U.S. COMMODITY FUTURES TRADING COMMISSION
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Division of Swap Dealer and
Intermediary Oversight

Joshua Sterling
Director

December 19, 2019

Peter Y. Malyshev
Reed Smith LLP
1301 K Street, N.W.
Suite 1000 – East Tower
Washington, D.C. 20005-3373

Re: Request for No-Action Relief Concerning Calculation of Initial Margin

Dear Mr. Malyshev:

This letter is in response to your letter dated November 4, 2019, to the Division of Swap Dealer and Intermediary Oversight ("**DSIO**") of the Commodity Futures Trading Commission ("**Commission**") requesting a no-action position with respect to Cargill Incorporated ("**Cargill**"), a limited purpose swap dealer[1] subject to the Commission's margin requirements for uncleared swaps.

In your letter, you request a position of no-action with respect to Cargill's failure to comply with Commission regulation 23.154(a). Specifically, you request relief that would permit Cargill, with respect to a swap entered into with another Commission registered swap dealer ("**SD**"), to use such SD's risk-based model calculation of initial margin ("**IM**") as the amount of IM that Cargill is required to collect from the SD and to determine whether the IM threshold amount of $50 million ("**$50 million IM Threshold**")[2] has been exceeded, which requires documentation

[1] *In re* Request of Cargill Incorporated for Limited Purpose Swap Dealer Designations Under Section 1a(49)(B) of the Commodity Exchange Act, Order of Limited Purpose Designations for Cargill Incorporated and An Affiliate (Oct. 29, 2013).

[2] Under Commission regulation 23.154(a)(3), SDs and major swap participants ("**MSPs**") subject to the Commission's regulations 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 an SD and its margin affiliates (or an MSP and its margin affiliates) on the one hand, and the SD's (or MSP's) counterparty and its margin affiliates on the other. *See* 17 CFR 23.151. 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, International Financial Reporting Standards, or other similar

concerning the posting, collection, and custody of IM ("**Documentation Requirements**").[3]

I. Regulatory Background

Pursuant to section 4s(e) of the Commodity Exchange Act ("**CEA**"),[4] the Commission is required to promulgate margin requirements for uncleared swaps applicable to each SD and MSP (together, "**covered swap entities**" or "**CSEs**") for which there is no Prudential Regulator.[5] The Commission published final margin requirements for CSEs in January 2016 (the "**CFTC Margin Rule**").[6]

The CFTC Margin Rule requires CSEs to collect and post IM with SDs, MSPs, and financial end users with material swap exposure ("**MSE**")[7] (collectively, "**covered counterparties**").[8] Commission regulation 23.154(a) directs CSEs to calculate, on a daily basis, the IM amount to be collected from covered counterparties and to be posted to financial end user counterparties with MSE.[9] CSEs have the option to calculate the IM amount by using either a risk-based model or the standardized IM table set forth in Commission regulation 23.154(c)(1). For a CSE that elects to use a risk-based model to calculate IM, Commission regulation 23.154(b)(1) requires

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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. *See* 17 CFR 23.151.

[3] *See* Initial Margin Documentation Requirements, CFTC Letter No. 19-16 (July 9, 2019) (providing that no documentation governing the posting, collection and custody of IM is required to be completed until the IM threshold amount exceeds $50 million).

[4] 7 U.S.C. § 1 et. seq.

[5] *See* 7 U.S.C. 6s(e)(1)(B). SDs and MSPs 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).

[6] *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. *See* 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. 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).

[7] 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.

[8] The term "covered counterparty" is defined in Commission regulation 23.151 as a financial end user with MSE or a swap entity, including an SD or MSP, that enters into swaps with a CSE. *See* 17 CFR 23.151.

[9] *See* 17 CFR 23.154(a).

the CSE to obtain a written approval to use the model from the Commission or a registered futures association.[10]

II. Summary of Request for No-Action Position

In your letter, you state that Cargill is a limited liability Delaware corporation and international producer and marketer of food, agricultural, financial and industrial commodities, trading agricultural physical commodities for 150 years.

You state that Cargill engages in swap dealing activities through Cargill Risk Management, an unincorporated unit contained within Cargill, and that it has registered as a limited purpose SD pursuant to a limited purpose designation order issued October 29, 2013, with respect to such swap dealing activity ("**CRM SD**"). The limited purpose designation has made it possible for CRM SD both to continue operating as it had in the past and to continue servicing counterparties seeking to mitigate their commercial risk. While CRM SD's swap activity primarily involves physical agricultural commodities, CRM SD may trade in swaps in other asset classes and may maintain positions that require collection of IM from SDs.

Commission regulation 23.154(a) allows SDs such as CRM SD to choose between the standardized table method or a risk-based model to calculate IM.[11] You note that CRM SD intends to use the standardized table method for most of its swaps, mostly involving non-SD counterparties. You state, however, that large SDs have adopted the ISDA SIMM risk-based model ("**SIMM Model**") to calculate IM. Because use of the standardized table to calculate IM to be collected by CRM SD could require SD counterparties to CRM SD to post a higher amount of IM than would be required by the SIMM Model, you assert that SD counterparties may choose not to trade with CRM SD. The higher amount of IM could also accelerate how soon the $50 million IM Threshold is reached and the timing for compliance with the Documentation Requirements. While acknowledging that CRM SD could alternatively develop a risk-based model for transactions with SD counterparties, you state that such approach would impose a disproportionate burden on CRM SD relative to the highly specialized and discrete nature of its swap business, which mainly focuses on commodities.

You therefore request no-action relief that would permit CRM SD to use its SD counterparties' SIMM Model IM calculation to determine the IM amount that must be collected from such SD counterparties and to determine whether the $50 million IM Threshold has been exceeded such that compliance with the Documentation Requirements would be required.

III. DSIO No-Action Position

Based on the foregoing, DSIO believes that a no-action position is warranted. Accordingly, DSIO will not recommend that the Commission take an enforcement action against CRM SD if

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[10] *See* 17 CFR 23.154(b)(1)(i). In this context, the term "registered futures association" refers to the National Futures Association ("NFA"), which is the only futures association registered with the Commission.

[11] It is expected that CRM SD will start to exchange IM in the last phase of the compliance schedule for the IM requirements. *See* 17 CFR 23.161 (setting forth the schedule for compliance with the IM requirements).

CRM SD collects IM from an SD counterparty as calculated by the SD counterparty, or if CRM SD uses the SD counterparty's IM calculations to determine whether the $50 million IM Threshold amount has been exceeded. DSIO's no-action position is subject to the following conditions:

1. CRM SD may only use an SD counterparty's IM calculation if the calculation was computed using a risk-based IM model approved by the Commission, the NFA, or a Prudential Regulator **("Approved IM Calculation Method")**.

2. Prior to using an SD counterparty's IM calculation generated pursuant to an Approved IM Calculation Method, CRM SD must agree with the SD counterparty in writing that such IM calculation will be used to determine the amount of IM to be collected from such SD counterparty, and to determine whether the $50 million IM Threshold amount has been exceeded and whether compliance with the Documentation Requirements is required. The CRM SD and the SD counterparty must also agree in writing that the IM calculation will be provided to CRM SD in such manner and time frame that would allow CRM SD to comply with the CFTC Margin Rule and other applicable Commission regulations.

3. CRM SD may only use an SD counterparty's IM calculation if the swaps entered into between CRM SD and the SD are for the purpose of hedging CRM SD's exposure to non-SD counterparties. CRM SD may not use an SD counterparty's IM calculation with respect to swaps it enters into with SDs in a swap dealing capacity.

4. To the extent CRM SD uses an SD counterparty's IM calculation generated pursuant to an Approved IM Calculation Method, CRM SD must monitor the Approved IM Calculation Method's output, in particular, to ensure the sufficiency of the calculated IM amounts. CRM SD must keep track of exceedances, that is, price movements above the amounts of IM generated pursuant to an Approved IM Calculation Method. If the exceedances indicate that the Approved IM Calculation Method being used fails to meet the relevant regulators' standards, CRM SD must take appropriate steps to ensure compliance with its risk management obligations and address the exceedances with its SD counterparty. If any adjustments or enhancements are applied to the amount of IM calculated pursuant to the Approved IM Calculation Method to ensure CRM SD's collection of adequate amounts of IM, CRM SD must provide written notice by email to NFA and Commission staff at SwapsMarginModel@NFA.Futures.Org and dsioletters@cftc.gov, respectively. CRM SD must also have an independent risk management unit, as prescribed in Commission regulation 23.600, perform an annual review of the Approved IM Calculation Method's output. CRM SD should be prepared to produce, upon request, records relating to the monitoring of the Approved IM Calculation Method output and any other records demonstrating CRM SD's ongoing monitoring.

5. As part of its risk management program pursuant to Commission regulation 23.600, CRM SD must independently monitor on an ongoing basis credit risk, including potential future exposure associated with uncleared swaps subject to the CFTC Margin Rule, to

determine, among other things, whether CRM SD is approaching the $50 million IM Threshold with respect to a counterparty.

This letter, and the positions taken herein, represent the views of DSIO only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the CEA or in Commission Regulations. Further, this letter, and the positions taken herein, is based upon the representations made to DSIO. Any different, changed, or omitted material facts or circumstances might render this no-action position void.

Questions concerning this letter may be directed to me at (202) 418-6056; Warren Gorlick, Associate Director, (202) 418-5195; or Carmen Moncada-Terry, Special Counsel, at (202) 418-5795.

Very truly yours,

Joshua Sterling
Director
Division of Swap Dealer and Intermediary Oversight