Statement by
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FDIC Margin
And
Capital Requirements for Covered Swap Entities
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I would like to preface my comments by saying that the three rules on the agenda of the FDIC Board today – a proposed rule on margin requirements for derivatives, a final rule on the liquidity coverage ratio, and a final rule on the leverage capital ratio – address three key areas of systemic risk and taken together are an important step forward in addressing the risks posed particularly by the largest, most systemically important financial institutions.

I support this second proposed rule to implement Sections 731 and 764 of the Dodd Frank Act to establish margin requirements for over-the-counter derivatives entered into by swaps entities consistent with the international agreement reached after issuance of the first NPR. Like the prior NPR, this NPR would be issued jointly by the FDIC along with the OCC, the Federal Reserve, the Farm Credit Administration and the Federal Housing Finance Agency.

Establishing margin requirements for over-the-counter (or "OTC") derivatives is one of the most important reforms of the Dodd Frank Act. Before the crisis, some institutions entered into large OTC derivatives positions without the prudent exchange of collateral—or margin—to support those positions. Going forward, Dodd Frank requires many standardized derivatives to be centrally cleared. For OTC derivatives—those that are not cleared—sections 731 and 764 require covered swaps entities to employ certain prudent collateral practices that derivatives clearinghouses use.

Specifically, under this proposed rule, covered swaps entities must post and collect initial margin, which serves a similar function as a performance bond or security deposit. They must also post and collect variation margin, which is collateral collected from counterparties to offset credit exposures created by changes in the value of their derivatives. The margining practices in this proposed rule should promote financial stability by reducing systemic leverage in the derivatives marketplace, and promote the safety and soundness of banks by discouraging the excessive growth of risky OTC derivatives positions.

A few points are worth highlighting. As I noted earlier, this NPR is consistent with an international agreement published in September, 2013 by the Basel Committee and the International Organization of Securities Commissions. The E.U. and other jurisdictions have already issued similar proposals. International consistency of requirements was a key concern of many commenters on the earlier proposed margin rule the agencies issued in 2011.

Second, the proposed rule does not require covered swaps entities to collect initial margin or variation margin from commercial end users. The proposed rule does require covered swaps entities, the large dealers subject to the rule, to post and collect initial margin on OTC derivatives they transact with each other, and with financial end users that have at least $3 billion in notional amount of non-cleared swaps.

Third, the margin rule likely will have little, if any, impact on community banks. Community banks typically do not have more than $3 billion in notional exposure of uncleared, OTC derivatives, and thus would not meet the proposed threshold for requiring swaps entities to collect initial margin from them. With regard to variation margin, community banks that do engage in uncleared, OTC derivatives are likely already posting variation margin in the normal course of business, or in amounts too small to fall within the scope of the rule.

Fourth, the proposed margin requirements would apply to new, non-cleared swaps entered into after the proposed rule's effective dates. The rule would not be applied retroactively to transactions entered into prior to the effective dates.

In conclusion, I would like to thank the staffs of all the agencies for their continued efforts on this rulemaking. This is an important next step toward implementing critical reforms for OTC derivatives activities and limiting risk in the financial system, and I look forward to the comments.

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