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CLIENT ALERT: CFTC FINALIZES EXEMPTION FROM MARGIN REQUIREMENTS FOR UNCLEARED SWAPS

The Commodity Futures Trading Commission (“CFTC”) recently released¹ a final rule and an interim final rule containing good news for many Spiegel clients. Under these rules, most Spiegel clients will remain exempt from a new requirement to post margin for uncleared swaps² with swap dealers or major swap participants, and they will not be required to document or calculate margin for such swaps. For your convenience, this memorandum briefly summarizes key points from these two rules.

Exception for Non-Financial End Users

The final rule establishes initial and variation margin requirements for uncleared swaps entered into by Covered Swap Entities (“CSEs”).³ It does not, however, require these entities to collect margin from counterparties who are non-financial end users. A financial end user is an entity that is not a CSE and is a bank-like entity, a lending company, a money services business, an entity regulated by the Federal Housing Finance Agency, an entity chartered under the Farm Credit Act of 1971, an investment company, an employee benefit plan, or an insurance company.⁴ An entity that is neither a CSE nor a financial end user is a non-financial end user. So long as your utility is not a CSE and is not a financial entity like those described in the rule, it is a non-financial end user.

Under the final rule, a non-financial end user and a CSE entering an uncleared swap are not required:

¹ Final rule and interim final rule both available at: CFTC, 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. pts. 23, 140) (“Final Rule”), <https://www.gpo.gov/fdsys/pkg/FR-2016-01-06/pdf/2015-32320.pdf>.

² Swaps cleared through exchanges must follow exchange rules and required margining.

³ CSEs are defined as those swap dealers and major swap participants that are not regulated by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration, or the Federal Housing Finance Agency.

⁴ The full definition is significantly more complex than this brief paraphrase. 17 C.F.R. § 23.151, definition of “financial end user,” Final Rule, 81 Fed. Reg. at 696.

- To exchange margin;⁵
- To calculate hypothetical initial and variation margin amounts each day for positions held by the non-financial entity if it has material swaps exposure to the CSE;⁶ or
- To complete the documentation required for swaps among CSEs and financial end users.⁷

Exemption for Commercial End-Users

In addition, the interim final rule implements a January, 2015 statutory provision that exempts from the margin rules uncleared swaps in which a counterparty qualifies for an exemption or exception from clearing under 7 U.S.C. §§ 2(h)(7)(A), 2(h)(7)(D), or 6(c)(1). An entity that falls within the definition of a “financial end user” and would thus otherwise be subject to the margin requirements for uncleared swaps is nevertheless exempt from those requirements if it fits the criteria in one of those three statutory sections. 17 C.F.R. § 23.150(b). The first is most likely to be relevant to Spiegel clients; it is available to an entity (sometimes referred to as a “commercial end-user”) that “(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 non-cleared swaps,” for those swaps that are being used to hedge or mitigate commercial risk.⁸

Both rules will become effective April 1, 2016. Comments on the interim final rule are invited, and will be due February 5, 2016.

We note that the information contained in this memorandum is highly simplified for general reading and is not intended as legal advice for any specific situation. Please do not hesitate to contact one of the attorneys listed below if you would like advice or additional information.

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⁵ See 17 C.F.R. § 23.151 definitions of “covered counterparty” and “financial end user;” 17 C.F.R. §§ 23.152, 153 (applying margin requirements only to sets of entities that do not include non-financial end-users).

⁶ This requirement was included in the proposed rule but has been deleted from the final rule. It would have implicitly required non-financial end users to monitor their swaps exposure to determine if they exceeded the material swaps exposure threshold. Final Rule, 81 Fed. Reg. at 647-48.

⁷ *Id.*

⁸ 7 U.S.C. § 2(h)(7)(A). If your utility is using the commercial end-user exception to the clearing requirement to allow it to engage in uncleared swaps to hedge or mitigate commercial risk, it should be submitting the notification required by 7 U.S.C. § 2(h)(7)(A)(iii) annually or transaction-by-transaction in accordance with 17 C.F.R. § 50.50(b)(1) or (2).