Statement of FDIC Vice Chairman Hoenig on the Capital Treatment of Derivatives and Variation Margin

August 14, 2017

It is important for the financial regulatory agencies to be responsive to legitimate burdens posed by rules and regulations that may have unintended consequences. Unfortunately this is not the case of the recently published supervisory guidance on the regulatory capital treatment of certain centrally-cleared, settled-to-market derivatives contracts, which may have its own negative and unintended consequences. The guidance effectively lowers the amount of capital required for certain derivatives contracts although the underlying economics of the transactions do not change. Under the Agencies' interpretation of footnote 2 of section 34 of the regulatory capital rule[1] the counterparties ostensibly settle on a daily basis, in effect lowering the potential future exposure of the derivative. However, the contract itself has not matured and therefore the potential future exposure and risks of settlement remain. Consequently, the capital available to absorb these risks will be artificially lowered and the residual burden shifted to the public.

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[1] See Table 1 "CONVERSION FACTOR MATRIX FOR DERIVATIVE CONTRACTS" under FDIC Section 324.34 https://www.fdic.gov/regulations/laws/rules/2000-4350.html#fdic2000part324.34