



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D.C. 20551

DIVISION OF SUPERVISION
AND REGULATION

SR 20-29

December 11, 2020

TO THE OFFICER IN CHARGE OF SUPERVISION AT EACH FEDERAL RESERVE BANK AND TO FINANCIAL INSTITUTIONS SUBJECT TO THE INITIAL AND VARIATION MARGIN REQUIREMENTS FOR NON-CLEARED SWAPS AND NON-CLEARED SECURITY-BASED SWAPS

SUBJECT: Treatment of Certain Legacy Swaps Affected by Brexit and the Swap Margin Rule

Applicability: This letter applies to all institutions supervised by the Federal Reserve that are subject to Regulation KK.

The Board of Governors of the Federal Reserve System (“Federal Reserve”) and the Office of the Comptroller of the Currency (“OCC”) are issuing the attached joint statement to explain that the staff of each of the Federal Reserve and OCC will exercise discretion to not recommend taking enforcement action if a covered swap entity is a party to a legacy swap that was amended under certain conditions, consistent with the intent of § 237.2(h)(2) of Regulation KK (“Swap Margin Rule”). The no action statement would allow legacy swaps – those entered into prior to the firm’s compliance date with the Swap Margin Rule – to maintain grandfathered treatment if transferred out of the United Kingdom to the EU or the United States, subject to specific conditions and time limitations.

In July 2020, the Federal Reserve, OCC, Federal Deposit Insurance Corporation, Farm Credit Administration, and Federal Housing Finance Agency (together “agencies”), amended the Swap Margin Rule to assist covered swap entities as they prepared for the event commonly described as “Brexit” (“Brexit amendment”).¹ The Brexit amendment was intended to address a covered swap entity’s ability to service its cross-border clients in the event that the United Kingdom (UK) withdrew from the European Union (EU) without a Withdrawal Agreement pursuant to Article 50(2) of the Treaty on European Union. In the event that no Withdrawal Agreement was ratified between the UK and EU, the Brexit amendment provides that any legacy swap that is currently exempt from the Swap Margin Rule would not become subject to margin

¹ See 84 FR 9940 (March 19, 2019). The agencies subsequently finalized the Brexit IFR. See 85 FR 39754 (August 31, 2020).

requirements by virtue of being modified solely for the purpose of transferring such swap from a UK entity to an affiliate located in the EU or the United States. The relief does not apply if the UK and EU entered into a Withdrawal Agreement because the agencies formulated the Brexit amendment on the premise that a Withdrawal Agreement would preserve “passporting rights” between the UK and EU.

A Withdrawal Agreement between the UK and EU was ratified in January 2020 and includes a transition period (the “Brexit Transition Period”) that, absent an extension, expires on December 31, 2020. The EU continues to recognize UK participation in the EU single market on an interim basis during the Brexit Transition Period. The Withdrawal Agreement does not address the continuation of passporting rights for UK entities to provide financial services in the EU at the expiration of the Brexit Transition Period. Interested parties have represented to the agencies that the UK and EU are negotiating a Free Trade Agreement that may not include passporting rights for UK entities. The absence of a free trade agreement that addresses passporting rights would result in UK entities losing the ability to continue servicing their EU clients when the Brexit Transition Period expires.

The Federal Reserve and the OCC believe it is appropriate to provide certainty to covered swap entities currently operating in the affected jurisdictions as to the legacy status of transferred swaps in light of the uncertainty regarding whether the EU will agree to a free trade agreement granting UK companies passporting rights related to financial services. Therefore, Federal Reserve and OCC staff would not recommend that their respective agencies take action if a covered swap entity is a party to a legacy swap that was amended under the conditions specified in the joint statement.

Reserve Banks are asked to distribute this letter to the supervised organizations in their districts that are subject to Regulation KK and to appropriate supervisory staff. In addition, institutions may send questions via the Board’s public website.²

Michael S. Gibson
Director
Division of
Supervision and Regulation

Attachments:

Statement Regarding Treatment of Certain Legacy Swaps Affected by Brexit and the Swap Margin Rule

² See <http://www.federalreserve.gov/apps/contactus/feedback.aspx>.

**Board of Governors of the Federal Reserve System
Office of the Comptroller of the Currency**

Statement Regarding Treatment of Certain Legacy Swaps Affected by Brexit and the Swap Margin Rule

The Board of Governors of the Federal Reserve System (“Federal Reserve”), the Office of the Comptroller of the Currency (“OCC”), the Federal Deposit Insurance Corporation (“FDIC”), the Farm Credit Administration (“FCA”), and the Federal Housing Finance Agency (“FHFA”) (collectively, the “agencies”) issued an interim final rule on March 19, 2019, to amend the Swap Margin Rule to assist covered swap entities¹ preparing for the event commonly described as “Brexit” (“Brexit IFR”).²

The Brexit IFR was intended to address a covered swap entity’s ability to service its cross-border clients if the United Kingdom (UK) withdrew from the European Union (EU) without a Withdrawal Agreement pursuant to Article 50(2) of the Treaty on European Union. In the event that no Withdrawal Agreement was ratified between the UK and EU, the Brexit IFR provides that any legacy swap that is currently exempt from the Swap Margin Rule would not become subject to margin requirements by virtue of being amended solely for the purpose of transferring such swap from a UK entity to an affiliate located in the EU or the United States. The relief in the Brexit IFR does not apply if the UK and EU enter into a Withdrawal Agreement because the agencies formulated the Brexit IFR on the premise that a Withdrawal Agreement would preserve “passporting rights” between the UK and EU.³

A Withdrawal Agreement between the UK and EU was ratified in January 2020 and includes a transition period (the “Brexit Transition Period”) that, absent an extension, expires on

¹ A “covered swap entity” is a Commodity Futures Trading Commission-registered swap dealer or major swap participant for which one of the agencies is the prudential regulator. 12 CFR part 45 (OCC); 12 CFR part 237 (Board); 12 CFR part 349 (FDIC); 12 CFR part 624 (FCA); 12 CFR part 1221 (FHFA); see also Final Rule, Margin and Capital Requirements for Covered Swap Entities, 80 FR 74840 (November 30, 2015).

² See 84 FR 9940 (March 19, 2019). The agencies subsequently finalized the Brexit IFR. See 85 FR 39754 (August 31, 2020).

³ Passporting rights mean the EU’s system of cross-border authorizations to engage in regulated financial activities. For example, passporting rights have previously enabled firms to use a UK establishment as their base of operations to provide financial services to customers across the EU.

December 31, 2020.⁴ The EU continues to recognize UK participation in the EU single market on an interim basis during the Brexit Transition Period. The Withdrawal Agreement does not address the continuation of passporting rights for UK entities to provide financial services in the EU at the expiration of the Brexit Transition Period. The agencies understand that the UK and EU are negotiating a free trade agreement that may not include passporting rights for UK entities. The absence of a free trade agreement that addresses passporting rights would result in UK entities losing the ability to continue servicing their EU clients when the Brexit Transition Period expires.

Covered swap entities subject to the Federal Reserve's and OCC's swap margin rules currently operate in the affected jurisdictions. The Federal Reserve and the OCC believe it is appropriate to provide certainty to covered swap entities regarding the status of their legacy swaps, consistent with the intent of the Brexit IFR, in light of the uncertainty regarding whether the UK and EU will agree to a free trade agreement granting UK companies passporting rights related to financial services. Therefore, Federal Reserve and OCC staff would not recommend that their respective agencies take action if a covered swap entity is a party to a legacy swap that was amended under the following conditions:

- (i) One or both parties booked the legacy swap at, or otherwise held the legacy swap at, an entity (including a branch or other authorized form of establishment) located in the UK;
- (ii) An entity in the UK amends the swap solely for the purpose of transferring it to an affiliate, or a branch, or other authorized form of establishment located in any EU member state or the United States, as provided in § __.1(h)(2)(ii);
- (iii) The covered swap entity continues to treat the swap as a legacy swap after the swap is amended;
- (iv) The transfer of the legacy swap is complete by the later of January 1, 2022, or one year after the expiration of EU passporting rights; and
- (v) The amendments do not modify the payment amount calculation methods, extend the maturity date, or increase the total effective notional amount of the swap.

Federal Reserve and OCC staff may amend, extend, terminate, or supersede this statement.

⁴ See European Council Press Release “Brexit: Council adopts decision to conclude the withdrawal agreement” (January 30, 2020), available at <https://www.consilium.europa.eu/en/press/press-releases/2020/01/30/brexit-council-adopts-decision-to-conclude-the-withdrawal-agreement/>.