

Supporting Statement
Margin and Capital Requirements for Covered Swap Entities
OMB Control No. 1557-0251

A. Justification.

1. Circumstances that make the collection necessary:

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) established a comprehensive regulatory framework for derivatives, which are generally characterized as swaps and security-based swaps.

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”). For certain types of swap entities that are prudentially regulated by one of the Agencies,¹ sections 731 and 764 of the Dodd-Frank Act require the Agencies to jointly adopt rules, for the entities under their respective jurisdictions, imposing capital requirements and initial and variation margin requirements on all non-cleared swaps. Swap entities that are prudentially regulated by the Agencies are referred to herein as “covered swap entities.”

Sections 731 and 764 of the Dodd-Frank Act required the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) to separately adopt rules imposing capital and margin requirements for swap entities for which there is no prudential regulator. The Dodd-Frank Act required the CFTC, SEC, and the Agencies to establish and maintain, to the maximum extent practicable, capital and margin requirements that are comparable, and to consult with each other periodically (but no less than annually) regarding these requirements.

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. They also require the Agencies, in establishing capital rules for covered swap entities, to consider 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.

¹ 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.

The swaps-related provisions are intended to reduce risk, increase transparency, promote market integrity within the financial system, and, in particular, address a number of weaknesses in the regulation and structure of the swaps markets that were revealed during the financial crisis. During the financial crisis, the opacity of swap transactions among dealers and between dealers and their counterparties created uncertainty about whether market participants were significantly exposed to the risk of a default by a swap counterparty. A regulatory margin requirement for non-cleared swaps reduces the uncertainty around the possible exposures arising from non-cleared swaps.

In addition, the financial crisis revealed that a number of significant participants in the swaps markets had taken on excessive risk through the use of swaps without sufficient financial resources to make good on their contracts. The imposition of an initial and variation margin requirement on non-cleared swaps will limit the ability of firms to take on excessive risks through swaps without sufficient financial resources. The minimum margin requirement will reduce the amount by which firms can leverage the underlying risk associated with the swap contract.

The OCC has determined that § 45.1(h), previously cleared as part of this information collection, no longer includes a disclosure collection of information because the conditions triggering the disclosure have expired. In addition, the OCC has omitted from this information collection the following provisions that were formerly referenced in the clearance because it has determined that they do not constitute collections of information under the Paperwork Reduction Act: §§ 45.1(d); 45.5(c)(2)(i); 45.8(c)(2); 45.8(d)(5), (12), and (13); 45.8(e); and 45.8(f)(2), (3), and (4).

2. Use of the information:

Twelve CFR 45.2 defines terms referenced in part 45. Under the definition of “eligible master netting agreement,” a covered swap entity that relies on such agreement for purpose of calculating required margin must (1) conduct sufficient legal review of the agreement to conclude with a well-founded basis that the agreement meets specified criteria and maintain sufficient written documentation of that legal review and (2) establish and maintain written procedures for monitoring relevant changes in law and to ensure that the agreement continues to satisfy the requirements of the definition. To demonstrate compliance with this section, records must be retained for as long as the covered swap entity relies on such agreement. The term “eligible master netting agreement” is used elsewhere in the rule to specify instances in which a covered swap entity may (1) calculate variation margin on an aggregate basis across multiple non-cleared swaps and security-based swaps and (2) calculate initial margin requirements under an initial margin model for one or more swaps and security-based swaps.

Section 45.7 generally requires a covered swap entity to ensure that any initial margin collateral that it collects or posts is held at a third-party custodian. Section 45.7(c) requires the custodian to act pursuant to a custody agreement that: (1) prohibits the custodian from rehypothecating, repledging, reusing, or otherwise transferring (through securities lending, securities borrowing, repurchase agreement, reverse repurchase agreement or other means) the collateral held by the custodian, except that cash collateral may be held in a general deposit account with the custodian if the funds in the account are used to purchase certain assets, such

assets are held in compliance with § 45.7, and such purchase takes place within a time period reasonably necessary to consummate such purchase after the cash collateral is posted as initial margin; and (2) is a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding. A custody agreement may permit the posting party to substitute or direct any reinvestment of posted collateral held by the custodian, provided that, with respect to collateral collected by a covered swap entity pursuant to § 45.3(a) or posted by a covered swap entity pursuant to § 45.3(b), the agreement requires the posting party to substitute only funds or other property that would qualify as eligible collateral under § 45.6, and for which the amount net of applicable discounts described in Appendix B would be sufficient to meet the requirements of § 45.3 and direct reinvestment of funds only in assets that would qualify as eligible collateral under § 45.6, and for which the amount net of applicable discounts described in Appendix B would be sufficient to meet the requirements of § 45.3.

Section 45.8 sets forth standards for the use of initial margin models. These standards include: (1) a requirement that the covered swap entity receive prior approval from the OCC based on demonstration that the initial margin model meets specific requirements (§ 45.8(c)(1)); (2) a requirement that a covered swap entity notify the OCC in writing 60 days 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 (§ 45.8(c)(3)); and (3) a requirement that the covered swap entity demonstrate to the satisfaction of the OCC that the omission of any risk factor from the calculation of its initial margin is appropriate, prior to omitting such risk factor (§ 45.8(d)(10)), and demonstrate to the satisfaction of the OCC that the incorporation of any proxy or approximation used to capture the risks of the covered swap entity's non-cleared swaps or non-cleared security-based swaps is appropriate prior to incorporating such proxy or approximation (§ 45.8(d)(11)). Also, if the validation process reveals any material problems with the initial margin model, the covered swap entity must promptly notify the OCC of the problems, describe to the OCC any remedial actions being taken, and adjust the initial margin model to ensure an appropriately conservative amount of required initial margin is being calculated (§ 45.8(f)(3)).

Section 45.8 also sets forth requirements for the ongoing review and documentation of initial margin models. These standards include a requirement that the covered swap entity adequately document all material aspects of its initial margin model (§ 45.8(g)) and that the covered swap entity must adequately document internal authorization procedures, including escalation procedures, that require review and approval of any change to the initial margin calculation under the initial margin model, demonstrable analysis that any basis for any such change is consistent with the requirements of § 45.8, and independent review of such demonstrable analysis and approval (§ 45.8(h)).

Section 45.9 addresses the treatment of cross-border transactions and, in certain limited situations, will permit a covered swap entity to comply with a foreign regulatory framework for non-cleared swaps (as a substitute for compliance with the prudential regulators' rule) if the prudential regulators jointly determine that the foreign regulatory framework is comparable to the requirements in the prudential regulators' rule. Section 45.9(e) allows a covered swap entity to request that the prudential regulators make a substituted compliance determination and

provides that the covered swap entity must provide the reasons therefore and other required supporting documentation. A request for a substituted compliance determination must include a description of the scope and objectives of the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps; the specific provisions of the foreign regulatory framework for non-cleared swaps and security-based swaps (scope of transactions covered; determination of the amount of initial and variation margin required; timing of margin requirements; documentation requirements; forms of eligible collateral; segregation and re-hypothecation requirements; and approval process and standards for models); the supervisory compliance program and enforcement authority exercised by a foreign financial regulatory authority or authorities in such system to support its oversight of the application of the non-cleared swap and security-based swap regulatory framework; and any other descriptions and documentation that the prudential regulators determine are appropriate. A covered swap entity may make a request under § 45.9 only if it is directly supervised by the authorities administering the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps.

Section 45.10 requires a covered swap entity to execute trading documentation with each counterparty that is either a swap entity or financial end user regarding credit support arrangements that: (1) provides the contractual right to collect and post initial margin and variation margin in such amounts, in such form, and under such circumstances as are required; and (2) specifies the methods, procedures, rules, and inputs for determining the value of each non-cleared swap or non-cleared security-based swap for purposes of calculating variation margin requirements, and the procedures for resolving any disputes concerning valuation.

3. Consideration of the use of improved information technology:

Any information technology may be used 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:

On April 7, 2023, the OCC published a notice for 60 days of comment concerning this collection (88 FR 20941). No comments were received.

9. Payment to respondents:

None.

10. Any assurance of confidentiality:

The information will be kept private to the extent permitted by law.

11. Justification for questions of a sensitive nature:

There are no questions of a sensitive nature. No personally identifiable information is collected.

12. Burden estimate:

Regulation	Type of Burden	Number of Respondents	Estimated Annual Frequency	Estimated Average Hours Per Response	Estimated Annual Burden Hours
§ 45.2 Definition of “Eligible Master Netting Agreement,” paragraphs (4)(i) and (ii) § 45.8(g) Documentation § 45.10 Documentation of Margin Matters	Recordkeeping	11	1	5	55
§ 45.7(c) Custody Agreement	Recordkeeping	11	1	100	1,100
§ 45.8(c) and (d) Initial Margin Model	Reporting	11	1	240	2,640
§ 45.8(f)(3) Initial Margin Modeling Report	Reporting	11	1	50	550
§ 45.8(h) Escalation Procedures	Recordkeeping	11	1	20	220
§ 45.9(e) Requests for Determinations	Reporting	11	3	10	330
Totals		11			4,895

Cost of hour burden

$$4,895 \text{ hours} \times \$128.05 = \$626,805$$

To estimate wages the OCC reviewed May 2022 data for wages (by industry and occupation) from the U.S. Bureau of Labor Statistics (BLS) for credit intermediation and related activities (NAICS 5220A1). To estimate compensation costs associated with the rule, the OCC

uses \$128.05 per hour, which is based on the average of the 90th percentile for six occupations adjusted for inflation (5.1 percent as of Q1 2023), plus an additional 34.3 percent for benefits (based on the percent of total compensation allocated to benefits as of Q4 2022 for NAICS 522: credit intermediation and related activities).

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:

Existing Burden: 14,900 hours.

Proposed Burden: 4,895 hours.

Change: -10,005 hours.

The reduction is due to the removal of provisions that were formerly referenced in the clearance due to the determination that they do not constitute collections of information under the Paperwork Reduction Act.

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.