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Derivatives Blog

Spring Forward, Fall Into New Margin Rules

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Welcome to the inaugural post of the Kirkland Derivatives Download! Thank you for reading.

Today we touch on margin requirements for uncleared derivatives. This topic generates frequent questions — which makes sense given how often the landscape has changed since various regulators worldwide started finalizing uncleared margin regulations.

We've all been living with the margin rules promulgated by the CFTC and the various prudential regulators (OCC, FDIC, etc.) for some time. The basic principles are pretty widely understood — mandatory variation margin generally apples to most trades (other than physically settled FX forwards and FX swaps) entered into between dealers and financial firms (excluding, of course, non-financial operating companies), and mandatory initial margin requirements are limited to major users of derivatives — those with "material swaps exposure."

Additionally, the market has acclimated to certain nuances in the United States. For example, swaps *and* security-based swaps are generally subject to uncleared margin rules when traded with bank-regulated dealers, but, generally speaking, *only* swaps are currently subject to margin rules when traded with non-bank-regulated dealers. And TBAs and delayed-settlement CMOs, which fundamentally act like security forwards, are outside the scope of the current uncleared margin regulations.

With new SEC rules and an updated set of FINRA proposals, however, the status quo will change. Come this fall, many dealers making markets in security-based swaps will be required to register with the SEC as security-based-swap dealers. Together

with the SEC's new margin and capital rules for uncleared security-based swaps, this will fill a gap in the existing regulatory architecture, bringing security-based swaps transacted with non-bank dealers into the fold of margin regulations. And it is looking increasingly likely that at some point next year, FINRA Rule 4210 will impose margining requirements on TBAs, delayed-settlement CMOs and other "covered agency transactions."

The immediate implication of both these rules will likely run to documentation. In the case of FINRA Rule 4210, broker-dealers will likely require their buy-side counterparties to negotiate Master Securities Forward Transactions Agreements. And security-based swap dealers will likely ask their customers to update ISDA-based documentation to provide for the SEC's margin requirements, which include mandatory initial margin even for market participants who do *not* have "material swaps exposure." For certain market participants, once these rules "go live," there may be an economic and operational impact stemming from altered margining requirements. We will provide more updates as things develop.

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