

II. Protecting the U.S. Commodities Market: CFTC Weighs in with New and Improved Final Swap Margin Rules

A. Introduction To The CFTC Final Swap Margin Rules

Following in the footsteps of the Prudential Regulators,¹ the Commodity Futures Trading Commission (CFTC) published its final rule imposing margin requirements for uncleared swaps applicable to swap entities under its jurisdiction (Covered Swaps).² Swaps are derivative contracts between counterparties to exchange cash flows at intervals for an agreed set time.³ Preliminarily set to be effective on April 1, 2016, the compliance phase-in dates range from September 2016 to September 2020, depending on the average daily aggregate

¹ 7 U.S.C. § 1a(39) (The Prudential Regulators comprise of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Farm Credit Administration, and the Federal Housing Finance Agency).

² Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016) (to be codified at 17 C.F.R. pt. 23 and 140) (Covered Swaps exclude foreign exchange forwards and swaps); *Prudential Regulators and CFTC Adopt Margin Rules for Uncleared Swaps*, SIDLEY AUSTIN LLP (Jan. 20, 2016), <http://www.sidley.com/news/2016-01-20-derivatives-update> [<https://perma.cc/ZD9F-YV67>] [hereinafter SIDLEY] (“The principal *jurisdictional* difference between the PR Final Rule and the CFTC Final Rule is that Bank CSEs are subject to the PR Final Rule, while Non-Bank CSEs that are registered with CFTC are subject to the CFTC Final Rule. Non-Bank CSEs that are registered with the SEC (once its registration regime is in place) will be subject to the SEC’s own margin rules (once they are adopted). Moreover, the PR Final Rule covers all Uncleared Swaps to which a Bank CSE is a party (whether swaps or security-based swaps), while the CFTC Final Rule covers only those Uncleared Swaps that are subject to the CFTC’s jurisdiction (i.e., it does not cover security-based swaps even when traded by a CFTC-registered Non-Bank CSE).”).

³ RICHARD HECKINGER ET AL., UNDERSTANDING DERIVATIVES – MARKETS AND INFRASTRUCTURE (Fed. Reserve Bank of Chicago 2013) (“[S]waps are OTC agreements to exchange cash flows at regular intervals over an agreed period according to terms agreed on today; in effect, a swap is a sequence of forwards. A bank and its client might agree, for example, that over the next five years, the client will pay the bank 5% per year on \$1.0 million in semiannual installments, while the bank will pay the client the three-month USD Libor rate on the same amount in quarterly installments.”).

notional amounts⁴ of uncleared swaps, foreign exchange forwards, and foreign exchange swaps between a Covered Swap Entity (CSE), and its margin affiliates.⁵

In general, the CFTC-Final Swap Margin Rule (CFTC-FSMR) applies to Non-Bank CSEs that are registered with the CFTC that engage in uncleared swaps—those not cleared by a Derivatives Clearing Organization, such as the Chicago Mercantile Exchange, Inc.⁶ The CFTC-FSMR requires CSEs, such as non-bank securities dealers and major swap participants, to post initial and variation margins.⁷ Whether the rule applies depends on the nature of the

⁴ See generally Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed Reg. at 643 n.64 (“The final rule defines material swaps exposure as 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, and August of the previous calendar year that exceeds \$8 billion, where such amount is calculated only for business days.”).

⁵ *Id.* at 703-04 (outlining the compliance dates for minimum margin requirements for uncleared swaps based on daily aggregate notional amounts and uncleared swap transaction dates); *id.* at 697 (defining a “margin affiliate” as an entity that is consolidated with or consolidates the other on financial statements; or is consolidated with a third company on a financial statement); 17 C.F.R. § 23.151; 12 C.F.R. § 237.2.

⁶ *Clearing*, CME GROUP, http://www.cmegroup.com/clearing/?utm_source=clearing_flyout&utm_medium=clearing_home&utm_campaign=flyout [<http://perma.cc/3QMA-SYFW>] (“CME Clearing monitors and processes more than one billion trades each year, worth more than \$1,000 trillion, and ensures the financial integrity of each transaction.”); see Gary E. Kalbaugh & Alexander F. Sand, *Cutting Back: Revisions to Dodd Frank Derivative Rules*, 35 THE J. ON THE LAW OF INVESTMENT & RISK MGMT. PRODS., 5 (“When a swap is subject to mandatory clearing, it follows that it has a derivatives clearing organization as a ‘central counterparty.’ The swap is therefore subject to the margin requirements of the derivatives clearing organization and, in the event that one party to the swap fails to meet its obligations, the derivatives clearing organization remains responsible to the other party for performance. This is seen as reducing the systemic risks associated with cleared swaps when compared to uncleared ‘over-the-counter’ swaps by (1) requiring margin; and (2) interposing a highly creditworthy central counterparty.”).

⁷ *CFTC Adopts Margin Rules for Uncleared Swaps*, DEBEVOISE & PLIMPTON (Dec. 30, 2015), http://www.debevoise.com/~media/files/insights/publications/2015/12/20151230_cftc_adopts_margin_rules.pdf [<https://perma.cc/D6EC-GDHW>] [hereinafter D&P] (“A ‘Covered Swap Entity’ is a Swap Entity for which none of the Banking Agencies is a

counterparty to the uncleared swap transaction: whether it is a (1) swap entity; (2) Financial End User with at least \$8 billion in Material Swaps Exposure; (3) Financial End User with less than \$8 billion in Material Financial Exposure; or (4) Non-Financial End User.⁸ This paper will discuss the costs, benefits, and implications of the CFTC-FSMR on the current financial macroclimate.

B. Background: Reeling in Reform for Uncleared Swaps

The purpose of the CFTC-FSMR traces back to the 2008 financial crisis, during which several weaknesses in the over-the-counter (OTC) derivatives markets became shockingly apparent.⁹ Systemic risk, shady derivative activities, and market abuse and manipulation, among other hazards, contaminated the swap market

prudential regulator; for example, nonbank SDs, nonbank subsidiary SDs of bank holding companies as well as certain foreign SDs and MSPs.”).

⁸ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 636 (listing entities that are deemed “financial end users,” such as bank holding companies, savings and loan holding companies, non-bank financial institutions, depository institutions, federal/state credit unions, securities holding companies, brokers, dealers, commodity pools, insurance companies, etc.); 17 C.F.R. § 23.151; 12 C.F.R. § 237.2 (“Material swaps exposure” is the average daily aggregate notional amount of “uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps with all counterparties for June, July and August of the previous calendar year that exceeds \$8 billion, where such amount is calculated only for business days” within the entity and its margin affiliates).

⁹ Basel Comm. on Banking Supervision and Bd. of the Int’l Org. of Secs. Comms., *Margin Requirements for Non-Centrally Cleared Derivatives*, at 2, <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD480.pdf>

[<https://perma.cc/84F3-HQRP>] (Mar. 2015) [hereinafter Basel Comm.] (“The economic and financial crisis that began in 2007 exposed significant weaknesses in the resiliency of banks and other market participants to financial and economic shocks.”); cf. *Financial Reform Dodd-Frank Central Clearing*, GOLDMAN SACHS (2012), <http://www.goldmansachs.com/gsam/worldwide/insights/FinReg/clearing-fact-sheet-2.pdf>

[<https://perma.cc/ZUA5-5AMZ>] (“Under the new mandatory clearing regime, your ultimate counterparty with respect to cleared swaps, will no longer be the entity with whom you traded. Rather, your transactions will be submitted through a clearing member, acting in an agency capacity, to a Central Clearinghouse (CCP) for clearing . . . [that] has appropriate tools and procedures for risk mitigation.”).

and other sectors.¹⁰ Credit derivatives—namely credit default swaps that were used to insure faulty collateralized debt obligations—played a key role in the financial crisis.¹¹ Infamous culprits like AIG participated in the abuse of credit default swaps by issuing illusory guarantees.¹² As an extension, the role of OTC derivatives in the financial crisis intimated a dire need for regulatory reform.¹³

The OTC derivatives market, the playground for uncleared swaps, is vital to the national and global economy.¹⁴ Importantly, it enables market participants to hedge risk, facilitate economic movement and liquidity, and to take advantage of economies of scope.¹⁵ On the international level, the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions passed margin requirements in September

¹⁰ Andrew Ackerman, *CFTC Adopts Scaled-Back Rule on Bank Safety*, WALL ST. J. (Dec. 16, 2015), <http://www.wsj.com/articles/cftc-adopts-scaled-back-rule-on-bank-safety-1450292369> [<http://perma.cc/ZM3D-EMCW>].

¹¹ See generally Steve Denning, *Big Banks and Derivatives: Why Another Financial Crisis is Inevitable*, FORBES (Jan. 8, 2013), <http://www.forbes.com/sites/stevedenning/2013/01/08/five-years-after-the-financial-meltdown-the-water-is-still-full-of-big-sharks/#28aac8d45474> [<https://perma.cc/C77V-A2PX>].

¹² Gary Gensler, Chairman, Commodities Futures Trading Comm'n, Testimony Before the Financial Crisis Inquiry Commission (July 1, 2010) (“I believe that derivatives played a central role in the 2008 financial crisis Credit default swaps were used as ‘wraps’ for securitized mortgage products. CDOs, for example, were often guaranteed by third-parties, such as AIG, through issuance of credit default swaps. Investment banks and other packagers of mortgages that wrapped securities with credit protection to sell to investors often reduced their own risk analysis [Which] helped feed into the housing bubble.”).

¹³ *Id.* (“Some have argued that the role of derivatives is limited to AIG or credit default swaps. I think it is broader than that. I also think we cannot just look to solve the immediate proximate causes of the last crisis. We have to look out across the whole marketplace. Even if AIG and credit default swaps were the leading culprits, I think we need to look into and regulate the entire market.”).

¹⁴ *Over-The-Counter Derivatives*, FED. RES. BANK OF N.Y., <https://www.newyorkfed.org/financial-services-and-infrastructure/financial-market-infrastructure-and-reform/over-the-counter-derivatives/index.html> [<http://perma.cc/NL33-PG35>] (explaining how the OTC market is an “important component of the financial markets and broader global economy”).

¹⁵ *Id.*

2013.¹⁶ On the national level, the Dodd-Frank Act,¹⁷ subsequently amended by Title III of the TRIPA,¹⁸ amended the Commodities Exchange Act.¹⁹ Title VII of Dodd-Frank enhanced the enforcement authority of the CFTC while Title III of the TRIPA²⁰ authorized the exemption of commercial end users and other qualified users from margin requirements.²¹

The Prudential Regulators followed suit by passing margin requirements that apply to swap dealers subject to supervision by the Prudential Regulators, such as bank holding companies and insured depository institutions, in October 2015.²² The green light from the

¹⁶ Basel Comm., *supra* note 9.

¹⁷ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

¹⁸ Terrorism Risk Insurance Program Reauthorization Act of 2015, Pub. L. 114-1, 129 Stat. 3 (2015) (“Title III of the Terrorism Risk Insurance Program Reauthorization Act of 2015 . . . exempts from the margin rules for uncleared swaps certain swaps for which a counterparty qualifies for an exemption or exception from clearing under the Dodd-Frank Act.”).

¹⁹ 7 U.S.C. § 1 (2012).

²⁰ Business Risk Mitigation and Price Stabilization Act of 2015, Pub. L. No. 114-1, §§ 301-03, 129 Stat. 3, 28-29 (2015).

²¹ *Id.* (“COMMODITY EXCHANGE ACT AMENDMENT.—Section 4s(e) of the Commodity Exchange Act (7 U.S.C. 6s(e)), as added by section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, is amended by adding at the end the following new paragraph: ‘(4) APPLICABILITY WITH RESPECT TO COUNTERPARTIES.— The requirements of paragraphs (2)(A)(ii) and (2)(B)(ii), including the initial and variation margin requirements imposed by rules adopted pursuant to paragraphs (2)(A)(ii) and (2)(B)(ii), shall not apply to a swap in which a counterparty qualifies for an exception under section 2(h)(7)(A), or an exemption issued under section 4(c)(1) from the requirements of section 2(h)(1)(A) for cooperative entities as defined in such exemption, or satisfies the criteria in section 2(h)(7)(D).’”).

²² Brett Ackerman et al., *Prudential Regulators Are First to Finalize Uncleared Swap Margin Rules*, LATHAM & WATKINS (Nov. 20, 2015), <https://www.lw.com/thoughtLeadership/LW-prudential-regulators-finalize-uncleared-swap-margin-rules> [<https://perma.cc/V5ZP-325T>] (explaining the “lessening [of] collateral requirements, expan[sion of] the collateral eligible to be posted for variation margin in transactions with financial end-users, narrowing [of] the cross-border reach of the rules, raising the initial margin threshold amount and providing some accommodations for inter-affiliate uncleared swaps.”); Gabriel D. Rosenberg & Jai R. Massari, *Regulation Through Substitution as Policy Tool: Swap Futurization under Dodd-Frank*, 2013 COLUM. BUS. L. REV. 667, 713-14 (2013) (“Variation margin,

Prudential Regulators pushed the CFTC to pass the current CFTC-FSMR.²³ It was designed to regulate CSEs that are not subject to the Prudential Regulators, for example, nonbank subsidiaries of bank holding companies, certain foreign swap dealers, and non-financial end users, among others.²⁴ The CFTC posits that commercial risks and other non-financial risks cannot be hedged adequately solely through the use of cleared swaps.²⁵ Certain commodities or products lack sufficient liquidity to be centrally risk-managed and cleared, such as agricultural crops and energy.²⁶ Strict margin requirements are important in alleviating the risk of default for high-risk counterparties but the exemptions are equally important to dilute regulatory burdens

sometimes known as mark-to-market margin, is collateral exchanged to reflect the actual price movements of a transaction. Variation margin is often calculated daily as the difference in the value of the transaction from the previous day's value. As such, variation margin can be thought of as protecting against the current exposure posed by one counterparty to another by virtue of accrued, but unrealized, gains or losses. Initial margin, also known as a performance bond, on the other hand, is meant to protect against potential future exposure that has not yet materialized, but may before the next variation margin payment is made.”).

²³ Terry Arbit & Kathleen Scott, *CFTC Finalizes its Dodd-Frank Margin Requirements for Uncleared Swaps of Certain Swap Dealers*, NORTON ROSE FULBRIGHT (Jan. 26, 2016), <http://www.regulationtomorrow.com/us/cftc-finalizes-its-dodd-frank-margin-requirements-for-uncleared-swaps-of-certain-swap-dealers/> [<http://perma.cc/97DC-NAGQ>] [hereinafter Arbit & Scott].

²⁴ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 636.

²⁵ See generally *Cleared Swap Handbook: Derivative Processing Under The Dodd-Frank Act and European Market Infrastructure Reform (EMIR)*, BANK OF N.Y. MELLON (2013), https://www.bnymellon.com/_global-assets/pdf/solutions-index/cleared-swap-handbook.pdf [<https://perma.cc/4MER-KSCE>].

²⁶ Statement of Commissioner J. Christopher Giancarlo, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 707 n.7 (Appendix 4) (“The costs of posting margin for uncleared swaps will likely be substantially higher than the costs associated with clearing. For example, the minimum liquidation time for cleared agricultural, energy and metals swaps is one-day for purposes of calculating initial margin, and give days for cleared interest rate and credit default swaps.”).

on those counterparties on the opposite end of the risk spectrum.²⁷ Ultimately, the CFTC designed the FSMR with informed guidance from the Basel Committee on Banking Supervision and the Prudential Regulators.²⁸

C. Mechanics Of CFTC-FSMR: Breaking Down Its Application

The CFTC-FSMR²⁹ sets forth minimum margin requirements for a category of swaps deemed uncleared swaps.³⁰ The CFTC-FSMR, however, now exempts a subclass of uncleared swaps from the mandatory collecting and posting of minimum initial and variation margins so long as the minimum transfer amount of \$500,000 is met.³¹ Application of the exemption depends on the nature of the counterparty to the transaction.³² Thus, the CFTC-FSMR margin requirements do not apply to swaps in which the counterparty qualifies

²⁷ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 697 (defining “Material swaps exposure” as 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 and August of the previous calendar year that exceeds \$8 billion, where such amount is calculated only for business days.”).

²⁸ *See id.* at 59898 (Oct. 3, 2014).

²⁹ *Id.* at 694-95.

³⁰ *Id.* at 697 (“[An ‘uncleared swap’ is] a swap that is not cleared by a registered derivatives clearing organization, or by a clearing organization that the Commission has exempted from registration by rule or order pursuant to section 5b(h) of the Act.”).

³¹ *Id.* at 636; *Margin Requirements for Non-Centrally Cleared Derivatives*, SIA PARTNERS (Jan. 8, 2016), <http://en.finance.sia-partners.com/new-margin-requirements-non-centrally-cleared-derivatives> [http://perma.cc/4ZCP-WJ3J] [hereinafter SIA].

³² *See* Section 2(h)(7)(A) of the Commodities Exchange Act, 7 U.S.C. § 2(h)(7)(A) (provides that the clearing requirement of Section 2(h)(1)(A) shall not apply to a swap if one of the counterparties to the swap: “(i) is not a financial entity; (ii) is using swaps to hedge or mitigate commercial risk; and (iii) notifies the Commission, in a manner set forth by the Commission, how it generally meets its financial obligations associated with entering into uncleared swaps” (referred to hereinafter as the “end-user exception”)).

under Section 2(h)(7)(A),³³ Section 2(h)(7)(D),³⁴ or is otherwise deemed exempt by rule, regulation, or order issued by the CFTC.³⁵

1. When Exemptions Apply: Certain Covered Swap Entities and Their Affiliates

Section 2(h)(7)(A) exempts Non-Financial End Users³⁶ so long as they use swaps to mitigate commercial risk and have notified the CFTC about how they generally meet their financial obligations regarding uncleared swaps.³⁷ On the other hand, Financial End Users with over \$8 billion in “material swaps exposure”³⁸ are not exempt. Importantly, CFTC-FSMR Financial End Users are enumerated as bank holding companies, savings and loan holding companies, depository institutions, foreign banks, credit unions, insurance companies, investment funds, money services businesses, and nonbank financial institutions supervised by the Federal Reserve Board.³⁹

³³ *Id.*

³⁴ 7 U.S.C. § 2(h)(7)(D) (outlining the treatment of affiliates and the respective prohibitions of certain affiliates from application of the end user exemption).

³⁵ D&P, *supra* note 7, at 4-5.

³⁶ 7 U.S.C. § 2(h)(7)(D) (“[A ‘Financial End User’ is] (I) a swap dealer; (II) a security-based swap dealer; (III) a major swap participant; (IV) a major security-based swap participant; (V) a commodity pool; (VI) a private fund as defined in section 80b-2(a) of title 15; (VII) an employee benefit plan as defined in paragraph (3) and (32) of section 1002 of title 29; (VIII) a person predominantly engaged in activities that are in the business of banking, or activities that are financial in nature, as defined in section 1843(k) of title 12.”).

³⁷ Section 2(h)(7)(A) of the Commodities Exchange Act, 7 U.S.C. § 2(h)(7)(A).

³⁸ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 697 (defining “material swaps exposure” as 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 and August of the previous calendar year that exceeds \$8 billion, where such amount is calculated only for business days”); D&P, *supra* note 7 (“[M]aterial swaps exposure must also include foreign exchange forwards and swaps.”).

³⁹ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 696-97; D&P, *supra* note 7, at 2.

Section 2(h)(7)(D) exempts affiliates of Non-Financial End Users from CFTC-FSMR margin requirements but only if the affiliate also uses the swap to hedge commercial risk of a non-financial entity.⁴⁰ This qualification to the exemption means that some affiliates to § 2(h)(7)(A) Non-Financial End Users—namely, swap dealers, security based dealers, major swap participants, and eligible investment companies—are still subject to the CFTC-FSMR initial margin requirements⁴¹ Affiliate underwriters, insurance companies, loan associations, commodity pools, and bank holding companies with over \$50 billion in consolidated assets remain exempt notwithstanding the Investment Company Act.⁴²

2. Special Affiliate Rules and Conditions for CFTC-FSMR Exemption

Moreover, special rules apply to qualifying affiliates.⁴³ Under the CFTC-FSMR, CSEs are exempt from collecting initial margin from an affiliate so long as four conditions are met.⁴⁴ First, the uncleared swap must be subject to a centralized risk system “reasonably designed to monitor and manage [uncleared swap] risks.”⁴⁵ Second, the CSE must have collected variation margin with its affiliate.⁴⁶ Third, the margin-affiliate must not be a swap entity

⁴⁰ 7 U.S.C. § 2(h)(7)(D)(i) (describing that the exemption for affiliates is not available if such entity is a (1) swap dealer; (2) security-based swap dealer (3) major swap participant; (4) major security-based swap participant; (5) investment company under 15 U.S.C. 80a-3 but for paragraph (1) or (7) of subsection (c) of that Act (15 U.S.C. 80a- 3(c)); (6) commodity pool; or (7) a bank holding company with over \$50B in consolidated assets (CEA 2(h)(7)(D)(ii)).

⁴¹ 17 C.F.R. § 23.150 (2016).

⁴² Investment Company Act of 1940, 15 U.S.C. § 80a-3(c).

⁴³ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 703.

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*; *The Final Margin Framework for Uncleared Swap Transactions*, GIBSON DUNN & CRUTCHER (Feb. 9, 2016), <http://www.gibsondunn.com/publications/Pages/Final-Margin-Framework-for-Uncleared-Swap-Transactions.aspx> [https://perma.cc/RWU8-K37A] [hereinafter Gibson Dunn Alert] (“Unlike the nuances and exceptions prevalent in the IM requirements, VM requirements under the Final Margin

subject to Prudential Regulator.⁴⁷ Fourth, the margin affiliate must not be a foreign Financial End User that is subject to comparable initial margin requirements for outward facing swaps with unaffiliated Financial End Users.⁴⁸ Nonetheless, CSEs must post and collect variation margin with other swap entities or Financial End Users.⁴⁹

The margin affiliate must not be a Foreign Financial End User because the CFTC-FSMR does not apply to “foreign uncleared swaps” unless the CFTC has found the jurisdiction to be “eligible for substituted compliance.”⁵⁰ The CFTC-FSMR excludes sovereign entities, eligible treasury affiliates, multilateral development banks, and the Bank for International Settlements from the definition of Financial End User.⁵¹

Requirements are fairly uniform, generally applying to all uncleared swaps between applicable counterparties.”).

⁴⁷ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 695.

⁴⁸ *Id.* at 703 (to be codified at 17 C.F.R. § 23.159(a)(2)(i)) (“A covered swap entity shall post initial margin to any margin affiliate that is a swap entity subject to the rules of a Prudential Regulator in an amount equal to the amount that the swap entity is required to collect from the covered swap entity pursuant to the rules of the Prudential Regulator.”); Gibson Dunn Client Alert, *supra* note 46.

⁴⁹ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 703; *see* Gibson Dunn Alert, *supra* note 46.

⁵⁰ *Compare* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 703 (defining an outward facing margin affiliate as a “margin affiliate that enters into swaps with third parties”), *with U.S. Banking Regulators Finalize Minimum Margin Requirements for Uncleared Swaps*, ROPES & GRAY LLP (Jan. 8, 2016), <https://www.ropesgray.com/newsroom/alerts/2015/November/US-Banking-Regulators-Finalize-Minimum-Margin-Requirements-for-Uncleared-Swaps.aspx> [<https://perma.cc/KZA4-7CTM>] [hereinafter Ropes Alert] (“[F]oreign non-cleared swaps’ means any uncleared swap of a foreign swap entity to which neither the counterparty (nor guarantor on either side of the swap) is (i) an entity organized in the United States (including a U.S. branch, agency, or subsidiary of a foreign bank or a natural person who is a resident of the United States); (ii) a branch or office of an entity organized in the United States; or (iii) a swap entity that is a subsidiary of an entity organized in the United States.”).

⁵¹ D&P, *supra* note 7, at 2.

3. Calculating Initial and Variation Margin

Under the CFTC-FSMR, a CSE⁵² is obligated to collect an initial margin from the covered counterparty.⁵³ It can use a risk-based model or a table based method to estimate the potential future exposure of the uncleared swap or netting portfolio of uncleared swaps.⁵⁴ This can be done by assessing financial stress for each asset class relating to the uncleared swaps, material price risks, for example, interest rate risk, credit risk, commodity risk, offsetting exposures, and other hedging benefits.⁵⁵ In addition, the CSE is required to ensure rigorous and relevant internal initial margin calculating models.⁵⁶ As such, it must periodically review and recalibrate its risk-based model or table-based model as necessary, maintain a risk management unit independent from the operation of the initial margin model, and refrain from evasion of the swap margin requirements through “selective application of the model and standardized approach.”⁵⁷

a. Eligible Collateral

After an estimate of the initial margin is calculated, the CSE is limited to collect and post only the following types of collateral: (1) cash; (2) U.S. treasury securities; (3) U.S. government agency securities guaranteed by the U.S. government; (4) securities issued by the European Central Bank or other sovereign entity with at most 20 percent risk weight under prudential regulations; (5) publicly traded

⁵² Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 695 (defining “covered swap entity” as “a swap dealer or major swap participant for which there is no prudential regulator”).

⁵³ *Id.* at 695 (defining “covered counterparty” as “financial end user with material swaps exposure or a swap entity that enters into a swap with a covered swap entity”).

⁵⁴ *Id.* at 699-701.

⁵⁵ *Id.* (“Potential future exposure is an estimate of the one-tailed 99 percent confidence interval for an increase in the value of the uncleared swap or netting portfolio of uncleared swaps due to an instantaneous price shock that is equivalent to a movement in all material underlying risk factors, including prices, rates, and spreads, over a holding period equal to the shorter of ten business days or the maturity of the swap or netting portfolio.”).

⁵⁶ *Id.* at 699.

⁵⁷ *Id.* at 700.

debt securities or asset backed securities guaranteed by U.S. government-sponsored enterprise with some direct financial support from U.S. government; (6) securities guaranteed by the Bank for International Settlements, the International Monetary Fund, or a multilateral development bank; (7) publicly-traded debt deemed acceptable as initial margin by prudential regulators; and (8) publicly-traded common equity securities in S&P or other indices; (9) redeemable pooled investment securities; and (10) gold.⁵⁸

b. Margin Haircuts

Second, the CSE must calculate the value of the initial margin using a formula that the CFTC has incorporated into the CFTC-FSMR: the product of the market value of the collateral times one minus the applicable haircut, that is, discount.⁵⁹ The FSMP authorizes: (1) an 8 percent haircut for initial margin collateral denominated in a currency different from the currency of the settlement for the uncleared swap; and (2) additional discounts according to the standardized haircut schedule.⁶⁰ Due to the technical rigor of the CFTC-FSMR, CSEs must be diligent in their valuations of initial margin and variation margin. Accordingly, they must comply with the CFTC-FSMR's particular documentation requirements.⁶¹ Required documentation must demonstrate the "methods, procedures, rules, inputs, and data" used in calculating the initial margin and variation margin⁶² and include procedures for valuation disputes.⁶³

4. Further Rules Regarding Eligible Collateral

Further rules and restrictions apply to the type of collateral eligible for initial margin purposes and variation margin purposes.⁶⁴ As per the CFTC-FSMR, collateral eligible for initial margin exclude securities issued by a (1) the CSE or its affiliate; (2) bank holding company, foreign bank, depository institution, or market intermediary;

⁵⁸ 81 Fed. Reg. at 701-02.

⁵⁹ 81 Fed. Reg. at 701.

⁶⁰ 81 Fed. Reg. at 702 (see incorporated chart—Standardized Haircut Schedule).

⁶¹ 81 Fed. Reg. at 702-03.

⁶² 81 Fed. Reg. at 702-03.

⁶³ *Id.*

⁶⁴ 81 Fed. Reg. at 703.

and (3) nonbanking financial institution supervised by the Federal Reserve under Title I of Dodd-Frank.⁶⁵ On the other hand, eligible collateral for variation margin is limited to immediately available and eligible cash currency.⁶⁶ Accordingly, a CSE must collect and post exclusive and eligible collateral listed in the CFTC-FSMR.⁶⁷

5. Custodial Arrangements with Third Party Custodians

Additionally, CSE are required to enter into custodial arrangements wherein the initial margin is held by a third party custodian (TPC), other than the CSE, a counterparty, or an affiliate of either.⁶⁸ The TPC is prohibited from “rehypothecating, repledging, reusing, or otherwise transferring” such initial margin collateral but is permitted to hold cash collateral in a general deposit account exclusively to purchase eligible non-cash assets enumerated in the CFTC-FSMR, for example, a security issued by or guaranteed by the European Central Bank or other sovereign entity with at most 20

⁶⁵ *Id.*; Arbit & Scott, *supra* note 23 (“Eligible collateral for variation margin under both sets of rules is limited to immediately available cash funds denominated in certain specified currencies. Eligible collateral for initial margin includes, in addition to the foregoing, certain enumerated securities, though haircuts may be required.”).

⁶⁶ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 702; *see generally* Basel Comm. on Banking Supervision and Bd. of the Int’l Org. of Secs. Comms., *Margin Requirements for Non-Centrally Cleared Derivatives* 4 (Mar. 2015), <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD480.pdf> [<https://perma.cc/84F3-HQRP>] (“[M]ethodologies for calculating initial and variation margin that serve as the baseline for margin collected from a counterparty should (i) be consistent across entities covered by the requirements and reflect the potential future exposure (initial margin) and current exposure (variation margin) associated with the portfolio of non-centrally cleared derivatives in question and (ii) ensure that all counterparty risk exposures are fully covered with a high degree of confidence.”).

⁶⁷ *See* Gibson Dunn Alert, *supra* note 46.

⁶⁸ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 702; Ropes Alert, *supra* note 50 (“Initial margin that is posted by a swap entity to a counterparty . . . must be held with a custodian that is not the swap entity, the counterparty, or an affiliate of the swap entity or counterparty (a ‘third-party custodian’).”).

percent risk weight under prudential regulations.⁶⁹ As such, the TPC cannot engage in securities lending, securities borrowing, repurchase agreements, or reverse repurchase agreements with the CSE's initial margin collateral.⁷⁰ However, the CSE may substitute, and the TPC may accept as substitute, previously posted collateral with other qualifying collateral.⁷¹ In addition, the CSE or its affiliate is permitted to act as custodian to initial margin collected from outward facing margin affiliates, that is, foreign margin affiliates.⁷²

D. Cost Benefit Analysis And Implications: CEA § 15(A) Factors

The Commodities and Exchange Act mandates that the CFTC take into consideration the costs and benefits of promulgating a regulation.⁷³ This encompasses the final rule's potential implications on the protection of market participants and the public; efficiency, competitiveness, and financial integrity of futures markets; price discovery; sound risk management practices; and other public interest considerations.⁷⁴ There have been a slew of mixed responses to the CFTC-FSMR as a result.⁷⁵

⁶⁹ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 701-02.

⁷⁰ Ropes Alert, *supra* note 50.

⁷¹ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 702-03; Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 701 (forms of margin).

⁷² *Id.* at 703.

⁷³ Consideration of costs and benefits and antitrust laws, 7 U.S.C. 19(a) (2012) (“(1) In general Before promulgating a regulation under this chapter or issuing an order . . . the Commission shall consider the costs and benefits of the action of the Commission . . . costs and benefits of the proposed Commission action shall be evaluated in light of- (A) considerations of protection of market participants and the public; (B) considerations of the efficiency, competitiveness, and financial integrity of futures markets; (C) considerations of price discovery; (D) considerations of sound risk management practices; and (E) other public interest considerations.”).

⁷⁴ *Id.*

⁷⁵ Ackerman, *supra* note 10 (contrasting the reactions to the final swap margin rules ranging from characterizations as “blindly trusting in large financial institutions” to “centraliz[ing] risk internally without increasing firms’ overall exposure to risk”).

6. Benefits: Protection, Congressional Intent, Consistency, and Systemic Risk Control

Regarding protection of market participants, the margin requirements should reduce overall credit and systemic risk.⁷⁶ Collecting margin protects the non-defaulting counterparties, customers, and the public-at-large from the defaulting entities.⁷⁷ The collateral acts to “absorb the losses” of the defaulting party.⁷⁸ At the same time, there is a balance struck in the scaling back of the 2014 margin requirement proposal.⁷⁹ Essential market participants, such as Goldman Sachs and Citigroup, already collect margin when they enter into uncleared swaps with other covered swap entities and trade with affiliates in a manner “designed to centralize risk internally without increasing firms’ overall exposure to risk.”⁸⁰

Moreover, the exemptions are consistent with Congressional intent insofar as the Commodities Exchange Act, as amended by Title III of the TRIPA,⁸¹ explicitly exempts non-financial end users and their affiliates, that is, commercial end users. CFTC Chairman Massad has notably pointed out that this exemption “seeks to provide a significant safeguard without imposing unnecessary costs on participants whose activities do not create the same level of systemic risk.”⁸² The derivative market is integral for commercial end users in

⁷⁶ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 689 (“[M]argin serves as a first line of defense in protecting an entity from risk arising from uncleared swaps, which ultimately mitigates the possibility of a systemic event.”).

⁷⁷ *Id.*

⁷⁸ *Id.* at 689.

⁷⁹ *Cf.* Ackerman, *supra* note 10 (“[B]ig banks won over CFTC officials in their push to scale back aspects of the agency’s 2014 proposal.”).

⁸⁰ *Id.* (“Over the past year, Goldman Sachs Group Inc., Citigroup Inc. and other big banks won over CFTC officials in their push to scale back aspects of the agency’s 2014 proposal. Banks said the trades between affiliates are designed to centralize risk internally without increasing firms’ overall exposure to risk. They also said their units already collect margin when they enter into swaps with other companies—trades also covered by the rules.”).

⁸¹ 129 Stat. 3. (2015).

⁸² *Hearing to Review the 2015 Agenda for the Commodity Futures Trading Commission Before the Comm. On Agric. House of Representatives*, 114th Cong. 8 (2015) (statement of Hon. Timothy G. Massad, Chairman, Commodities Futures Trading Comm’n) [hereinafter Massad Statement]

hedging transactions.⁸³ Swaps allow commercial end users to offset commercial risk, foil “undue burdens,” and evade “unintended consequences.”⁸⁴ Initial margin requirements may not be vital for relatively minimal material swap exposures.⁸⁵ A corn farmer, for example, can use a corn basis swap to manage overall risk in helping buyers and sellers manage the risk of price differentials. The impact of the corn basis swap trickles down to ensure lower prices and availability for the average corn consumer.⁸⁶

In addition, the CFTC-FSMR is in harmony with the margin requirements on both the international and national level set by the Basel Committee on Banking Supervision and Board of the International Organization of Securities in 2013 and the Prudential Regulators earlier in 2015, respectively.⁸⁷ For example, the minimum

(justifying the congressional intent behind the commercial end user exemption).

⁸³ *Id.* (“For the derivative markets to contribute to the broader economy, they must work well for commercial end-users . . . [by making] sure that our proposed rule on margin for uncleared swaps exempts commercial end-users.”); *Hearing to Review the 2015 Agenda for the Commodity Futures Trading Commission Before the Comm. On Agric. H. of Representatives*, 114th Cong. 8 (2015) (statement of Rep. Austin Scott) (“[E]nd-users, who were not the cause of the financial crisis, are the collateral damage of Dodd-Frank’s reforms Providing relief to the end-user community through much-needed clarifications of the law will continue to be my focus on this Committee.”).

⁸⁴ Massad Statement, *supra* note 82 (“[M]any manufacturers, farmers, ranchers, and other businesses . . . rely on these markets to hedge commercial risks.”).

⁸⁵ *Id.*

⁸⁶ *See id.* (“[Swaps] enable farmers to lock in a price for their crops, utilities to manage their fuel cost, and manufacturers to hedge the price of industrial metals.”).

⁸⁷ Massad Statement, *supra* note 82 (“Europe, Japan and the United States have each proposed rules which are largely consistent, and which reflect a set of standards agreed to by a broader international consensus.”); *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 Fed. Reg. at 645 (“The Commission believes the final rule’s approach is appropriate in assessing a swap counterparty’s overall size and risk exposure and providing for a simple and transparent measurement of exposure that presents only a modest operational burden. This approach also is intended to achieve consistency with other jurisdictions based on the 2013 international framework which sets a threshold based on overall gross notional non-centrally cleared derivatives activity.”).

threshold required by both the Prudential Regulators and the CFTC is \$500,000USD, while that of Basel is \$500,000EUR.⁸⁸ The CFTC has also revised the method for calculating margin to better conform to global standards⁸⁹ and has worked with Prudential Regulators in crafting the CFTC-FSMR to follow closely to the prudential margin requirements. In fact, there are only a handful of notable differences between the two.⁹⁰ This harmonization promotes sound risk management practices with pooled guidance from international regulators, the Prudential Regulators, the CFTC, and the SEC to help identify potential future exposure throughout the market-at-large.⁹¹

1. Costs: Insufficient Protection, Fragmentation, Opportunity, and Complexity

⁸⁸ *Hearing to Review the 2015 Agenda for the Commodity Futures Trading Commission Before the Comm. On Agric. House of Representatives*, 114th Cong. 12 (2015); Margin and Capital Requirements for Covered Swap Entities, Dep't of the Treasury Office of the Comptroller of the Currency, 12 CFR Part 45; Bd. of Govs. of the Fed. Reserve Sys., 12 CFR Part 237; FDIC, 12 CFR Part 349; FCA 12 CFR Part 624; FHFA, 12 CFR Part 1221; Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 698.

⁸⁹ See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 Fed. Reg. 59,898, 59,934 (Oct. 3, 2014); Ed Beeson, *Spirited CFTC Launches New Uncleared Swap Margin Plan*, LAW 360 (Sept. 17, 2014), <http://www.law360.com.ezproxy.bu.edu/articles/575660/spirited-cftc-launches-new-uncleared-swap-margin-plan> [<http://perma.cc/VWM3-9YKX>].

⁹⁰ SIDLEY, *supra* note 2 (“The Swap Margin Rules closely follow the Prudential Regulators’ and CFTC’s respective 2014 rule proposals (the 2014 PR Rule Proposal and the 2014 CFTC Rule Proposal; collectively, the 2014 Rule Proposals). They are also largely consistent with the policy framework establishing minimum standards for margin requirements for non-centrally cleared derivatives published in March 2015 by the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions (the BCBS/IOSCO Standards).”).

⁹¹ Massad Statement, *supra* note 82 (“Harmonization is critical to creating a sound international framework for regulation . . . First, we must make sure that inter-affiliate transactions are not used as a loophole or as a means to escape the obligation to collect margin from third parties.”).

The main sentiment on the other side is that the CFTC-FSMR has removed a “vital shock absorber”⁹² especially because posting initial margin and variation margin by collecting eligible collateral from the counterparty mitigates the exposure risk. CFTC Commissioner Sharon Bowen has written the new rule as “a return to blindly trusting in large financial institutions.”⁹³ Notwithstanding enhanced reporting requirements⁹⁴ for all swaps—cleared and uncleared—this sentiment carries some merit given that as much as 50 percent of the market for certain uncleared swaps, for example, uncleared credit default swaps (integral to the cause of the financial crisis) and interest rate swaps, could be deemed exempt from initial margin requirements, a vital tool in minimizing risk.⁹⁵ Under the CFTC-FSMR, Swap Entities and Financial End Users with at least \$8 billion in Material Swaps Exposure are required to secure the uncleared swap transaction with a CSE. Others are exempt but it is indeterminate if such categorization will result in sound policy.⁹⁶

Another criticism is that the global swap markets are too fragmented, with lack of harmony and unfavorable limits on liquidity.⁹⁷ On the one hand, Swap Dealers, Major Swap Participants,

⁹² Ed Beeson, *Split CFTC Finalizes Swap Margin Rules Amid Controversy*, LAW 360 (Dec.16, 2015), <http://www.law360.com.ezproxy.bu.edu/articles/738692/split-cftc-finalizes-swap-margin-rules-amid-controversy> [<http://perma.cc/YV35-L2QX>] (“[A]gency measures fell under a blistering dissent from one of its commissioners, Democrat Sharon Bowen, who said changes made to the final rules following pressure from the industry have removed a “vital shock absorber” that would allow financial institutions to survive a collapse were a credit-default swap to go awry.”).

⁹³ Dissenting Statement of Commissioner Sharon Y. Brown, 81 Fed. Reg. 636, app. at 707 (Jan. 6, 2016) (Appendix 3) (explaining that the CFTC “should not be trying to guess whether a large, complex financial institution’s global risk controls will be sufficient to protect the swap dealers we regulate”); Andrew Ackerman, *supra* note 10 (“Ms. Bowen said ahead of the vote that the scaled-back provisions are a ‘mistake’ that could lead to a repeat of the financial crisis. That is when firms like American International Group Inc.’s soured trades on swaps—the same type of instruments covered by Wednesday’s new rules—led to large taxpayer bailouts.”).

⁹⁴ See generally Massad Statement, *supra* note 82.

⁹⁵ Beeson, *supra* note 92.

⁹⁶ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 636.

⁹⁷ *Hearing to Review the 2015 Agenda for the Commodity Futures Trading Commission Before the Comm. On Agric. H. of Representatives*, 114th Cong. 8 (2015).

and Financial End Users may have to rethink their corporate structure, optimize affiliate transactions to adjust to the “require[ment of] more capital, as the operational and financial costs of transactions will rise.”⁹⁸ On the other hand, Non-Financial End Users and Commercial End Users are excluded but the impact is not guaranteed to be positive: the FSMR-at-large may cause a “rise in end-user prices reflecting the cost increases induced by this new regulation in the overall value chain.”⁹⁹ Since the CFTC-FSMR defines Financial End Users to include insurance companies, banks, bank holding companies, practically all hedge funds, eligible alternative investment vehicles, eligible securitization vehicles, these aforementioned entities will be subject to at least as much variation margin requirements in connection with uncleared swaps with CSEs.¹⁰⁰ If they also have material swaps exposure, they will be subject to initial margin requirements as well. For example, hedge funds with material swaps exposure will lose formerly-available flexibility in negotiating their own collateral terms and thresholds with swap counterparties.¹⁰¹

The FDIC has estimated that “financial institutions and their counterparties are expected to be required to post an additional \$315 billion of collateral to cover their uncleared swaps.”¹⁰² The

⁹⁸ SIA, *supra* note 31; *see* Gibson Dunn Alert, *supra* note 46.

⁹⁹ SIA, *supra* note 31; *see* Gibson Dunn Alert, *supra* note 46 (“[T]he uncleared swaps subject to margin requirements compared to cleared swaps or futures will be much more expensive (as the margin calculation for uncleared swaps is based off of a longer liquidation timeframe than for cleared swaps or futures).”).

¹⁰⁰ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. at 636.

¹⁰¹ SIDLEY, *supra* note 2 (“For fund managers that have been accustomed to negotiating their own favorable collateral terms with their swaps counterparties (e.g., negotiated unsecured thresholds), the Swap Margin Rules will impose new constraints. However, required initial margin, where the fund has material swaps exposure, will be posted in both directions (subject to the \$50 million initial margin threshold and \$500,000 minimum transfer amount). Although initial margin amounts will not be netted against one another for posting purposes (and will be subject to mandatory third-party custodial arrangements and a prohibition on rehypothecation), the presence of two-way initial margin posting will limit credit exposure, provided the arrangements are subject to enforceable netting agreements. Funds that do not have material swaps exposure will retain their ability to negotiate initial margin terms with CSEs that may be more favorable than those required by the Swap Margin Rules.”).

¹⁰² SIA, *supra* note 31.

opportunity cost on the use of margin is substantial because the same funding required for posting collateral could have been used to fund investment opportunities.¹⁰³ The CFTC expects that the “cost[] of the final rule would most likely range from \$290 million to \$2.05 billion,” but can amount to as much as \$23.26 billion.¹⁰⁴

Moreover, the CFTC-FSMR may disadvantage U.S. Financial End Users with \$8 billion Material Swaps Exposure because they have to deliver initial margin as collateral to the CSE when the Global Standard exceeds \$11 billion.¹⁰⁵ Moreover, significant disparities in margin rules on the international and domestic level will result in overlapping supervisory authorities, “undue competitive distortions,” and “regulatory arbitrage.”¹⁰⁶ It is foreseeable that the increased costs of CFTC-FSMR compliance will lead to decreases in liquidity; changes in trading strategies, structures, and operations; and more stringent assessments in counterparty selection.¹⁰⁷

Some even point out that the CFTC-FSMR is too complex.¹⁰⁸ Under the CFTC-FSMR, counterparties are “required to segregate received Initial Margin from their assets and other clients’ assets, the operational complexity of custody will rise significantly.”¹⁰⁹ This

¹⁰³ *Table B, Estimated Annual Cost of Initial Margin Requirements for CSEs and Their Covered Counterparties*, 81 Fed. Reg. 636, app. at 692 (Jan. 6, 2016) (Appendix A to Preamble). *But see* 17 C.F.R. § 23.150-161 (“The final margin rule incorporates various cost-mitigating provisions—such as the initial margin thresholds, expansion of eligible collateral for variation margin for financial end users, and minimum transfer amount—to contain potentially adverse impacts on the market and the public.”).

¹⁰⁴ *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 636, app. at 692 (Jan. 6, 2016) (Appendix A to Preamble).

¹⁰⁵ *See also* Ed Beeson, *Spirited CFTC Launches New Uncleared Swap Margin Plan*, LAW 360 (Sept. 17, 2014), <http://www.law360.com.ezproxy.bu.edu/articles/575660/spirited-cftc-launches-new-uncleared-swap-margin-plan> [<http://perma.cc/VWM3-9YKX>].

¹⁰⁶ *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 Fed. Reg. at 681 (“The Commission also recognizes that many CSEs are part of bank holding companies with global operations that are subject to overlapping jurisdictions by multiple supervisory authorities, both domestic and foreign. Significant disparities in margin rules can lead to undue competitive distortions and ultimately, opportunities for regulatory arbitrage.”).

¹⁰⁷ Gibson Dunn Alert, *supra* note 46.

¹⁰⁸ *See generally* SIA, *supra* note 31.

¹⁰⁹ *Id.*

inevitably will lead to multiple legal agreements with different custodians, including qualifying TPCs, rigorous reporting on collateral and models for collateral valuation, and “less flexible substitution mechanisms.”¹¹⁰ Moreover, arguably arbitrary minimum transfer amounts (set at \$500,000 for both initial and variation margin), intermittently changing material swaps exposures for a given firm (set at \$8 billion), and no strong designation of which model to use for calculating required margins, will require CSEs to remain vigilant in order to keep in compliance.¹¹¹

E. Conclusion

In light of the CFTC-FSMR’s potential effects on the important issues of market participant protection; protection of the public; efficiency, competitiveness, and financial integrity of futures markets; price discovery; sound risk management practices; and other public interest considerations,¹¹² it appears the CFTC is on the right track.¹¹³ Despite the aforementioned costs and concerns over complexity, Dodd-Frank intimates effective swap market regulation for non-standardized, uncleared swaps that are subject to significant

¹¹⁰ SIA, *supra* note 31.

¹¹¹ See Ackerman, *supra* note 10.

¹¹² Consideration of Costs and Benefits and Antitrust Laws, 7 U.S.C. 19(a).

¹¹³ Commodity Futures Trading Commission is not required to promulgate only rules that have low or no costs; rather, the agency is simply required to show that it “considered” and “evaluated” costs of rule in accordance with 7 USCS § 19(a); *Inv. Co. Inst. v. U.S. CFTC*, 891 F. Supp. 2d 162, 207 (D.D.C. 2012); Ed Beeson, *Split CFTC Finalizes Swap Margin Rules Amid Controversy*, LAW 360 (Dec.16, 2015), <http://www.law360.com.ezproxy.bu.edu/articles/738692/split-cftc-finalizes-swap-margin-rules-amid-controversy> [<http://perma.cc/YV35-L2QX>] (“[T]he final rule provides significant protections from the risks of such transactions, including requiring the centralized risk management program. Initial margin also will be required when an inter-affiliate trade involves a non-U.S. affiliate that doesn’t collect initial margin off of its own third-party trades.”). *Contra* Ed Beeson, *Split CFTC Finalizes Swap Margin Rules Amid Controversy*, LAW 360 (Dec.16, 2015), <http://www.law360.com.ezproxy.bu.edu/articles/738692/split-cftc-finalizes-swap-margin-rules-amid-controversy> [<http://perma.cc/YV35-L2QX>] (quoting Massachusetts Senator Elizabeth Warren “who in the run-up to the rulemaking reportedly blasted the change as another example of Wall Street interests watering down critical market protections created by Dodd-Frank.”).

exposure. Consistent with the vision of international regulators as well as our Prudential regulators, the CFTC-FSMR seeks to remedy the risk of cascading defaults from the more likely large financial institutions with large swap activity while granting some relief for those entities that were not the primary catalysts of the financial crisis.¹¹⁴

At the same time, the CFTC-FSMR, in imposing a general requirement for variation margin in inter-affiliate uncleared swap transactions, curtails more immediate and tangible risk by “forc[ing] entities to recognize losses . . . already incurred.”¹¹⁵ In harmonizing the initial and variation margin requirements with other key regulators, instituting variation margin calculation and control criteria, segregating initial margin collateral into the hands of a custodian, implementing documentation requirements, and carefully exempting certain non-financial and other eligible entities, the CFTC-FSMR is a sure step towards a more workable and effective regulatory framework for uncleared swaps.¹¹⁶ Nevertheless, it will effectuate a shift in the way swap dealers, major swap market participants, and other qualified entities do business in the uncleared swaps market.¹¹⁷

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¹¹⁴ Massad Statement, 81 Fed. Reg. at 705 (Appendix 2); Ross Pazzol, *CFTC Adopts Final Margin Rules for Swap Dealers*, THE NAT'L LAW REV. (Dec. 18, 2015), <http://www.natlawreview.com/article/cftc-adopts-final-margin-rules-swap-dealers> [<https://perma.cc/Q7CE-QEUR>].

¹¹⁵ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg., app. at 707 (Brown, dissenting) (“Variation margin, on the other hand, force entities to recognize losses they have already incurred. Together, variation margin and initial margin reduce systemic risk and excess leverage. They help ensure the parties have the capacity to perform on the swap over time.”).

¹¹⁶ See *Margin Requirements for Uncleared Swaps*, SULLIVAN & CROMWELL LLP (Jan. 7, 2016), https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Margin_Requirements_for_Uncleared_Swaps.pdf [<https://perma.cc/2V8T-MPG3>] (Jan. 7, 2016); Beeson, *supra* note 113.

¹¹⁷ Gibson Dunn Alert, *supra* note 46.

¹¹⁸ Student, Boston University School of Law (J.D. 2017).