

Supporting Statement

Margin and Capital Requirements for Covered Swap Entities

**OMB Control No. 1557-0251
(Assigned but not Approved)**

On May 11, 2011, in connection with a prior proposal for this rulemaking,¹ the OCC submitted an ICR for review. On June 14, 2011, OMB filed a comment on the ICR pursuant to 5 C.F.R. § 1320.11 withholding approval and instructing the OCC to examine public comment in response to the proposal and include in the next ICR a description of how the OCC has responded to any public comments on the ICR, including comments on maximizing the practical utility of the collection and minimizing the burden. This ICR is being filed pursuant to the publication of a second proposal for this rulemaking. No comments were received on the ICR filed pursuant to the first proposal.

A. Justification.

1. Circumstances that make the collection necessary:

Title VII of the Dodd-Frank Act² established a comprehensive regulatory framework for derivatives, which are generally characterized as swaps³ and security-based swaps.^{4 5}

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”).⁶ For certain types of swap entities that are prudentially regulated by one of the Agencies,^{7 8} Sections 731 and 764 of the Dodd-Frank Act require the Agencies to jointly adopt rules for swap entities under their respective jurisdictions imposing: capital requirements; and initial and variation margin requirements on all non-cleared swaps.⁹ Swap entities that are prudentially regulated by the Agencies and therefore subject to the proposed rule are referred to herein as “covered swap entities.”

1 79 FR 27564.

2 Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111-203, 124 Stat. 1376 (July 21, 2010).

3 Interest rate swaps, commodity-based swaps, and broad-based credit swaps.

4 Single-name and narrow-based credit swaps and equity-based swaps.

5 7 U.S.C. § 1a(47); 15 U.S.C. § 78c(a)(68). Swaps and security-based swaps are sometimes referred to herein collectively as “derivatives.”

6 7 U.S.C. § 6s; 15 U.S.C. § 78q-8.

7 7 U.S.C. § 1a(39).

8 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.

9 7 U.S.C. § 6s(e)(1); 15 U.S.C. § 78q-8(e)(1).

Sections 731 and 764 of the Dodd-Frank Act require the Commodity Futures Trading Commission and the Securities and Exchange Commission to separately adopt rules imposing capital and margin requirements for swap entities for which there is no prudential regulator. The Dodd-Frank Act requires 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.¹⁰

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. In addition, they require the Agencies, in establishing capital rules for covered swap entities, to take into account 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.

2. Use of the information:

The information requirements in joint regulations proposed by the Agencies are found in §§ __.2, definition of “eligible master netting agreement, paragraph (4)(i) and (ii), __.5(b)(2)(i), __.8(c)(1), __.8(c)(2), __.8(c)(3), __.8(d)(5), __.8(d)(10), __.8(d)(11), __.8(d)(13), __.8(e), __.8(f)(2), __.8(f)(3), __.8(f)(4), __.8(g), __.8(h), __.9(e), and __.10.

Section __.2 defines terms used in the proposed rule, including the definition of “eligible master netting agreement,” which provides that a covered swap entity that relies on the agreement for purpose of calculating the required margin must (i) conduct sufficient legal review of the agreement to conclude with a well-founded basis that the agreement meets specified criteria and (ii) establish and maintain procedures for monitoring relevant changes in law. The term “eligible master netting agreement” is used elsewhere in the proposed rule to specify instances in which a covered swap entity may (i) calculate variation margin on an aggregate basis across multiple non-cleared swaps and security-based swaps and (ii) calculate initial margin requirements under an initial margin model for one or more swaps and security-based swaps.

Section __.5(b)(2)(i) specifies that a covered swap entity shall not be deemed to have violated its obligation to collect or post margin from or to a counterparty if the covered swap entity has made the necessary efforts to collect or post the required margin, including the timely initiation and continued pursuit of formal dispute resolution mechanisms, or has otherwise demonstrated upon request to the satisfaction of the agency that it has made appropriate efforts to

¹⁰ 7 U.S.C. § 6s(e)(3); 15 U.S.C. § 78o-8(e)(3).

collect or post the required margin.

Section __.8 establishes standards for initial margin models. These standards include:

- A requirement that the covered swap entity receive prior approval from the relevant Agency based on demonstration that the initial margin model meets specific requirements (§§ __.8(c)(1) and __.8(c)(2));
- A requirement that a covered swap entity notify the relevant Agency in writing 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 (§ __.8(c)(3));
- A variety of quantitative requirements, including requirements that the covered swap entity validate and demonstrate the reasonableness of its process for modeling and measuring hedging benefits, demonstrate to the satisfaction of the relevant Agency that the omission of any risk factor from the calculation of its initial margin is appropriate, demonstrate to the satisfaction of the relevant Agency that 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, periodically review and, as necessary, revise the data used to calibrate the initial margin model to ensure that the data incorporate an appropriate period of significant financial stress (§§ __.8(d)(5), __.8(d)(10), __.8(d)(11), __.8(d)(13));
- A requirement that a covered swap entity review its initial margin model annually (Sec. __.8(e));
- A requirement that the covered swap entity validate its initial margin model initially and on an ongoing basis, describe to the relevant Agency any remedial actions being taken, and report internal audit findings regarding the effectiveness of the initial margin model to the covered swap entity's board of directors or a committee thereof (§§ __.8(f)(2), __.8(f)(3), and __.8(f)(4));
- A requirement that the covered swap entity adequately document all material aspects of its initial margin model (§ __.8(g)); and
- 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 this section, and independent review of such demonstrable analysis and approval (§ __.8(h)).

Section __.9(e) allows a covered swap entity to request that the prudential regulators make a substituted compliance determination and 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 rehypothecation 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 this section only if directly supervised by the authorities administering the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps.

Section __.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 (i) 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 (ii) 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:

National banks may use any information technology 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:

The agencies published a second notice of proposed rulemaking in the *Federal Register*

for comment. No comments were received in response to the ICR filed in connection with the first proposal.¹¹

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
§ __.2 Definition of “Eligible Master Netting Agreement,” paragraphs (4)(i) and (ii) § __.8(g) Documentation § __.10 Documentation of Margin Matters	Recordkeeping	20	1	5	100
§ __.5(b)(2)(i) Required Margin	Recordkeeping	20	1	4	80
§ __.8(c) and (d) Initial Margin Model	Reporting	20	1	240	4,800
§ __.8(e) Periodic Review § __.8(f) Control, Oversight, and Validation Mechanisms	Recordkeeping	20	1	40	800
§ __.8(h) Escalation Procedures	Recordkeeping	20	1	20	400
§ __.9(e) Requests for Determinations	Reporting	20	3	10	600
Totals		20			6,780

13. Estimate of annualized costs to respondents (excluding cost of hour burden in Item #12):

None.

14. Estimate of annualized costs to the government:

11 79 FR 27564.

None.

15. Changes in burden:

The increase in burden is due to the fact that this is a new collection.

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.