TEIGLAND-HUNT LLP

T-H Client Alert

July 27, 2021

CFTC Guidance Regarding Recent Amendment to Regulation 39.13(g)(8)(ii)

1. Summary

Since becoming effective on January 27, 2021, an amendment to US Commodity Futures Trading Commission ("CFTC") Regulation 39.13(g)(8)(ii), passed in January 2020 (the "2020 Amendment"),[1] has raised concerns among some market participants about futures commission merchants ("FCMs") coming under commercial pressure to collect less initial margin, leading to heightened overall risk. At the core of these concerns is a change in terminology that, some market participants believe, allows FCMs to exercise greater discretion when distinguishing between clients who are required to post only the baseline level of initial margin required by the relevant clearing house and higher risk customers who are required to post initial margin above the baseline level.

The CFTC's Division of Clearing and Risk ("DCR") has published a memorandum (the "Memorandum") in which DCR states that it does not expect to see significant changes in margining practices in response to the 2020 Amendment. However, we encourage Clients to remain in dialogue with their FCMs to ensure that their accounts remain appropriately categorized under Regulation 39.13(g)(8)(ii).

2. Background and Concerns

When originally adopted in 2011, Regulation 39.13(g)(8)(ii) required FCMs to collect additional margin (customer initial margin) for "non-hedge positions." The 2020 Amendment replaced the term "non-hedge" with the arguably more subjective phrase "heightened risk profile" and clarified that the FCM is responsible for determining which categories of customers have a "heightened risk profile" and must, therefore, post customer initial margin. In the Memorandum, DCR states that the reason for replacing "non-hedge" with "heightened risk profile" was to more closely align the terminology of the rule with the substantive nature of the requirement. DCR notes further that the change is a codification of CFTC interpretative guidance published almost a decade ago (the "2012 Interpretive Guidance") that provided clearing houses with greater flexibility to define criteria for assessing customer margin requirements.

Nonetheless, the 2020 Amendment has raised concerns that requiring FCMs to determine which customers present a "heightened risk profile," rather than which are "non-hedge," places a degree of discretion in the hands of the individual FCM that could result in the FCM deciding to collect less margin in respect of speculative accounts, creating competitive pressure that results in a market-wide reduction in customer margin.

[1] *See* 85 Fed. Reg. 4800 (Jan. 27, 2020).

3. DCR's Position

In the Memorandum, DCR makes clear its position that, while the 2020 Amendment introduced a change in terminology, the underlying concept is the same as that in the 2012 Interpretive Guidance that DCOs have followed for years and that, therefore, any changes in margining practices among FCMs should not be significant. In particular, DCR notes that an FCM can only categorize an account as non-high risk that was previously categorized as a "non-hedge" account if it can demonstrate that it is warranted based on the risk profile of the customer.

4. Recommendation

We encourage Clients to remain in dialogue with their FCMs to ensure that their accounts remain appropriately categorized in light of the 2020 Amendment and the Memorandum.

If you have any questions regarding the 2020 Amendment or the Memorandum, please contact:

Ryan Patino	***+1 212 269 1451***	***rpatino@t-hllp.com***
Alexander Hunt	***+1 212 269 5371***	***ahunt@t-hllp.com***

Teigland-Hunt LLP
127 West 24th Street, 4th Fl, New York, NY 10011
www.t-hllp.com