Federal Deposit Insurance Corporation
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Financial Institution Letter

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Regulatory Capital Treatment of Certain Centrally-Cleared Derivative Contracts Under the FDIC's Capital Rule

Summary: The FDIC is issuing the attached letter that provides supervisory guidance on the regulatory capital treatment of certain centrally-cleared, settled-to-market derivative contracts. Certain central counterparties have revised their rulebooks such that variation margin is considered a settlement payment and not collateral. If an FDIC-supervised institution determines the transfer of variation margin on a centrally-cleared, settled-to-market contract settles any outstanding exposure on the contract and resets the fair value of the contract to zero, the contract's remaining maturity is the time until the next exchange of variation margin. This guidance may affect a derivative contract's calculation of potential future exposure, which uses a conversion factor based, in part, on the contract's remaining maturity.

Statement of Applicability to Institutions with Total Assets Under $1 Billion: This Financial Institution Letter applies to all FDIC-supervised institutions.

Distribution:
FDIC-supervised banks and savings associations

Suggested Routing:
Chief Executive Officer
Chief Financial Officer
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Related Topics:
Capital Adequacy of FDIC-Supervised Institutions, 12 CFR Part 324 (Regulatory Capital Rules)

Attachment:
Regulatory Capital Treatment of Certain Centrally-Cleared Derivative Contracts Under Regulatory Capital Rules

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Highlights

- Under previous rulebooks for certain central counterparties, variation margin on derivative contracts or netting sets was considered collateral. Under revised rulebooks for some central counterparties, variation margin on centrally-cleared derivative contracts is considered a settlement payment.
- The capital rule determines the trade exposure amount for a derivative based on current credit exposure and potential future exposure. Current credit exposure is determined by reference to the mark-to-fair value of a derivative contract under U.S. generally accepted accounting principles. Potential future exposure is determined in part by a conversion factor that is dependent on the type of contract and its remaining maturity.
- If the variation margin on a centrally-cleared derivative contract settles outstanding exposure on the contract and resets the fair value to zero, the FDIC-supervised institution may consider the remaining maturity to be the time until the next exchange of variation margin.
- To conclude that a centrally-cleared derivative contract is settled for purposes of the capital rule, the FDIC-supervised institution should, among other things, determine that ownership of the variation margin has transferred, and the transferor has relinquished all legal claims to the variation margin. The rulebooks of central counterparties may contain additional requirements, such as the payment of fees and expenses, to achieve settlement on centrally-cleared derivative contracts. The legal and accounting analysis performed by the FDIC-supervised institution should consider such requirements.
- For regulatory capital purposes, an FDIC-supervised institution may apply this guidance to centrally-cleared, settled-to-market derivative contracts beginning as of the date of its issuance.