

SUPPORTING STATEMENT
Margin and Capital Requirements for Covered Swap Entities
(OMB No. 3064-NEW)

INTRODUCTION

The FDIC is requesting approval from the OMB to establish a new information collection comprised of reporting and recordkeeping requirements contained in a notice of proposed rulemaking on Margin and Capital Requirements for Covered Swap Entities, jointly issued by the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB), the Farm Credit Administration (FCA), and the Federal Housing Financing Agency (FHFA), to implement sections 731 and 764 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), Pub. L. No. 111-203, 124 Stat 1376 (2010) (proposed rule).

JUSTIFICATION

1. Circumstances and Need

Sections 731 and 764 of the Dodd Frank Wall Street Reform and Consumer Protection Act (Dodd Frank Act) require the FDIC, the FRB, the OCC, the FCA, and the FHFA (collectively, the Agencies) to establish minimum margin and capital requirements for registered swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants for which one of the Agencies is the prudential regulator (covered swap entities). Specifically, sections 731 and 746 require the Agencies to jointly issue regulations that address minimum margin and capital requirements for covered swap entities to address certain derivatives they enter into that are not cleared through a clearinghouse (OTC derivatives).

The proposed rule requires covered swap entities to calculate and collect initial margin and variation margin from all counterparties. For swap entities, the proposed rule requires reciprocal collection from other swap entities for all initial and variation margin requirements. However, the proposed rule provides a series of risk-based margin collection thresholds for covered swap entities that are designed to limit the impact of margin collection requirements on lower risk financial end users. The proposed initial margin and variation margin collection requirements for covered swap entities change as the characteristics of their counterparties change. Specifically, the collection requirements are different for: 1) covered swap entity-to-swap entity transactions; 2) covered swap entity to high- and low-risk financial end user transactions; and 3) covered swap entity-to-nonfinancial end user transactions. For nonfinancial (commercial) end users, the proposed rule requires a covered swap entity to calculate a credit exposure limit and collect initial margin and variation margin from a commercial end user when the credit exceeds the calculated limit. The proposed rule does not contain an explicit minimum supervisory threshold for margin collection from commercial end users.

In addition to the requirements for calculating and collecting initial and variation margin, the proposed rule requires a covered swap entity to execute trading documentation with each counterparty that 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. The trading documentation must also specify (i) the methods, procedures, rules, and inputs for determining the value of each swap or security-based swap for purposes of calculating variation margin requirements and (ii) the procedures by which any disputes concerning the valuation of swaps or security-based swaps, or the valuation of assets collected or posted as initial margin or variation margin, may be resolved.

2. Use of Information Collected

The information collected under the proposed rule will be used by regulators to verify compliance with the proposed rule, by bank management to verify that contractual obligations are being met, and provide bank management with analysis of the ongoing risks of uncleared OTC derivative exposures. Under current safety and soundness guidance and capital rules issued by the appropriate Federal banking agencies, banks are required to identify, measure, monitor and control the risks of counterparty exposures arising from the use of derivatives contracts. The additional reporting requirements contained in this proposed rule bolster existing bank internal analysis and onsite examination of the risks posed by OTC derivatives activities by increasing the qualitative and quantitative analysis of the possible losses from counterparty credit risks. This analysis includes variation and initial margin amounts be calculated, and in some cases, requires that counterparties to these transactions provide cash or high quality liquid and marketable securities to reduce these exposures.

3. Use of Technology to Reduce Burden

Banks may use technology to the extent feasible and/or desirable or appropriate to make the required reports and to maintain the required records.

4. Efforts to Identify Duplication

The reporting and recordkeeping requirements in the rule are new and are not otherwise duplicated.

5. Minimizing the Burden on Small Banks

The proposed rule could impact two types of small entities: (1) financial institutions that are swap entities that are subject to the proposed rule's capital and margin requirements; and (ii) counterparties that engage in derivatives transactions with swap entities that are subject to the proposed rule's margin requirements. Based on 2010 Call Report data, the Agencies do not expect that any small depository is likely to be a swap entity that is subject to the rule's capital and margin requirements. Regarding counterparties that engage in derivatives transactions with swap entities that are subject to the rule's margin requirements, the number of such counterparties and the extent to which certain types of companies are likely to be counterparties are unknown. However, the Agencies have requested comment on the impact of the margin requirements on end users from which swap entities may be required to collect initial margin

and/or variation margin and have solicited comment on any approaches that would reduce the burden on all counterparties, including small entities.

6. Consequences of Less Frequent Collection

The reporting and recordkeeping requirements in this information collection are either event-generated or annual. The event-generated reporting and recordkeeping requirements relate to documentation of legal review and establishment of procedures to monitor changes in the law for qualifying master netting agreements; validation and documentation that initial margin models meet specified quantitative standards; and written notification of changes to or problems with initial margin models. Requiring swap entities to prepare reports or maintain records any less frequent than at the time of the event would impair the ability of the Agencies to ensure the safety and soundness of swap entities and circumvent the goals of reducing risk to swap entities and the financial system, increasing transparency for derivatives transactions, and promoting market integrity. The annual reporting and recordkeeping requirements relate to review of initial margin models and reports to boards of directors of internal audit findings. Requiring swap entities to review initial margin models and report on internal findings on an annual basis is considered the minimum necessary to ensure the model effectiveness and to take any necessary remedial action.

7. Special Circumstances

There are no special circumstances.

8. Consultation With Members of the Public

The agencies have published a joint notice of proposed rulemaking seeking public comment on all aspects of the proposal. The request for comment includes specific questions on each aspect of the proposal on which the agencies are seeking feedback. The Agencies will consider all comments received in development of the final rule and will respond to all comments received in the preamble of the final rule document.

9. Payment or Gift to Respondents

No payments or gifts will be provided to respondents.

10. Confidentiality

No assurances of confidentiality have been made by the agencies.

11. Information of a Sensitive Nature

None of the information required to be reported or maintained is of a sensitive nature.

12. Estimated Burden

The estimated reporting and recordkeeping burden is set forth in the following table:

Sections Containing Paperwork Burden	No. of Respondents	Hours Per Response	Frequency Of Response	Total Burden Hours
Sections __.2(t)(3) and (4) - Qualifying master netting agreement, __.5 - Documentation of margin matters, and __.8(g) -- Documentation	3	5	1	15
Sections 4(e)(2)(i) - Variation margin and 6(d) - Eligible collateral	3	4	1	12
Sections __.8(c)(1), (2), and (3) - Requirements for Initial Margin Models, and __.8(d)(3), (8), (9), (10), and (12) - Quantitative Requirements	3	240	1	720
Sections __.8(e)(1) - Periodic review and __.8(f)(2), (3), and (4) - Control, oversight and validation mechanisms	3	40	1	120
Total Burden				867

13. Estimate of Total Annual Cost Burden

Covered institutions already have established systems to accumulate data and produce reports for the internal calculation of margin and capital for counterparty credit risk. Therefore, only nominal additional maintenance costs are involved. It is estimate that for the 3 impacted institutions a total of 40 additional hours periodic review and related control and validation mechanism for a total of 120 hours will be required.

14. Estimate of Total Annual Cost to the Federal Government

The FDIC does not expect to incur material incremental costs in connection with monitoring compliance with the reporting and recordkeeping requirements.

15. Reason for Change in Burden

This is a new information collection.

16. Publication

The information collected will not be published by the FDIC.

17. Display of Expiration Date

The expiration date will be set forth in the preamble to the final rule.

18. Exceptions to Certification

This is not a statistical information collection. Therefore, the FDIC cannot appropriately certify that the information collection “uses effective and efficient statistical survey methodology appropriate to the purpose for which the information is to be collected.”

B. COLLECTION OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.