

**Regulatory Capital Treatment of Certain Centrally-cleared Derivative Contracts
Under Regulatory Capital Rules**

August 14, 2017

Staffs of the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (jointly, the Agencies) are providing supervised institutions with this guidance on the regulatory capital treatment of certain centrally-cleared derivative contracts in light of recent changes to the rulebooks of certain central counterparties.¹ In particular, supervised institutions have requested guidance on the treatment of cleared settled-to-market contracts under the regulatory capital rules of the Agencies.

This supervisory guidance is based on the application of the regulatory capital rules to the facts and circumstances presented. This guidance does not represent new rules or regulations.²

Centrally cleared derivative contracts and netting sets of centrally cleared derivative contracts (together, Cleared Derivative Contract Netting Sets) generally are subject to margin requirements that are assessed by central counterparties at the beginning of the contract and during the life of the contract. Central counterparties have rulebooks that specify how to determine the amount of margin required at the beginning of a Cleared Derivative Contract Netting Set—generally called initial margin—and the amount of additional margin necessary to address subsequent periodic changes in the fair value of the Cleared Derivative Contract Netting Set—generally called variation margin.³

Certain central counterparties recently have modified their variation margin requirements for certain Cleared Derivative Contract Netting Sets. Under the previous requirements of these central counterparties' rulebooks, variation margin transferred to cover the exposure that arises from marking Cleared Derivative Contract Netting Sets to fair value was considered collateral pledged by one party to the other, with title to the collateral remaining with the posting party (Collateralized-to-Market Contracts). Under the central counterparties' revised rulebooks, variation margin for certain Cleared Derivative Contract Netting Sets is considered a settlement payment for the exposure that arises from marking the Cleared Derivative Contract Netting Sets

¹ See 78 Fed. Reg. 62018 (October 11, 2013) (OCC and Board) and 79 Fed. Reg. 20754 (April 14, 2014) (FDIC). The guidance applies solely to the regulatory capital rules of the Agencies, which are codified at 12 CFR part 3 (OCC), 12 CFR part 217 (Board), and 12 CFR part 324 (FDIC) and does not apply to other OCC, Board, or FDIC regulations.

² For purposes of this guidance, section numbers refer to the Agencies' common regulatory capital rules. As an example, section 34 refers to 12 CFR 3.34 for OCC-regulated institutions, 12 CFR 217.34 for Board-regulated institutions, and 12 CFR 324.34 for FDIC-supervised institutions.

³ Variation margin requirements generally derive from marking a Cleared Derivative Contract Netting Set to fair value and transferring an amount equal to the change in fair value of the Cleared Derivative Contract Netting Set from one party to the other. Initial margin may also be adjusted from time to time by the central counterparty to reflect changes in the potential future exposure of the contract or other factors.

to fair value (Settled-to-Market Contracts), with title to the payment transferring to the receiving party. For both types of contracts, the amount of variation margin is based on the change in fair value of the Cleared Derivative Contract Netting Sets since the previous exchange of variation margin.

The regulatory capital rules provide that an institution must determine the trade exposure amount for a Cleared Derivative Contract Netting Set using the methodology described in section 34 of the rules for purposes of the standardized approach risk-based capital calculation and the supplementary leverage ratio calculation.⁴ To calculate this trade exposure amount, an institution must determine the current credit exposure and the potential future exposure of the derivative contract or netting set of derivative contracts.⁵ Current credit exposure is determined by reference to the mark-to-fair value of each derivative contract under U.S. generally accepted accounting principles. Potential future exposure is determined, in part, by multiplying each derivative contract's notional principal amount by a conversion factor.⁶ The conversion factors vary by the category (for example, interest rate, equity) and remaining maturity of the derivative contract.⁷ The regulatory capital rules provide that, for a derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the fair value of the contract is zero, the remaining maturity equals the time until the next reset date.⁸

Accordingly, for the purpose of the regulatory capital rules, if, after accounting and legal analysis, the institution determines that (i) the variation margin payment on a centrally cleared Settled-to-Market Contract settles any outstanding exposure on the contract, and (ii) the terms are reset so that fair value of the contract is zero, the remaining maturity on such contract would equal the time until the next exchange of variation margin on the contract.⁹

In conducting its legal analysis to determine whether variation margin may be considered settlement of outstanding exposure under the regulatory capital rules, an institution should evaluate whether the transferor of the variation margin has relinquished all legal claims to the variation margin and whether the payment of variation margin constitutes settlement under the central counterparty's rulebook, any other applicable agreements governing the derivative

⁴ See 12 CFR 3.35(b)(2) and (c)(2) (citing 12 CFR 3.34), 12 CFR 3.10(c)(4)(ii)(B) (OCC); 12 CFR 217.35(b)(2) and (c)(2) (citing 12 CFR 217.34), 12 CFR 217.10(c)(4)(ii)(B) (Board); and 12 CFR 324.35(b)(2) and (c)(2) (citing 12 CFR 324.34), 12 CFR 324.10(c)(4)(ii)(B) (FDIC). The risk-weighted asset calculations under the advanced approaches capital framework have similar requirements. See 12 CFR 3.133(b)(2) and (c)(2) (citing 12 CFR 3.132) (OCC); 12 CFR 217.133(b)(2) and (c)(2) (citing 12 CFR 217.132) (Board); 12 CFR 324.133(b)(2) and (c)(2) (citing 12 CFR 324.132) (FDIC). The calculations described in this guidance apply to individual derivative contracts and netting sets of cleared derivative contracts.

⁵ 12 CFR 3.34(a), see also 12 CFR 3.132(c) (OCC); 12 CFR 217.34(a), see also 12 CFR 217.132(c) (Board); 12 CFR 324.34(a), see also 12 CFR 324.132(c) (FDIC).

⁶ 12 CFR 3.34(a)(1)(ii), see also 12 CFR 3.132(c)(5)(ii) (OCC); 12 CFR 217.34(a)(1)(ii), see also 12 CFR 217.132(c)(5)(ii) (Board); 12 CFR 324.34(a)(1)(ii), see also 12 CFR 324.132(c)(5)(ii) (FDIC).

⁷ 12 CFR 3.34, Table 1, see also 12 CFR 3.132, Table 2 (OCC); 12 CFR 217.34, Table 1, see also 12 CFR 217.132, Table 2 (Board); 12 CFR 324.34, Table 1, see also 12 CFR 324.132, Table 2 (FDIC).

⁸ 12 CFR 3.34, Table 1, Fn. 2, see also 12 CFR 3.132, Table 2, Fn. 2 (OCC); 12 CFR 217.34, Table 1, Fn. 2, see also 12 CFR 217.132, Table 2, Fn. 2 (Board); 12 CFR 324.34, Table 1, Fn. 2, see also 12 CFR 324.132, Table 2, Fn. 2 (FDIC).

⁹ Id.

contract, and applicable law.¹⁰ Among other items, settlement of any outstanding exposure would generally involve a clear and unequivocal transfer of ownership of the variation margin from the transferor to the transferee, the transferee taking possession of the variation margin, and termination of any claim of the transferor on the variation margin transferred, including any security interest in the variation margin. Any right of the transferor to repurchase or similarly recover the variation margin payment from the transferee would generally be inconsistent with treating the derivative contract as settled under the regulatory capital rules.

¹⁰ Among other requirements, a central counterparty's rulebook may require an institution to satisfy additional obligations, such as payment of other expenses and fees, in order to recognize payment of variation margin as satisfying settlement under the rulebook. The legal and accounting analysis performed by the institution should take all such requirements into account.