

## Supporting Statement

### Margin and Capital Requirements for Covered Swap Entities

OMB Control No. 1557-NEW

#### A. Justification.

##### 1. Circumstances that make the collection necessary:

Title VII of the Dodd-Frank Act<sup>1</sup> established a comprehensive regulatory framework for derivatives, which are generally characterized as swaps<sup>2</sup> and security-based swaps.<sup>3 4</sup>

Sections 731 and 764 of the Dodd-Frank Act require the registration and regulation of swap dealers and major swap participants and security-based swap dealers and major security-based swap participants, respectively (collectively, “swap entities”).<sup>5</sup> For certain types of swap entities that are prudentially regulated by one of the Agencies,<sup>6 7</sup> Sections 731 and 764 of the Dodd-Frank Act require the Agencies to jointly adopt rules for swap entities under their respective jurisdictions imposing: capital requirements; and initial and variation margin requirements on all non-cleared swaps.<sup>8</sup> Swap entities that are prudentially regulated by the Agencies and therefore subject to the proposed rule are referred to herein as “covered swap entities.”

Sections 731 and 764 of the Dodd-Frank Act require the Commodity Futures Trading Commission and the Securities and Exchange Commission to separately adopt rules imposing capital and margin requirements for swap entities for which there is no prudential regulator. The Dodd-Frank Act requires the CFTC, SEC, and the Agencies to establish and maintain, to the maximum extent practicable, capital and margin requirements that are comparable, and to

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<sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111-203, 124 Stat. 1376 (July 21, 2010).

<sup>2</sup> Interest rate swaps, commodity-based swaps, and broad-based credit swaps.

<sup>3</sup> Single-name and narrow-based credit swaps and equity-based swaps.

<sup>4</sup> 7 U.S.C. § 1a(47); 15 U.S.C. § 78c(a)(68). Swaps and security-based swaps are sometimes referred to herein collectively as “derivatives.”

<sup>5</sup> 7 U.S.C. § 6s; 15 U.S.C. § 78q-8.

<sup>6</sup> 7 U.S.C. § 1a(39).

<sup>7</sup> The Agencies are the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency and the Farm Credit Administration.

<sup>8</sup> 7 U.S.C. § 6s(e)(1); 15 U.S.C. § 78q-8(e)(1).

consult with each other periodically (but no less than annually) regarding these requirements.<sup>9</sup>

The capital and margin standards for swap entities imposed under sections 731 and 764 of the Dodd-Frank Act are intended to offset the greater risk to the swap entity and the financial system arising from the use of swaps and security-based swaps that are not cleared. They require that the capital and margin requirements imposed on swap entities must, to offset the greater risk to the swap entity and the financial system arising from the use of non-cleared swaps: help ensure the safety and soundness of the swap entity; and be appropriate for the greater risk associated with the non-cleared swaps and non-cleared security-based swaps held as a swap entity. In addition, they require the Agencies, in establishing capital rules for covered swap entities, to take into account the risks associated with other types of swaps or classes of swaps or categories of swaps engaged in and the other activities conducted by that person that are not otherwise subject to regulation applicable to that person by virtue of the status of the person as a swap dealer or a major swap participant.

## 2. Use of the information:

The information requirements in joint regulations proposed by the Agencies are found in §§ \_\_.2(t)(3), \_\_.2(t)(4), \_\_.4(e)(2)(i), \_\_.5, \_\_.6(d)(2)(i), \_\_.8(c)(1), \_\_.8(c)(2), \_\_.8(c)(3), \_\_.8(d)(3), \_\_.8(d)(8), \_\_.8(d)(9), \_\_.8(e)(1), \_\_.8(f)(2), \_\_.8(f)(3), \_\_.8(f)(4), and \_\_.8(g).

Compliance with the information collections found in sections \_\_.2(t)(3) and \_\_.2(t)(4) would be mandatory for any covered swap entity wishing to take a qualifying master netting agreement into account for purposes of calculating initial margin or variation margin.

Compliance with the information collections found in §§ \_\_.4(e)(2)(i), \_\_.5, and \_\_.6(d)(2)(i) would be mandatory for all covered swap entities.

Compliance with the information collections found in §§ \_\_.8(c)(1), \_\_.8(c)(2), \_\_.8(c)(3), \_\_.8(d)(3), \_\_.8(d)(8), \_\_.8(d)(9), \_\_.8(d)(10), \_\_.8(d)(12), \_\_.8(e)(1), \_\_.8(f)(2), \_\_.8(f)(3), \_\_.8(f)(4), and \_\_.8(g) would be mandatory for all covered swap entities wishing to use an initial margin model to calculate initial margin requirements.

Section \_\_.2 defines terms used in the proposed rule, including the definition of “qualifying master netting agreement” contained in § \_\_.2(t). Sections \_\_.2(t)(3) and \_\_.2(t)(4) provide that, with respect to a qualifying master netting agreement, a covered swap entity must (i) conduct sufficient legal review of the agreement to conclude with a well-founded basis that the agreement meets specified criteria and (ii) establish and maintain procedures for monitoring relevant changes in law. The term “qualifying master netting agreement” is used elsewhere in the proposed rule to specify instances in which a covered swap entity may (i) calculate variation margin on an aggregate basis across multiple swaps and security-based swaps and (ii) calculate initial margin requirements under an initial margin model on a portfolio basis.

Section \_\_.4 requires that on and after the date on which a covered swap entity enters into

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<sup>9</sup> 7 U.S.C. § 6s(e)(3); 15 U.S.C. § 78q-8(e)(3).

a non-cleared swap or non-cleared security-based swap, the covered swap entity shall collect variation margin from the counterparty to such swap or security-based swap in specified amounts. Section \_\_.4(e)(2)(i) requires that, in cases where a counterparty refuses to provide required variation margin, a covered swap entity demonstrated upon request to the satisfaction of the relevant Agency that it has made appropriate efforts to collect the required variation margin unless it has otherwise made the necessary efforts to attempt to collect the required variation margin, including the timely initiation and continued pursuit of formal dispute resolution mechanisms.

Section \_\_.5 requires a covered swap entity to execute trading documentation with each counterparty that (i) includes credit support arrangements that grant the covered swap entity the contractual right to collect initial margin and variation margin in such amounts, in such form, and such circumstances as are required by the initial margin and variation margin requirements set forth in the proposed rule and (ii) meets other specified criteria.

Section \_\_.6 establishes certain forms of eligible collateral that a covered swap entity shall collect for initial margin and variation margin required pursuant to this part and requires a covered swap entity to monitor the market value of any eligible collateral it has collected to satisfy initial margin or variation margin required by this part and, to the extent that the market value of such collateral has declined, collect such additional eligible collateral as is necessary to bring itself into compliance with the margin requirements of this part. Section \_\_.6(d)(2)(i) requires that, in cases where a counterparty refuses to provide required additional margin, a covered swap entity demonstrated upon request to the satisfaction of the relevant Agency that it has made appropriate efforts to collect the required additional margin unless it has otherwise made the necessary efforts to attempt to collect the required additional margin, including the timely initiation and continued pursuit of formal dispute resolution mechanisms.

Section \_\_.8 establishes standards for initial margin models. These standards include:

- A requirement that the covered swap entity receive prior approval from the relevant Agency based on demonstration that the initial margin model meets specific requirements (§§ \_\_.8(c)(1) and \_\_.8(c)(2));
- A requirement that a covered swap entity notify the relevant Agency in writing before extending use of the model to additional product types, making certain changes to the initial margin model, or making material changes to modeling assumptions (§ \_\_.8(c)(3));
- A variety of quantitative requirements, including requirements that the covered swap entity validate and demonstrate the reasonableness of its process for modeling and measuring hedging benefits, demonstrate to the satisfaction of the relevant Agency that the omission of any risk factor from the calculation of its initial margin is appropriate, demonstrate to the satisfaction of the relevant Agency that any conversion of initial margin calculated using a different holding period is appropriate, periodically review and, as necessary, revise the data used to calibrate the initial margin model to ensure that the data incorporate an

appropriate period of significant financial stress (§§ \_\_.8(d)(3), \_\_.8(d)(8), \_\_.8(d)(9), \_\_.8(d)(12));

- A requirement that a covered swap entity review its initial margin model annually (§ \_\_.8(e));
- A requirement that the covered swap entity validate its initial margin model initially and on an ongoing basis, describe to the relevant Agency any remedial actions being taken, and report internal audit findings regarding the effectiveness of the initial margin model to the covered swap entity's board of directors or a committee thereof (§§ \_\_.8(f)(2), \_\_.8(f)(3), and \_\_.8(f)(4)); and
- A requirement that the covered swap entity adequately document all material aspects of its initial margin model (§ \_\_.8(g)).

3. Consideration of the use of improved information technology:

National banks may use any information technology that permits review by OCC examiners.

4. Efforts to identify duplication:

The information required is unique. It is not duplicated elsewhere.

5. Methods used to minimize burden if the collection has an impact on a substantial number of small entities:

Not applicable.

6. Consequences to the Federal program if the collection were conducted less frequently:

Conducting the collection less frequently would present safety and soundness risks.

7. Special circumstances necessitating collection inconsistent with 5 CFR Part 1320:

None. The information collection is conducted in accordance with OMB guidelines in 5 CFR part 1320.

8. Efforts to consult with persons outside the agency:

The agencies published a notice of proposed rulemaking in the *Federal Register* for comment on May 11, 2011. 76 FR 27564.

9. Payment to respondents:

None.

10. Any assurance of confidentiality:

There is no assurance of confidentiality, with the exception of certain model validation and other counterparty-specific information.

11. Justification for questions of a sensitive nature:

There are no questions of a sensitive nature.

12. Burden estimate:

§\_\_.2 – Definitions, §\_\_.5 – Documentation of margin matters, and §\_\_.8(g) -- Documentation: recordkeeping – 5 hours per respondent.

§\_\_.4(e)(2)(i) – Variation margin and §\_\_.6(d)(2)(i) – Eligible collateral: recordkeeping -- 4 hours per respondent.

§\_\_.8(c) and (d) – Initial margin model: reporting – 240 hours per respondent.

§\_\_.8(e) -- Periodic review and §\_\_.8 (f) – Control, oversight and validation mechanisms: recordkeeping – 40 hours per respondent.

20 respondents @ 289 hours per respondent = 5,780 hours

13. Estimate of annualized costs to respondents (excluding cost of hour burden in Item #12):

None.

14. Estimate of annualized costs to the government:

None.

15. Changes in burden:

Former: 0 respondents; 0 hours  
New: 20 respondents; 5,780 hours  
Difference: + 20 respondents; + 5,780 hours

16. Information regarding collections whose results are planned to be published for statistical use:

No publication for statistical use is contemplated.

17. Display of expiration date:

Not applicable.

18. Exceptions to certification statement:

Not applicable.

B. Collections of Information Employing Statistical Methods.

Not applicable.