2016, the Commission amended the CFTC Margin Rule to add Commission regulation 23.160, providing rules on its cross border application. *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements*, 81 FR 34818 (May 31, 2016). 17 CFR 23.160.

documentation governing the posting, collection, and custody of initial margin (“IM documentation”).<sup>5</sup> This advisory clarifies that no IM documentation is required until the amount of IM exchangeable between a CSE and a counterparty, on a counterparty by counterparty basis, exceeds the initial margin threshold amount of \$50 million (or “\$50 million IM threshold”).<sup>6</sup> The Division expects that CSEs will closely monitor as the amount of IM approaches the \$50 million IM threshold and take appropriate steps to ensure that the required IM documentation is in place at such time as the threshold is reached.

This advisory applies only to CSEs. The CFTC Margin Rule does not require counterparties to CSEs, other than other CSEs, to establish custodial services, document margin relationships, or operationalize the exchange of IM. Therefore, this advisory is not applicable to non-SD counterparties and does not address any obligation of such counterparties or suggest any such obligations.

## II. Requested Guidance

Covered swap entities are required to post and collect IM with counterparties that are SDs or financial end users with material swap exposure (“MSE”)<sup>7</sup> in accordance with a compliance schedule set forth in Commission regulation 23.161.<sup>8</sup> Five compliance dates, from September 1, 2016 to September 1, 2020, are staggered such that CSEs and their counterparties, starting with

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<sup>4</sup> The CFTC Margin Rule applies to SDs for which there is not a prudential regulator. *See* 7 U.S.C. 6s(e)(1)(B). SDs for which there is a prudential regulator must meet the margin requirements for uncleared swaps established by the applicable prudential regulator. 7 U.S.C. 6s(e)(1)(A). *See also* 7 U.S.C. 1a(39) (defining the term “Prudential Regulator” to include the Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Farm Credit Administration; and the Federal Housing Finance Agency). The Prudential Regulators published final margin requirements in November 2015. *See* Margin and Capital Requirements for Covered Swap Entities, 80 FR 74840 (Nov. 30, 2015). The margin requirements of the Prudential Regulators are similar to the CFTC Margin Rule, including with respect to the compliance schedule.

<sup>5</sup> *See* 17 CFR 23.157 (requiring entry into custodial agreements with custodians that hold funds posted or collected as IM) and 17 CFR 23.158 (requiring execution of documentation providing for the contractual right and obligation to exchange IM and variation margin).

<sup>6</sup> Under Commission regulation 23.154(a)(3), CSEs are not required to post or collect IM until the initial margin threshold amount has been exceeded. *See* 17 CFR 23.154(a)(3). The term “initial margin threshold amount” is defined in Commission regulation 23.151 to mean “an aggregate credit exposure of \$50 million resulting from all uncleared swaps between a covered swap entity and its margin affiliates on the one hand, and a covered counterparty and its margin affiliates on the other.” 17 CFR 23.151.

<sup>7</sup> Commission regulation 23.151 provides that MSE for an entity means that the entity and its margin affiliates have an average daily aggregate notional amount of uncleared swaps, uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps with all counterparties for June, July or August of the previous calendar year that exceeds \$8 billion, where such amount is calculated only for business days. A company is a “margin affiliate” of another company if: (i) either company consolidates the other on a financial statement prepared in accordance with U.S. Generally Accepted Accounting Principles, the International Financial Reporting Standards, or other similar standards; (ii) both companies are consolidated with a third company on a financial statement prepared in accordance with such principles or standards; or (iii) for a company that is not subject to such principles or standards, if consolidation as described in paragraph (1) or (2) of this definition would have occurred if such principles or standards had applied. 17 CFR 23.151.

<sup>8</sup> *See* 17 CFR 23.161.

the largest average daily aggregate notional amounts (“AANA”) of uncleared swaps and certain other financial products, and then successively lesser AANA, come into compliance with the IM requirements in a series of phases.

The fourth compliance date, September 1, 2019, will bring within the scope of compliance CSEs and counterparties where each exceeds \$750 billion in AANA. On the fifth compliance date, September 1, 2020, CSEs with counterparties that are SDs or financial end users with a MSE exceeding \$8 billion in AANA will be required to comply with the IM requirements. As a result of the large reduction in the compliance threshold from \$750 billion to \$8 billion, a significant number of counterparties will come into scope of the IM requirements.

Coming within the scope of the IM requirement creates regulatory obligations for CSEs and implications for their counterparties.<sup>9</sup> CSEs must calculate IM<sup>10</sup> and monitor IM amounts to determine if and when collection or posting of IM is required. Prior to collecting and posting IM with counterparties, CSEs must execute IM documentation, including credit support annexes addressing the regulatory requirement to exchange IM and custodian arrangements addressing the regulatory requirement to segregate margin assets with an independent custodian.<sup>11</sup> The amount and complexity of the documentation may vary depending on the terms of the swap transactions, as well as regulatory requirements and business practices in various jurisdictions.<sup>12</sup> In addition, CSEs and their counterparties will need to have adequate resources and time to set up and implement the arrangements.

### **III. Guidance**

This advisory clarifies that while no specific IM documentation is required prior to reaching the \$50 million IM threshold, DSIO expects that CSEs will take appropriate steps to have the required IM documentation upon reaching the IM threshold. The applicable IM documentation requirements are interpreted accordingly and discussed in more detail below.

#### **A. Preparatory Steps**

Commission regulation 23.504 requires SDs, including CSEs, to establish, maintain and follow written policies and procedures reasonably designed to ensure the execution of IM documentation. Commission regulation 23.504 directs CSEs to take appropriate steps to ensure the timely execution of IM documentation required by the CFTC Margin Rule, such that a CSE

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<sup>9</sup> See 17 CFR 23.161(b) (providing that once a CSE must comply with the margin requirements for uncleared swaps with respect to a counterparty, the CSE remains subject to the requirements of Commission regulations 23.150 through 23.161 with respect to such counterparty).

<sup>10</sup> See 17 CFR 23.154(a).

<sup>11</sup> See 17 CFR 23.157.

<sup>12</sup> For example, custodian arrangements, which may involve a single custodian or separate custodians for the parties, may take different forms, such as tri-party or third party arrangements, and may require the execution of multiple documents, including account control agreements, collateral transfer agreements, securities agreements, membership agreements, among others.

must complete the documentation by the time it reaches the \$50 million IM threshold. In the event a CSE opts to post IM below the threshold, before reaching the threshold, the CSE must require that the IM collateral be held by an independent custodian and must enter into a custodian agreement in accordance with Commission regulation 23.157(c).

SDs must also comply with section 4s(j)(2) of the Commodity Exchange Act<sup>13</sup> and implementing Commission regulation 23.600.<sup>14</sup> Pursuant to these provisions, SDs must establish a risk management system to monitor and manage risk associated with their swap activities, including legal risk, such as the failure to comply with applicable CFTC regulations. CSEs must therefore have an appropriate risk management system to calculate and monitor IM amounts and must act diligently as such amounts approach the \$50 million IM threshold, so that they can ensure compliance with the IM requirements and have all required IM documentation in place once IM amounts reach such level.

#### B. IM Documentation Requirements

Commission regulation 23.504 requires SDs to establish, maintain and follow written policies and procedures reasonably designed to ensure that SDs execute swap trading relationship documentation, including credit support annexes and custodial arrangements, prior to or contemporaneously with entering into a swap transaction.<sup>15</sup> Concerning IM documentation, the rule provides that the documentation is required if there are any IM requirements.<sup>16</sup> The rule also provides that documentation for custodial arrangements is required if there are any such arrangements.<sup>17</sup>

Commission regulation 23.158, which is part of the set of rules comprising the CFTC Margin Rule (Commission regulations 23.150 through 23.161), provides that CSEs must execute margin documentation that complies with the requirements of Commission regulation 23.504.<sup>18</sup> The documentation must provide CSEs with the contractual right and obligation to exchange IM with a counterparty, in such amounts, in such form and under such circumstances, as required by Commission regulations 23.150 through 23.161. Commission regulation 23.157(c) also requires CSEs to enter into an agreement with each custodian that holds any funds posted as IM, and funds collected as IM pursuant to Commission regulation 23.152.<sup>19</sup>

#### C. DSIO Guidance

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<sup>13</sup> 7 U.S.C. § 6c(j)(2).

<sup>14</sup> 17 CFR 23.600.

<sup>15</sup> See 17 CFR 23.504(a)(2).

<sup>16</sup> See 17 CFR 23.504(b)(3)(i).

<sup>17</sup> See 17 CFR 23.504(b)(3)(iv).

<sup>18</sup> See 17 CFR 23.158.

<sup>19</sup> See 17 CFR 23.157(c).

DSIO believes that the above-referenced rules collectively require the execution of IM documentation when the collection or posting of IM is actually required; that is when the \$50 million IM threshold is exceeded. In this regard, DSIO points to the Commission's statement in the preamble to the CFTC Margin Rule that "[t]he final rule does not require a CSE to collect or post initial margin collateral to the extent that the aggregate un-margined exposure either to or from its counterparty remains below \$50 million."<sup>20</sup>

DSIO notes that Commission regulation 23.504 requires the execution of IM documentation "prior to or contemporaneously with entering into a swap transaction." However, the IM documentation is required only if there are any IM requirements and any custodial arrangements. Accordingly, to the extent the \$50 million IM threshold is not exceeded, there are no applicable IM requirements, and no need for any pertinent documentation or custodial arrangements.<sup>21</sup>

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<sup>20</sup> Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR at 652.

<sup>21</sup> While CSEs and their counterparty may enter into custodial arrangements in anticipation of meeting the \$50 million IM threshold, the arrangements are not required until the threshold is exceeded. The Commission also notes that once a CSE and a counterparty exceed the \$50 million IM threshold, even in the event that the IM amount subsequently falls below the threshold level, the CSE must still meet all the above IM documentation requirements.