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BCBS/IOSCO Provide Guidance on Uncleared Swap Margin Rule Implementation

Article By:

Guy C. Dempsey, Jr.

On March 5, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) issued guidance on two issues that have been identified in connection with the implementation of the framework for margin requirements for non-centrally cleared derivatives previously adopted by the two groups that initially went into effect in 2016. This framework is embodied in the margin rules for uncleared swaps that were adopted in the United States by the banking regulators for swap dealers subject to prudential regulation and by the Commodity Futures Trading Commission for other swap dealers.

The first issue arises because the margin rules apply to any swap executed before the effective date of the margin rules (a legacy swap), if the legacy swap is amended in a material way after the effective date. As a result of that principle, market participants have been concerned that all legacy swaps would become subject to margin because of amendments that will be necessary to reflect the replacement of current benchmark interest rates like LIBOR. The guidance on this issue is that "[a]mendments to legacy derivative contracts pursued solely for the purpose of addressing interest rate benchmark reforms do not require the application of the margin requirements for the purposes of the BCBS/IOSCO framework."

The second issue arises because of the fact that the phase-in level for initial margin drops to zero in 2020. That change is likely to bring numerous new small market participants into scope for initial margin, and all of those new parties will be faced with putting in place new initial margin documentation and custodial relationships even though initial margin will not actually be posted until the swap exposure of the party exceeds $50 million. The guidance on this issue is that compliant documentation and related arrangements are not needed "if the bilateral initial margin amount does not exceed the framework's €50 million initial margin threshold." However, the guidance goes on to make the related point that parties must "act diligently when their exposures approach the threshold to ensure that the relevant arrangements are in place if the threshold is exceeded."

Since the guidance takes the form of a press release, it does not have the force of law or regulation, but national regulators are expected to adopt rules that are consistent with these recommendations.

The text of the press release is available here.

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