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Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements; Agency Information Collection Activities: Proposed Collection, Comment Request: Final Rule, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements; Final Rule and Notice

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 23

RIN 3038–AC97

Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: On January 6, 2016, the Commodity Futures Trading Commission (''Commission'' or ''CFTC'') published final regulations to implement section 4s(e) of the Commodity Exchange Act, which requires the Commission to adopt initial and variation margin requirements for uncleared swaps of swap dealers and major swap participants that do not have a Prudential Regulator (collectively, ''Covered Swap Entities'' or ''CSEs''). In this release, the Commission is adopting a rule to address the cross-border application of the Commission's margin requirements for CSEs' uncleared swaps.

DATES: The final rule is effective August 1, 2016.

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I. Background

A. Introduction

In the wake of the 2008 financial crisis, Congress enacted Title VII of the Wall Street Reform and Consumer Protection Act (''Dodd-Frank Act''),[1] which modified the Commodity Exchange Act (''CEA'') [2] to establish a comprehensive regulatory framework for swaps. A cornerstone of this framework is the reduction of systemic risk to the U.S. financial system through the establishment of margin requirements for uncleared swaps. CEA section 4s(e), added by section 731 of the Dodd-Frank Act, directs the Commission to adopt rules establishing minimum initial and variation margin requirements on all swaps that are not cleared by a registered derivatives clearing organization (''DCO'').[3] To offset the greater risk to the swap dealer or major swap participant and the financial system arising from the use of uncleared swaps, the Commission's margin requirements must (i) help ensure the safety and soundness of the swap dealer or major swap participant, and (ii) be appropriate for the risk associated with the uncleared swaps held as a swap dealer or major swap participant.[4] Under CEA section 4s(e), the Commission's margin requirements apply to each swap dealer or major swap participant for which there is no Prudential Regulator (collectively, ''Covered Swap Entities'' or ''CSEs'').[5] The Commission published final margin requirements for CSEs in January 2016.[6]

In July 2015, consistent with its authority in CEA sections 4s(e) and 2(i),[7] the Commission proposed a rule to address the cross-border application of the Commission's margin requirements (the ''proposed rule'').[8] The proposed rule set out the circumstances under which a CSE would be allowed to satisfy the Commission's margin requirements by complying with comparable foreign margin requirements

[1] Public Law 111–203, 124 Stat. 1376 (2010).

[2] 7 U.S.C. 1 *et seq.*

[3] *See* 7 U.S.C. 6s(e)(2)(B)(ii).

[4] 7 U.S.C. 6s(e)(3)(A).

[5] *See* 7 U.S.C. 6s(e)(1)(B). Swap dealers and major swap participants for which there is a Prudential Regulator must meet the margin requirements for uncleared swaps established by the applicable Prudential Regulator. 7 U.S.C. 6s(e)(1)(A). *See also* 7 U.S.C. 1a(39) (defining the term ''Prudential Regulator'' to include the Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Farm Credit Administration; and the Federal Housing Finance Agency). The Prudential Regulators published final margin requirements in November 2015. *See* Margin and Capital Requirements for Covered Swap Entities, 80 FR 74840 (Nov. 30, 2015) (''Prudential Regulators' Final Margin Rule'').

[6] *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016) (the ''Final Margin Rule''). The Final Margin Rule, which became effective April 1, 2016, is codified in part 23 of the Commission's regulations. *See* 17 CFR 23.150–159, 161.

[7] *See* 7 U.S.C. 2(i). Section 2(i) of the CEA states that the provisions of the CEA relating to swaps that were enacted by the Wall Street Transparency and Accountability Act of 2010 (including any rule prescribed or regulation promulgated under that Act), shall not apply to activities outside the United States unless those activities (1) have a direct and significant connection with activities in, or effect on, commerce of the United States; or (2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of this Act that was enacted by the Wall Street Transparency and Accountability Act of 2010.

[8] *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements, 80 FR 41376 (July 14, 2015) (''Proposal'').

(''substituted compliance''); offered certain CSEs a limited exclusion from the Commission's margin requirements (the ''Exclusion''); and outlined a framework for assessing whether a foreign jurisdiction's margin requirements are comparable to the Commission's requirements (''comparability determinations''). The Commission developed the proposed rule after close consultation with the Prudential Regulators and in light of comments from and discussions with market participants and foreign regulators.[9]

The Commission requested comment on all aspects of the proposed rule. After a careful review of the comments,[10] the Commission is adopting a final rule largely as proposed but with some modifications, as described below (the ''Final Rule'').[11]

B. Key Considerations in the Cross-Border Application of the Margin Regulations

The overarching objective of the cross-border margin framework is to further the congressional mandate to ensure the safety and soundness of CSEs in order to offset the greater risk to CSEs and the financial system arising from the use of swaps that are not cleared.[12] Margin's primary function is to protect a CSE from counterparty default, allowing it to absorb losses and continue to meet its obligations using collateral provided by the defaulting counterparty.[13] While the requirement to post margin protects the counterparty in the event of the CSE's default, it also functions as a risk management tool, limiting the amount of leverage a CSE can incur by requiring that it have adequate eligible collateral to enter into an uncleared swap. In this way, margin serves as a first line of defense not only in protecting the CSE but in containing the amount of risk in the financial system as a whole, reducing the potential for contagion arising from uncleared swaps.[14]

The Commission recognizes that, to achieve the goals of the Dodd-Frank Act, its cross-border framework must take into account the global state of the swap market. The nature of modern financial markets means that risk is not static or contained by geographic boundaries. Market participants engage in swaps on a 24-hour basis in global markets, and many financial entities operate through a complex web of branches, subsidiaries, and affiliates that are scattered across the globe.[15] These branches and affiliated entities are highly interdependent, sharing not only information technology and operational support but risk management, treasury, and custodial functions. Risks from a swap entered into by an affiliated entity in one jurisdiction may be transferred to another affiliate in a different jurisdiction through inter-affiliate transactions. As part of their risk management practices, swap dealers also commonly lay off the risk of client-facing swaps in the interdealer market, which, as a result of consolidation among global financial institutions, has become concentrated among a relatively small number of dealers.[16] These developments, along with others, have led to a highly interconnected global swap market, where risks originating in one jurisdiction and entity are easily transferred to other jurisdictions and entities, increasing the possibility of cascading defaults.

As the 2008 financial crisis illustrated, the global nature of the swap market heightens the potential that risks assumed by a firm overseas stemming from its uncleared swaps can be transmitted across national borders to cause or contribute to substantial losses to U.S. persons and threaten the stability of the entire U.S. financial system. Complex financial and operational relationships among domestic and international affiliates, including guarantees from U.S. entities at entities like American International Group (AIG) and Lehman Brothers Holding Inc., demonstrated how the transfer of risk across multinational affiliated entities, including risk associated with swaps, is not always transparent and can be difficult to fully assess. More recent events, including major losses from J.P. Morgan Chase &

[9] In 2014, in conjunction with reproposing its margin requirements, the Commission requested comment on three alternative approaches to the cross-border application of its margin requirements: (i) A transaction-level approach consistent with the Commission's guidance on the cross-border application of the CEA's swap provisions, *see* Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 FR 45292 (July 26, 2013) (''Guidance''); (ii) an approach consistent with the Prudential Regulators' proposed cross-border framework for margin, *see* Margin and Capital Requirements for Covered Swap Entities, 79 FR 57348 (Sept. 24, 2014) (''Prudential Regulators' Proposed Margin Rule''); and (iii) an entity-level approach that would apply margin rules on a firm-wide basis (without any exclusion for swaps with non-U.S. counterparties). *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 FR 59898 (Oct. 3, 2014) (''Proposed Margin Rule''). Following a review of comments received in response to this release, the Commission's Global Markets Advisory Committee (''GMAC'') hosted a public panel discussion on the cross-border application of margin requirements.

[10] The Commission received eighteen comment letters in response to the Proposal: Alternative Investment Management Association and Investment Association (Sept. 11, 2015) (''AIMA/IA''); American Bankers Association and ABA Securities Association (Sept. 14, 2015) (''ABA/ABASA''); American Council of Life Insurers (Sept. 14, 2015) (''ACLI''); Americans for Financial Reform (Sept. 14, 2015) (''AFR''); Chris Barnard (Sept. 14, 2015) (''Barnard''); Better Markets, Inc. (Sept. 14, 2015) (''Better Markets''); Financial Services Roundtable (Sept. 14, 2015) (''FSR''); FMS-Wertmanagement (Sept. 14, 2015) (''FMS–WM''); Institute for Agriculture and Trade Policy (Sept. 14, 2015) (''IATP''); Investment Company Institute Global (Sept. 14, 2015) (''ICI Global''); International Swaps and Derivatives Association, Inc. (Sept. 11, 2015) (''ISDA''); Institute of International Bankers and Securities Industry and Financial Markets Association (Sept. 14, 2015) (''IIB/SIFMA''); Japanese Bankers Association (Sept. 13, 2015) (''JBA''); LCH.Clearnet Group Ltd. (Sept. 14, 2015) (''LCH.Clearnet''); Managed Funds Association (Sept. 14, 2015) (''MFA''); PensionsEurope (Sept. 14, 2015) (''PensionsEurope''); Asset Management Group of the Securities Industry and Financial Markets Association (Sept. 14, 2015) (''SIFMA AMG''); and Vanguard (Sept. 14, 2015) (''Vanguard''). The comment file is available at *http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1600*.

[11] The Final Rule is codified at 17 CFR 23.160.

[12] *See* 7 U.S.C. 6s(e)(3)(A).

[13] *See* Proposal, 80 FR at 41377.

[14] Although margin and capital are, by design, complementary, they serve equally important but different risk mitigation functions. Unlike margin, capital is difficult to rapidly adjust in response to changing risk exposures. Capital therefore can be viewed as a backstop in the event that margin is insufficient to cover losses resulting from a counterparty default. The Commission proposed capital rules in 2011. *See* Capital Requirements for Swap Dealers and Major Swap Participants, 76 FR 27802 (May 12, 2011) (''Proposed Capital Rule''). The Commission intends to repropose capital rules later this year.

[15] The largest U.S. banks have somewhere between 2,000 to 3,000 affiliated global entities, hundreds of which are based in the Cayman Islands. Data from the National Information Center (NIC), a repository of financial data and institutional characteristics of banks and other entities regulated by the Federal Reserve, show the increasing complexity of U.S. banks' foreign operations. *See* NIC, available at *http://www.ffiec.gov/nicpubweb/nicweb/nichome.aspx*. For instance, in 1990, there were 1,300 foreign nonbank subsidiaries in the database; at the end of 2014, there were more than 6,000. Foreign ownership is also highly concentrated in a few large firms: Goldman Sachs and Morgan Stanley own more than 2,000 foreign nonbank subsidiaries and, together with General Electric, own 63 percent of all foreign bank subsidiaries. Citigroup, JPMorgan Chase, and Bank of America account for 75 percent of all foreign branches.

[16] According to the Quarterly Report on Bank Trading and Derivatives Activities issued by the Office of the Comptroller of the Currency (OCC) for the second quarter of 2015, the notional value of derivative contracts held by insured U.S. commercial banks and savings associations was $197.9 trillion. *See* Office of the Comptroller of the Currency, Quarterly Report on Bank Trading and Derivatives Activities Second Quarter 2015, 1 (2015), available at *http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq215.pdf*. At the same time, four large commercial banks with the most derivatives activity—Goldman Sachs, JPMorgan Chase Bank NA, Citibank, and Bank of America NA—held 91.1% of the notional amount of these derivatives contracts. *Id.* at 11, 16. Contracts for swaps specifically accounted for $117.5 trillion of the $197.9 trillion total notional. *Id.* at 16.

Co.'s ''London Whale'' or the near failure of FCXM Inc. following trading losses at its London and Singapore affiliates, illustrate the continued potential for cross-border activities to have a significant impact on U.S. entities and markets.

The global nature of the swap market, coupled with the interconnectedness of market participants, also necessitate that the Commission recognize the supervisory interests of foreign regulatory authorities and consider the impact of its choices on market efficiency and competition, which are vital to a well-functioning global swap market.[17] Foreign jurisdictions are at various stages of implementing margin reforms. To the extent that other jurisdictions adopt requirements with different coverage or timelines, the Commission's margin requirements may lead to competitive burdens for U.S. entities and deter non-U.S. persons from transacting with U.S. CSEs and their affiliates overseas. The Commission's substituted compliance regime—a central element of the Final Rule—is intended to address these concerns without compromising the congressional mandate to protect the safety and soundness of CSEs and the stability of the U.S. financial system.

Substituted compliance has long been a central element of the Commission's cross-border policy.[18] It is an approach that recognizes that market participants in a globalized swap market are subject to multiple regulators and potentially face duplicative or conflicting regulations. Under the Final Rule's substituted compliance regime, the Commission would, under certain circumstances, allow a CSE to satisfy the Commission's margin requirements by instead complying with the margin requirements in the relevant foreign jurisdiction. Substituted compliance helps preserve the benefits of an integrated, global swap market by reducing the degree to which market participants will be subject to multiple sets of regulations. Further, substituted compliance encourages collaboration and coordination among U.S. and foreign regulators in establishing robust regulatory standards for the global swap market.

The Commission is mindful of the challenges involved in implementing a substituted compliance framework for margin. If implemented properly, substituted compliance has the potential to enhance market efficiency and liquidity and foster global coordination of margin requirements without compromising the safety and soundness of CSEs and the U.S. financial system. However, if substituted compliance were extended to foreign jurisdictions that do not have adequate oversight or protections with regard to uncleared swaps, the effectiveness of the Commission's margin requirements could be undermined, importing additional risk into the financial system. The Commission therefore believes that close coordination with its foreign counterparts is essential to ensuring that the benefits of substituted compliance are achieved.

Consistent with the congressional mandate to coordinate rules ''to the maximum extent practicable,'' [19] in developing the Final Rule, Commission staff worked closely with staff of the Prudential Regulators to align the Final Rule with the cross-border framework in the Prudential Regulators' Final Margin Rule.[20] Aligning with the Prudential Regulators' cross-border margin rule is particularly important given the composition of the global swap market.[21] Currently, approximately 106 swap dealers and major swap participants are provisionally registered with the Commission. Of those entities, an estimated 54 are CSEs subject to the Commission's margin rules, with the remaining 52 entities falling within the scope of the Prudential Regulators' margin rules. Of the 54 CSEs subject to the Commission's margin requirements, approximately 33 CSEs are affiliated with a prudentially-regulated swap entity. Therefore, substantial differences between the Commission's and Prudential Regulators' cross-border regulations could lead to competitive disparities between affiliates within the same corporate structure, leading to market inefficiencies and incentives to restructure their businesses in order to avoid the more stringent cross-border margin framework.

In granting the Commission new authority over swaps under the Dodd-Frank Act, Congress also called for coordination and cooperation with foreign regulatory authorities.[22] Consistent with that mandate, and building on international efforts to develop a global margin framework,[23] the Commission closely consulted with its foreign counterparts in developing the Final Rule. As other jurisdictions finalize their margin rules and the Commission implements its cross-border margin framework, the Commission is committed to continuing to coordinate with foreign regulators, with a view toward mitigating any conflicting or otherwise substantially divergent margin requirements for uncleared swaps across jurisdictions.

II. The Final Rule

The Commission is adopting rules regarding how the Commission's margin requirements will apply to cross-border uncleared swaps. Broadly speaking, the final cross-border framework is designed to address the risks to a CSE, as an entity, associated with its uncleared swaps, consistent with CEA section 2(i) [24] and the statutory objectives of the margin requirements. As discussed above, section 4s(e) was enacted to address the risks to CSEs and to the U.S. financial system arising from uncleared swaps. The source of risk to a CSE is not confined to its uncleared

[17] In determining the extent to which the Dodd-Frank swap provisions apply to activities overseas, the Commission strives to protect U.S. interests, as determined by Congress in Title VII, and minimize conflicts with the laws of other jurisdictions, consistent with principles of international comity. *See* Guidance, 78 FR at 45300–01 (referencing the Restatement (Third) of Foreign Relations Law of the United States).

[18] For example, under part 30 of the Commission's regulations, if the Commission determines that the foreign regulatory regime would offer comparable protection to U.S. customers transacting in foreign futures and options and there is an appropriate information-sharing arrangement between the home supervisor and the Commission, the Commission has permitted foreign brokers to comply with their home regulations (in lieu of the applicable Commission regulations), subject to appropriate conditions. *See, e.g.,* Foreign Futures and Options Transactions, 67 FR 30785 (May 8, 2002); Foreign Futures and Options Transactions, 71 FR 6759 (Feb. 9, 2006).

[19] *See* 7 U.S.C. 6s(e)(3)(D)(ii).

[20] *See* Prudential Regulators' Final Margin Rule, 80 FR 74840. The cross-border provision is section ___.9 of the Prudential Regulators' Final Margin Rule and is substantially similar to the Commission's Final Rule.

[21] The Securities and Exchange Commission (''SEC'') has not yet finalized similar rules imposing margin requirements for security-based swap dealers and major security-based swap participants. The SEC proposed its margin rule in October 2012. *See* Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70214 (Nov. 23, 2012).

[22] 15 U.S.C. 8325(a) (added by section 752 of the Dodd-Frank Act).

[23] In October 2011, the Basel Committee on Banking Supervision (''BCBS'') and the International Organization of Securities Commissions (''IOSCO''), in consultation with the Committee on Payment and Settlement Systems (''CPSS'') and the Committee on Global Financial Systems (''CGFS''), formed a Working Group on Margining Requirements (''WGMR'') to develop international standards for margin requirements for uncleared swaps. Representatives of 26 regulatory authorities participated, including the Commission. In September 2013, the WGMR published a final report articulating eight key principles for non-cleared derivatives margin rules. These principles represent the minimum standards approved by BCBS and IOSCO and their recommendations to the regulatory authorities in member jurisdictions. *See* BCBS/IOSCO, Margin requirements for non-centrally cleared derivatives (updated March 2015) (''BCBS/IOSCO framework''), available at *http://www.bis.org/bcbs/publ/d317.pdf*.

[24] *See* 7 U.S.C. 2(i).

swaps with U.S. counterparties or to swaps transacted within the United States. Risk arising from uncleared swaps involving non-U.S. counterparties can potentially have a substantial adverse effect on a CSE and therefore the stability of the U.S. financial system. Nevertheless, certain categories of uncleared swaps will be eligible for substituted compliance or the Exclusion based on the Commission's consideration of comity principles and the impact of the Final Rule on market efficiency and competition.

The sections that follow summarize, as appropriate, the approach taken in the proposed rule, the comments received in response, and the resulting Final Rule. Section A discusses certain key definitions (''U.S. person,'' ''guarantee,'' and ''Foreign Consolidated Subsidiary'' or ''FCS'') in the Final Rule, which inform how the Commission's margin requirements apply to market participants in the cross-border context. Section B describes the cross-border application of the Commission's margin requirements, including the circumstances under which substituted compliance and the limited Exclusion are available and the application of two special provisions designed to accommodate swap activities in jurisdictions that do not have a legal framework to support custodial arrangements and netting in compliance with the Final Margin Rule (''non-segregation jurisdictions'' [25] and ''non-netting jurisdictions,'' respectively).[26] Section C describes the Commission's framework for issuing comparability determinations.

As a preliminary matter, the Commission notes that several commenters requested Commission action outside the scope of the Final Rule, including modifications to the substantive margin requirements [27] or the Guidance.[28] The Commission notes that concerns regarding the general nature and application of the initial and variation margin requirements were addressed in the Final Margin Rule. Notably, the Final Margin Rule included substantial modifications from the Proposed Margin Rule that further aligned the Commission's margin requirements with the BCBS–IOSCO framework, which should further reduce the potential for conflicts with the margin requirements of foreign jurisdictions.[29] With respect to the Guidance, the Commission reiterates its intention to periodically review its cross-border policy in light of future developments, including its experience following adoption of the Final Rule.[30]

Commenters also requested that the Commission delay the cross-border application of its margin rules until after it has made comparability determinations.[31] Although the Commission declines to establish an open-ended delay in applying its margin rules, it remains committed to coordinating with foreign regulators to implement its cross-border margin framework in a workable manner.

A. Key Definitions

The extent to which substituted compliance and the Exclusion are available depends on whether the relevant swap involves a U.S. person, a guarantee by a U.S. person, or a ''Foreign Consolidated Subsidiary'' (or ''FCS''). The Final Rule adopts definitions of ''U.S. person,'' ''guarantee,'' and ''Foreign Consolidated Subsidiary'' solely for purposes of the margin rules. These definitions are discussed below.

1. U.S. Person

Under the Final Rule, the term ''U.S. person'' is defined to include individuals or entities whose activities have a significant nexus to the U.S. market as a result of their being domiciled or organized in the United States or by virtue of the strength of their connection to the U.S. markets, even if they are domiciled or organized outside the United States. As discussed in section II.B.2.b.i. below, U.S. CSEs [32] are generally subject to the margin rules with only partial substituted compliance and are not eligible for the Exclusion.

a. Proposed Rule

In the proposed rule, the term ''U.S. person'' was defined to mean the following:

- Any natural person who is a resident of the United States (proposed § 23.160(a)(10)(i));
- Any estate of a decedent who was a resident of the United States at the time of death (proposed § 23.160(a)(10)(ii));
- Any corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund or any form of entity similar to any of the foregoing (other than an entity as described in paragraph (a)(10)(iv) or (v) of proposed § 23.160) (a legal entity), in each case that is organized or incorporated under the laws of the United States or that has its principal place of business in the United States, including any branch of

[25] As used in this release, a ''non-segregation jurisdiction'' is a jurisdiction where inherent limitations in the legal or operational infrastructure of the foreign jurisdiction make it impracticable for the CSE and its counterparty to post initial margin pursuant to custodial arrangements that comply with the Final Margin Rule, as further described in section II.B.4.b.

[26] As used in this release, a ''non-netting jurisdiction'' is a jurisdiction in which a CSE cannot conclude, with a well-founded basis, that the netting agreement with a counterparty in that foreign jurisdiction meets the definition of an ''eligible master netting agreement'' set forth in the Final Margin Rule, as described in section II.B.5.b.

[27] See, *e.g.,* ACLI at 2–3 (Commission should defer to International Standards with respect to acceptable forms of collateral for margin); FMS–WM at 1–2 (legacy portfolio entity backed by full faith and credit of sovereign government should be considered a ''sovereign entity'' within scope of Commission's margin requirements); ISDA at 14–15 (inter-affiliate swaps should be exempt from initial margin requirements and accounting standards to determine consolidation should be applied throughout margin rules); JBA at 6 (Commission should work with foreign counterparts to harmonize aspects of its margin rules, including treatment of ''legacy trades,'' inter-affiliate trades, and forms of eligible collateral); LCH.Clearnet at 4 (differences in approach to margin requirements between cleared and uncleared swaps should promote central clearing).

[28] *See, e.g.,* AFR at 2 (adopting cross-border approach to margin alone would create ''serious problems''); AIMA/IA at 4 (Commission should amend Guidance to include U.S. person definition in the proposed rule); Better Markets at 6 (adopting cross-border approach to margin alone would be ''a disservice to the comprehensive existing Guidance;'' should instead make ''targeted, limited changes'' to Guidance); ICI Global at 7–8 (one U.S. person definition should apply consistently with respect to cross-border application of all swap requirements); IIB/SIFMA at 17–19 (proposed U.S. person and guarantee definitions should replace corresponding interpretations in Guidance); ISDA at 12 (same); JBA at 11–12 (same); SIFMA AMG at 4, 9–13 (same); Vanguard at 5 (same).

[29] For example, the Final Margin Rule raised the material swaps exposure level from $3 billion to the BCBS–IOSCO standard of $8 billion, which reduces the number of entities that must collect and post initial margin. *See* Final Margin Rule, 81 FR at 644. In addition, the definition of uncleared swaps was broadened to include DCOs that are not registered with the Commission but pursuant to Commission orders are permitted to clear for U.S. persons. *See id.* at 638.

[30] *See* Guidance, 78 FR at 45297. *See also United States* v. *Edge Broadcasting Co.,* 509 U.S. 418, 434 (1993) (''[A]n agency does not have to make progress on every front before it can make progress on any front.''). *See also Personal Watercraft Indus. Ass'n* v. *Dep't of Commerce,* 48 F.3d 540, 544 (D.C. Cir. 1995).

[31] *See, e.g.,* ABA/ABASA at 3 (''sufficient time'' for foreign jurisdictions to adopt margin rules); AIMA/IA at 3 (''sufficient time'' to reach agreement with foreign counterparts); ISDA at 16–17 (12 months after margin rules are finalized in U.S., EU, and Japan, or two-year ''transitional comparability determination,'' providing substituted compliance for all foreign jurisdictions that adopt rules based on BCBS–IOSCO framework, while Commission undertakes comparability analysis); JBA at 3, 4 (at least 18 months after margin rules are finalized in the U.S., EU, and Japan); PensionsEurope at 3 (12–18 months); SIFMA AMG at 4, 14–15 (at least 18 months).

[32] *See* 17 CFR 23.160(a)(8) (defining ''U.S. CSE'' as a CSE that is a ''U.S. person,'' as defined in the Final Rule). *See also* 17 CFR 23.160(a)(4) (defining ''non-U.S. CSE'' as a CSE that is not a U.S. person).

the legal entity (proposed § 23.160(a)(10)(iii));

- Any pension plan for the employees, officers or principals of a legal entity as described in paragraph (a)(10)(iii) of proposed § 23.160, unless the pension plan is primarily for foreign employees of such an entity (proposed § 23.160(a)(10)(iv));
- Any trust governed by the laws of a state or other jurisdiction in the United States, if a court within the United States is able to exercise primary supervision over the administration of the trust (proposed § 23.160(a)(10)(v));
- Any legal entity (other than a limited liability company, limited liability partnership or similar entity where all of the owners of the entity have limited liability) owned by one or more persons described in paragraphs (a)(10)(i) through (v) of proposed § 23.160 who bear(s) unlimited responsibility for the obligations and liabilities of the legal entity, including any branch of the legal entity (proposed § 23.160(a)(10)(vi)); and
- Any individual account or joint account (discretionary or not) where the beneficial owner (or one of the beneficial owners in the case of a joint account) is a person described in paragraphs (a)(10)(i) through (vi) of proposed § 23.160 (proposed § 23.160(a)(10)(vii)).[33]

The Commission explained that, as indicated in paragraphs (iii) and (vi) of the proposed rule, a legal entity's status as a U.S. person would be determined at the entity level and would therefore include a foreign branch of a U.S. person.[34] An affiliate or subsidiary of a U.S. person that is organized or incorporated outside the United States, however, would not be deemed a ''U.S. person'' solely by virtue of its affiliation with the U.S. person.[35] The Commission also stated that a swap counterparty should generally be permitted to reasonably rely on its counterparty's written representation with regard to its status as a U.S. person.[36]

The proposed rule was generally consistent with the U.S. person interpretation set forth in the Guidance, with certain exceptions.[37] Notably, the proposed rule did not define ''U.S. person'' to include a commodity pool, pooled account, investment fund, or other collective investment vehicle that is majority-owned by one or more U.S. persons (the ''U.S. majority-owned fund prong'').[38] The proposed rule also did not include a catchall provision, thereby limiting the definition of ''U.S. person'' for purposes of the margin rule to persons enumerated in the rule.[39] Finally, paragraph (vi) of the proposed rule (the ''unlimited U.S. responsibility prong'') represented a modified version of a similar concept from the Guidance, which interprets ''U.S. person'' to include a legal entity ''directly or indirectly majority-owned'' by one or more U.S. person(s) that bear unlimited responsibility for the legal entity's liabilities and obligations.[40]

The Commission requested comment on all aspects of the proposed definition of ''U.S person,'' including whether the definition should include a U.S. majority-owned fund prong or an unlimited U.S. responsibility prong and whether it should be identical to the U.S. person definition adopted by the SEC.[41]

b. Comments

In general, commenters raised few objections to the proposed ''U.S. person'' definition. Nearly all commenters supported the absence of a U.S. majority-owned fund prong,[42] and several expressly supported the absence of a catchall provision.[43] With respect to the U.S. majority-owned funds prong, commenters argued that U.S. ownership alone is not indicative of whether a fund's activities have a direct and significant effect on the U.S. financial system [44] and that identifying and tracking a fund's beneficial ownership may pose a significant challenge in certain circumstances.[45] Commenters added that characterizing such U.S. majority-owned funds as U.S. persons may lead to duplicative margin requirements because such funds will likely also be subject to foreign regulation.[46]

A few commenters, however, requested changes regarding the unlimited U.S. responsibility prong. ISDA and JBA recommended that, consistent with the Guidance, the Commission require that the U.S. person(s) bearing unlimited responsibility for the obligations and liabilities of the legal entity have a majority ownership stake in the entity. ISDA argued broadly that, to avoid confusion and regulatory overlap, legal entities that have multiple owners with unlimited liability for the obligations and liabilities of the legal entity should only be subject to the jurisdiction of the majority owner.[47] JBA argued that the definition should be consistent with the Guidance in order to avoid the possibility that the Commission's margin requirements would apply to a ''broader scope of U.S. persons relative to other swap regulations.'' [48] IIB/SIFMA requested that the unlimited U.S. responsibility prong be removed altogether, arguing that unlimited responsibility is ''largely equivalent'' to a guarantee and should therefore be afforded the same treatment.[49]

[33] *See* proposed 17 CFR 23.160(a)(10). *See also* proposed 17 CFR 23.160(a)(5) (defining ''non-U.S. person'' as any person that is not a ''U.S. person'').

[34] *See* Proposal, 80 FR at 41383 (stating that the definition includes any foreign operations that are part of the U.S. legal person, regardless of their location); proposed 17 CFR 23.160 (a)(10)(iii), (vi) (defining such U.S. persons to include ''any branch of the legal entity'').

[35] *See* Proposal, 80 FR at 41383 (explaining that the status of a legal person as a U.S. person would not affect whether a separately incorporated or organized legal person in the affiliated corporate group is a U.S. person).

[36] *See id.* (recognizing that the information necessary to accurately assess a counterparty's U.S. person status may be available only through overly burdensome due diligence).

[37] *See* Proposal, 80 FR at 41382–84. *See also* Guidance, 78 FR at 45308–17 (setting forth the interpretation of ''U.S. person'' for purposes of the Guidance).

[38] *See* Proposal, 80 FR at 41383. *See also* Guidance, 78 FR 45313–14 (discussing the U.S. majority-ownership prong for purposes of the Guidance). The Guidance interpreted ''majority-owned'' in this context to mean the beneficial ownership of more than 50 percent of the equity or voting interests in the collective investment vehicle. *See id.* at 45314.

[39] *See* Proposal, 80 FR at 41383. *See also* Guidance, 78 FR at 45316 (discussing the inclusion of the prefatory phrase ''include, but not be limited to'' in the interpretation of ''U.S. person'' in the Guidance).

[40] *See* Proposal, 80 FR at 41383. *See also* Guidance, 78 FR at 45312–13 (discussing the unlimited U.S. responsibility prong for purposes of the Guidance).

[41] *See* Proposal, 80 FR at 41384. *See also* 17 CFR 240.3a71–3(a)(4) (setting forth the definition of ''U.S. person'' adopted by the SEC for purposes of security-based swap regulation).

[42] *See e.g.,* AIMA/IA at 3–4; FSR at 2, 8; IATP at 4; IIB/SIFMA at 18; ISDA at 12; JBA at 11; MFA at 3, 5–6; SIFMA AMG at 10, Vanguard at 5.

[43] *See e.g.,* IIB/SIFMA at 17; ISDA at 12 (the absence the prefatory phrase ''includes, but is not limited to'' would ''increase legal certainty''); SIFMA AMG at 10–11.

[44] *See e.g.,* AIMA/IA at 3; FSR at 8; IATP at 4; IIB/SIFMA at 18 (fund owners are not direct counterparties to swap and their risk of loss is limited to extent of their investment in the fund); MFA at 6.

[45] *See e.g.,* AIMA/IA at 3–4 (highlighting challenges presented by nominee accounts); IATP at 4 (ownership can be complex and variable over the life of a fund); IIB/SIFMA at 18 (highlighting challenges associated with funds formed before adoption of Guidance); SIFMA AMG at 10. *But see* MFA at 5–6 (funds organized or having a principal place of business in the United States are properly included in the U.S. person definition).

[46] *See* AIMA/IA at 4 (''comparable foreign rules'' will apply to limit the likelihood and impact of a counterparty default); FSR at 8 (neither SEC nor EU regulators have proposed exercising jurisdiction over an entity on the basis of majority control); ISDA at 12 (neither BCBS–IOSCO framework nor proposed EU rules impose rules on funds based on jurisdiction of its owners).

[47] *See* ISDA at 12.

[48] *See* JBA at 11–12.

[49] *See* IIB/SIFMA at 17–18 (while guarantor may have legal defenses to enforcement of guarantee, both U.S. guarantee and unlimited U.S.

Commenters also made certain other recommendations to further conform the U.S. person definition to the interpretation of ''U.S. person'' in the Guidance.[50] ICI Global, SIFMA AMG, and Vanguard requested that the Commission confirm that, as indicated in the Guidance, a pool, fund or other collective investment vehicle that is publicly offered only to non-U.S. persons and not offered to U.S. persons would not fall within the scope of the U.S. person definition.[51] SIFMA AMG also added that language in paragraphs (iii) and (vi) specifying that a legal entity deemed a U.S. person would include ''any branch of the legal entity'' was unnecessarily confusing.[52]

Finally, FSR and JBA requested that, in the interest of harmonizing margin requirements and reducing compliance costs, the Commission should, consistent with the SEC's cross-border rules, exclude from the U.S. person definition certain designated international organizations.[53] IATP argued, however, that such exclusion would be either unnecessary or inappropriate.[54]

c. Final Rule

The Final Rule defines ''U.S. person'' as proposed, but the Commission is providing some additional clarifications in response to commenters. As stated in the Proposal, the definition generally follows a traditional, territorial approach to defining a U.S. person, and the Commission believes that this definition offers a clear, objective basis for determining those individuals or entities that should be identified as U.S. persons.

Under the Final Rule, a legal person's status as a U.S. person is determined at the entity level and therefore includes any foreign operations that are part of the legal person, regardless of their location. Consistent with this approach, the definition includes any foreign branch of a U.S. person.[55] The status of a legal entity as a U.S. person would not generally affect whether a separately incorporated or organized legal entity in the affiliated corporate group is a U.S. person. Therefore, an affiliate or a subsidiary of a U.S. person that is organized or incorporated in a non-U.S. jurisdiction would not be deemed a U.S. person solely by virtue of being affiliated with a U.S. person.[56]

Sections 23.160(a)(10)(i) through (v) and (vii) of the Final Rule identify certain persons as U.S. persons by virtue of being domiciled or organized in the United States. The Commission has traditionally looked to where a legal entity is organized or incorporated (or, in the case of a natural person, where he or she resides) to determine whether it is a U.S. person.[57] Persons domiciled or organized in the United States are likely to have significant financial and legal relationships in the United States and are therefore appropriately included within the definition of ''U.S. person.''

Consistent with this traditional approach, section 23.160(a)(10)(iii) of the Final Rule includes persons that are organized or incorporated outside the United States but have their principal place of business in the United States. For purposes of this section, the Commission interprets ''principal place of business'' to mean the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person. This interpretation is consistent with the Supreme Court's decision in *Hertz Corp.* v. *Friend,* which described a corporation's principal place of business, for purposes of diversity jurisdiction, as the ''place where the corporation's high level officers direct, control, and coordinate the corporation's activities.'' [58]

The Commission is of the view that determining the principal place of business of an investment fund may require consideration of additional factors beyond those applicable to operating companies. In the case of a fund, the senior personnel that direct, control, and coordinate a fund's activities are generally not the named directors or officers of the fund but rather persons employed by the fund's investment adviser or the fund's promoter. Therefore, consistent with the Guidance, the Commission would generally consider the principal place of business of a fund to be in the United States if the senior personnel responsible for either (1) the formation and promotion of the fund or (2) the implementation of the fund's investment strategy are located in the United States, depending on the facts and circumstances that are relevant to determining the center of direction, control and coordination of the fund.[59]

Section 23.160(a)(10)(vi) of the Final Rule defines ''U.S. person'' to include certain legal entities owned by one or more U.S. person(s) and for which such person(s) bear unlimited responsibility for the obligations and liabilities of the legal entity.[60] In such cases, the U.S.

responsibility prong create risk to U.S. persons only to the extent that legal entity incurs losses and fails to perform obligations).

[50] As indicated above, several commenters recommended generally that the Commission establish a uniform definition of ''U.S. person'' that would apply both in the context of the cross-border application of the margin rules and with respect to the other swaps regulatory topics covered by the Guidance. *See supra* note 28.

[51] *See* ICI Global at 5–7 (clarification is necessary to avoid imposing Dodd-Frank Act swap provisions on entities that only have ''nominal nexus'' to United States); SIFMA AMG at 10–12 (reclassifying such funds as U.S. persons solely for purposes of margin rule would be extremely complicated and burdensome for asset managers and their clients); Vanguard at 5. *See also* Guidance, 78 FR at 45314 (providing that a collective investment vehicle that is publicly offered only to non-U.S. persons and not offered to U.S. persons generally would not fall within any of the prongs of the ''U.S. person'' interpretation in the Guidance).

[52] SIFMA AMG at 12 (such language, which is not present in corresponding prongs of U.S. person interpretation in Guidance, could ''cause confusion in terms of whether a person having any branches in the United States needs to take into account its U.S. person status, including in assessing the entity's principal place of business'').

[53] *See* FSR at 8; JBA at 12 (while international financial institutions ''are invested by the U.S. government, financial institutions generally separate them from the U.S. country risk in evaluating their credit risk in practice''). *See also* 17 CFR 240.3a71–3(a)(4)(iii) (defining ''U.S. person'' for purposes of the SEC's regulation of security-based swaps to exclude the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, and their agencies and pension plans, and any other similar international organizations, their agencies and pension plans).

[54] *See* IATP at 4 (intergovernmental organizations should ''voluntarily practice'' the margin requirements in order to ''realize the objectives of the [sic] intergovernmental investment charters'').

[55] The Commission clarifies that the inclusion of ''any branch of the legal entity'' in sections 23.160(a)(10)(iii) and (vi) of the Final Rule is intended to make clear that the definition includes both foreign and U.S. branches of an entity and does not introduce any additional criteria for determining an entity's U.S. person status.

[56] *See also* 17 CFR 23.160(a)(5) (defining ''non-U.S. person'' as any person that is not a U.S. person).

[57] *See, e.g.,* 17 CFR 4.7(a)(1)(iv) (defining ''Non-United States person'' for purposes of part 4 of the Commission regulations, which applies to commodity pool operators).

[58] 559 U.S. 77, 80 (2010).

[59] *See* Guidance, 78 FR at 45309–12 (providing guidance on application of the principal place of business test to funds and other collective investment vehicles in the context of cross-border swaps, including examples of how the Commission's approach could apply to a consideration of whether the ''principal place of business'' of a fund is in the United States in particular hypothetical situations). Note that the examples included in the Guidance are for illustrative purposes only and do not purport to address all potential variations in the structure of collective investment vehicles or all factors relevant to determining whether a collective investment vehicle's principal place of business is in the United States.

[60] The Commission does not view the unlimited U.S. responsibility prong as equivalent to a U.S. guarantee (as ''guarantee'' is defined in the Final Rule). As stated in the Guidance, a guarantee does not necessarily provide for ''unlimited responsibility for the obligations and liabilities of the guaranteed entity'' in the same sense that the owner of an unlimited liability corporation bears such unlimited liability. *See* 78 FR at 45312.

person owner(s) serve as a financial backstop for all of the legal entity's obligations and liabilities. Creditors and counterparties accordingly look to the U.S. person owner(s) when assessing the risk of dealing with the entity.[61] Because the U.S. person owner(s)' responsibility is unlimited, the amount of equity the U.S. owner(s) have in the legal entity would not be relevant.

In line with the proposed rule, the Final Rule does not include a U.S. majority-owned funds prong. Although the U.S. owners of such funds may be adversely impacted in the event of a counterparty default, the Commission believes that, on balance, the majority-ownership test should not be included in the definition of U.S. person for purposes of the margin rules. Non-U.S. funds with U.S. majority-ownership, even if treated as a non-U.S. person, are excluded from the Commission's margin rules only in limited circumstances (namely, when these funds transact with a non-U.S. CSE that is not a consolidated subsidiary of a U.S. entity or a U.S. branch of a non-U.S. CSE). This result, coupled with the implementation issues raised by commenters, persuade the Commission that including a U.S. majority-owned funds prong in the scope of the ''U.S. person'' definition would not be appropriate for purposes of the margin rules.[62] The Final Rule's U.S. person definition also does not include the prefatory phrase ''includes, but is not limited to'' that was included in the Guidance. As stated in the proposed rule, the Commission believes that this catchall should not be included in order to provide legal certainty regarding the application of U.S. margin requirements to cross-border swaps.

The Commission notes that, as discussed in the proposed rule, the Final Rule defines ''U.S. person'' in a manner that is substantially similar to the definition used by the SEC in the context of cross-border regulation of security-based swaps.[63] The Commission further believes that any differences, such as the inclusion of an unlimited U.S. responsibility prong, are necessary and appropriate in the context of the cross-border application of margin requirements for uncleared swaps, for the reasons discussed above.[64] With respect to the designated international organizations excluded from the SEC's U.S. person definition, the Commission notes that a similar exclusion is unnecessary in the context of the cross-border application of the Commission's margin rules, given that such entities are generally considered non-financial end users under the Final Margin Rule and are therefore unaffected by application of the margin requirements for uncleared swaps.[65]

2. Guarantees

Under the Final Rule, the term ''guarantee'' is defined to include arrangements, pursuant to which one party to an uncleared swap has rights of recourse against a guarantor, with respect to its counterparty's obligations under the uncleared swap. As discussed in section II.B.2.b.i. below, non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person (''U.S. Guaranteed CSEs'')[66] are eligible for substituted compliance to the same extent as U.S. CSEs and are similarly ineligible for the Exclusion.

a. Proposed Rule

The proposed rule defined the term ''guarantee'' as an arrangement pursuant to which one party to a swap with a non-U.S. counterparty has rights of recourse against a U.S. person, with respect to the non-U.S. counterparty's obligations under the swap. The proposed rule defined ''rights of recourse'' as a conditional or unconditional legally enforceable right to receive or otherwise collect payment, in whole or in part. An arrangement would constitute a ''guarantee'' regardless of whether the rights of recourse were conditioned upon the non-U.S. counterparty's insolvency or failure to meet its obligations under the relevant swap or whether the counterparty seeking to enforce the guarantee is required to make a demand for payment or performance from the non-U.S. counterparty before proceeding against the U.S. guarantor. The Commission requested comment on all aspects of its proposed definition of ''guarantee,'' including whether it would be appropriate to distinguish guarantee arrangements with a legally enforceable right of recourse from those without direct recourse.[67]

b. Comments

Most commenters supported the proposed definition of ''guarantee.''[68] Commenters generally preferred it to the broader interpretation of ''guarantee'' in the Guidance, which includes other types of financial arrangements and support (*e.g.,* keepwell agreements and liquidity puts),[69] and agreed that it would promote legal certainty and lower compliance costs as a result.[70] IIB/SIFMA further argued the proposed definition is appropriate in the margin context and consistent with CEA section 2(i) because, absent such a legal relationship to a U.S. person, a non-U.S. person would not have a sufficient connection with activities in U.S. commerce to warrant the application of

[61] By extension, by virtue of their unlimited responsibility for the legal entity's swap obligations, the U.S. person owner(s) have an interest in the swap activities of the legal entity to the same extent as if the swap activities were conducted by the U.S. person directly.

[62] Such a fund may nevertheless be a U.S. person by virtue of fitting within the scope of § 23.160(a)(10)(iii) (entities organized or having a principal place of business in the United States). In response to commenters, the Commission further clarifies that whether a pool, fund or other collective investment vehicle is publicly offered only to non-U.S. persons and not offered to U.S. persons would not be relevant in applying § 23.160(a)(10)(iii).

[63] *See* Proposal, 80 FR at 41382 n.46 (discussing the SEC's ''U.S. person'' definition for purposes of security-based swap regulation).

[64] The SEC does not include the U.S. responsibility prong in its U.S. person definition, but instead treats a legal entity where one or more U.S. person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity as a non-U.S. person with a guarantee. The Commission believes that, for the reasons stated above, these entities should be included as a U.S. person rather than being treated as a non-U.S. person with a guarantee for purposes of the margin requirements for uncleared swaps.

[65] Under the Final Margin Rule, the following international organizations are expressly considered non-financial end users: (1) The International Bank for Reconstruction and Development; (2) The Multilateral Investment Guarantee Agency; (3) The International Finance Corporation; (4) The Inter-American Development Bank; (5) The Asian Development Bank; (6) The African Development Bank; (7) The European Bank for Reconstruction and Development; (8) The European Investment Bank; (9) The European Investment Fund; (10) The Nordic Investment Bank; (11) The Caribbean Development Bank; (12) The Islamic Development Bank; (13) The Council of Europe Development Bank; and (14) Any other entity that provides financing for national or regional development in which the U.S. government is a shareholder or contributing member or which the Commission determines poses comparable credit risk). *See* 17 CFR 23.151 (defining ''financial end user,'' ''non-financial end user,'' and ''multilateral development bank''). Under the Final Margin Rule, CSEs are not required to exchange margin with non-financial end users.

[66] This release uses the term ''U.S. Guaranteed CSE'' for convenience only. Whether a non-U.S. CSE falls within the meaning of the term ''U.S. Guaranteed CSE'' varies on a swap-by-swap basis, such that a non-U.S. CSE may be considered a U.S. Guaranteed CSE for one swap and not another, depending on whether the non-U.S. CSE's obligations under such swap are guaranteed by a U.S. person.

[67] *See* Proposal, 80 FR at 41385.

[68] *See* FSR at 2, 9; IATP at 5; IIB/SIFMA at 18–19; ISDA at 12; JBA at 12; SIFMA AMG at 4, 13.

[69] *See* IIB/SIFMA at 18–19; ISDA at 12; JBA at 12; SIFMA AMG at 13.

[70] *See* IIB/SIFMA at 18–19; ISDA at 12 (interpretation of ''guarantee'' in Guidance requires facts-and-circumstances analysis to determine whether arrangement supports a party's ability to pay or perform under swap); JBA at 12; SIFMA AMG at 13 (expressing approval that the proposed definition aligns with guarantee definition adopted by SEC).

U.S. margin rules.[71] Commenters expressed concern, however, that multiple ''guarantee'' definitions could lead to confusion and recommended that the Commission apply the proposed ''guarantee'' definition throughout its cross-border policy.[72]

AFR and Better Markets opposed the proposed ''guarantee'' definition.[73] Both expressed a preference for the broader interpretation of ''guarantee'' in the Guidance and, like other commenters, recommended that the term have one consistent meaning.[74] AFR argued that both implicit guarantees, such as when a parent entity faces reputational incentives to provide financial support for a subsidiary, and other formal agreements that obligate a U.S. person to provide financial support, create a direct and significant nexus to the U.S. financial system and should be included within the scope of the term ''guarantee.'' [75] Accordingly, the proposed definition of ''guarantee'' may not fully capture the risk to the U.S. financial markets.[76] AFR suggested that the policy objective of increasing the availability of substituted compliance in the margin context would be better achieved by adopting the broad interpretation of ''guarantee'' in the Guidance and instead limiting the availability of substituted compliance with respect to swaps involving an ''explicit recourse guarantee.'' [77]

c. Final Rule

The Final Rule defines ''guarantee'' for purposes of the cross-border application of the Commission's margin rules to mean an arrangement pursuant to which one party to an uncleared swap has rights of recourse against a guarantor, with respect to its counterparty's obligations under the uncleared swap.[78] For these purposes, a party to an uncleared swap has rights of recourse against a guarantor if the party has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from the guarantor with respect to its counterparty's obligations under the uncleared swap. A counterparty has a right of recourse against a guarantor even if the right of recourse is conditioned upon its counterparty's insolvency or failure to meet its obligations under the swap, and regardless of whether the counterparty seeking to enforce the guarantee is first required to make a demand for payment or performance from its counterparty before proceeding against the guarantor. Further, the term ''guarantee'' applies equally regardless of whether the U.S. guarantor is affiliated with either counterparty or is an unaffiliated third party. In addition, the terms of the guarantee need not necessarily be included within the swap documentation or even otherwise reduced to writing, so long as a party to the swap has legally enforceable rights of recourse under the laws of the relevant jurisdiction.

The Final Rule's definition of guarantee is generally consistent with the proposed rule's definition of guarantee, but reflects certain changes that are intended to more closely align it with the definition included in the Prudential Regulators' Final Margin Rule.[79] Language has been added to the Final Rule to address the concerns of the Commission and Prudential Regulators that swaps could be structured in a manner that would avoid application of the margin requirements to swaps that are guaranteed by a U.S. person.[80] Under this additional language, the term ''guarantee'' also encompasses any arrangement pursuant to which the guarantor itself has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from any other guarantor with respect to the counterparty's obligations under the uncleared swap. Under the Final Rule, such arrangement will be deemed a guarantee of the counterparty's obligations under the uncleared swap by the other guarantor.

To illustrate, consider a swap between a non-U.S. CSE (''Party A'') and a non-U.S. person (''Party B''). Party B's obligations under the swap are guaranteed by a non-U.S. affiliate (''Party C''), who in turn has a guarantee from its U.S. CSE parent entity on Party C's swap obligations (''Parent D''). The Final Rule would deem a guarantee to exist between Party B and Parent D with respect to Party B's obligations under the swap with Party A.[81]

The Commission is cognizant that many other financial arrangements or support, other than a recourse guarantee as defined in the Final Rule, may be provided by a U.S. person to a non-U.S. CSE. The Commission acknowledges that these other financial arrangements or support may transfer risk directly back to the U.S. financial system, with possible significant adverse effects, in a manner similar to an arrangement that is covered by the definition of a ''guarantee'' in the Final Rule. However, the Commission believes that, in the context of the Final Rule, non-U.S. CSEs benefitting from such other forms of U.S. financial support will likely meet the definition of an FCS, a concept included in the final margin rules adopted by the Prudential Regulators, and thereby be adequately covered by the Commission's margin requirements. In this way, the Commission believes that the Final Rule achieves the dual goals of protecting the U.S. markets while promoting a workable cross-border margin framework that closely tracks the cross-border application of the Prudential Regulators' Final Margin Rule.[82]

3. Foreign Consolidated Subsidiary (''FCS'')

Under the Final Rule, the term ''Foreign Consolidated Subsidiary'' identifies non-U.S. CSEs that are consolidated for accounting purposes with an ultimate parent entity that is a U.S. person (a ''U.S. ultimate parent entity''). As further discussed in section II.B.2.b.ii. below, substituted compliance would be broadly available to an FCS to the same extent as any other non-U.S. CSE, but such an FCS would not be eligible for the Exclusion.

a. Proposed Rule

The proposed rule defined a ''Foreign Consolidated Subsidiary'' as a non-U.S. CSE in which an ''ultimate parent entity'' [83] that is a U.S. person has a

[71] *See* IIB/SIFMA at 18–19. *See also* FSR at 9 (''transaction-level'' swap risk would not transfer back to United States absent right of recourse against a U.S. person and ''entity-level'' risk would be captured by other regulatory requirements, such as capital rules).

[72] *See* ISDA at 12; JBA at 12; SIFMA AMG at 13.

[73] AFR at 3, 5–7; Better Markets at 4.

[74] *See* AFR at 3 (adopting different definition solely for purposes of margin rules would not only complicate overall set of cross-border rules, but establish an ''extremely poor precedent'' for narrowing guarantee concept in applying rest of Guidance); Better Markets at 4 (proposed definition is ''less robust'' than interpretation of guarantee in Guidance and should not be different in margin context).

[75] *See* AFR at 6.

[76] *See id.*

[77] *See id.* at 5–6.

[78] *See* 17 CFR 23.160(a)(2).

[79] The Final Rule also includes certain technical edits that would not affect the substance of the rule as compared to the proposed rule.

[80] Based on this change to the definition of ''guarantee,'' the Final Rule differs from the proposed rule in that it treats certain non-U.S. persons as if they were U.S. persons.

[81] This example is included for illustrative purposes only, and is not intended to cover all examples of swaps that could be affected by changes in the Final Rules.

[82] The Commission has determined that using the term ''explicit recourse guarantee'' in lieu of the broader ''guarantee'' would, in light of the Prudential Regulators' use of the comparable term ''guarantee,'' likely only cause confusion without making any substantive difference with respect to the cross-border application of the Commission's margin requirements.

[83] *See* proposed 17 CFR 23.160(a)(6) (defining ''ultimate parent entity'' as the parent entity in a

Continued

controlling interest, in accordance with U.S. generally accepted accounting principles (''U.S. GAAP'') such that the U.S. ultimate parent entity includes the non-U.S. CSE's operating results, financial position and statement of cash flows in its consolidated financial statements, in accordance with U.S. GAAP.[84] The Commission explained that the fact that an entity is included in the consolidated financial statements of another entity is an indication of potential risk to the other entity that offers a clear and objective standard for the application of margin requirements. The Commission further explained that, as a result of the FCS' direct connection to, and the possible negative impact of its swap activities on, its U.S. ultimate parent entity and the U.S. financial system, an FCS raises a more substantial supervisory concern in the United States relative to other non-U.S. CSEs.

The Commission requested comment on all aspects of its proposed FCS definition, including whether the Commission should instead adopt the ''control test'' proposed by the Prudential Regulators, which focused solely on the level of ownership and control a U.S. person would have over a non-U.S. subsidiary.[85]

b. Comments

A few commenters expressed strong support for the FCS concept.[86] AFR and Better Markets characterized it as an improvement to the cross-border approach to margin taken in the Guidance, calling it a ''logical and reasonable approach'' to capturing non-U.S. subsidiaries of U.S. swap entities that may expect an implicit guarantee from a U.S. parent and an ''effective remedy to evasion.''[87] AFR stated that, by virtue of being included in the same consolidated financial statement, an FCS has a direct financial impact on its U.S. ultimate parent entity, even absent a direct recourse guarantee.[88]

Nevertheless, AFR and IATP expressed some concern over the reliance on U.S. GAAP, particularly with respect to its ability to capture off-balance sheet entities.[89] IATP suggested that the Commission consider including in the FCS definition an option to carry out the consolidated financial reporting according to International Financial Reporting Standards (''IFRS'').[90] AFR also expressed concern that reliance on U.S. GAAP may not capture all entities that could expect an implicit guarantee from a U.S. parent, including privately held entities that are not required to prepare consolidated financial statements under U.S. GAAP, and certain variable interest entities or owned funds.[91]

AFR and IATP therefore urged the Commission to expand the FCS definition in a few ways. Both recommended that the FCS definition include entities whose U.S. parent entity is not required to prepare consolidated financial statements (*e.g.,* a private partnership) but that would otherwise meet the standard for consolidation.[92] AFR argued that failing to include such entities within the meaning of ''FCS'' could result in entities with a similar nexus to the U.S. financial system being treated differently based on factors such as whether the ultimate parent is publicly traded.[93] AFR also urged the Commission to incorporate a facts-and-circumstances test for determining when a foreign subsidiary's relationship with its U.S. parent may create a sufficient nexus to require compliance with U.S. margin rules.[94]

A few commenters opposed the FCS concept altogether.[95] IIB/SIFMA argued that, absent a legal obligation to provide support, an FCS's potential effect on its U.S. ultimate parent entity is not sufficiently ''direct'' to create a nexus to the U.S. financial system within the meaning of CEA section 2(i).[96] Nevertheless, most commenters, including IIB/SIFMA, preferred the proposed FCS definition to the control test proposed by the Prudential Regulators.[97] IIB/SIFMA also appreciated that the proposed FCS definition would foreclose the possibility of such a non-U.S. CSE having multiple parent entities.[98]

c. Final Rule

The Final Rule defines ''Foreign Consolidated Subsidiary'' as proposed.[99] Specifically, ''Foreign Consolidated Subsidiary'' means a non-U.S. CSE in which an ultimate parent entity that is a U.S. person has a controlling financial interest, in accordance with U.S. GAAP, such that the U.S. ultimate parent entity includes the non-U.S. CSE's operating results, financial position and statement of cash flows in the U.S. ultimate parent entity's consolidated financial statements, in accordance with U.S. GAAP. The term ''ultimate parent entity'' means the parent entity in a consolidated group in which none of the other entities in the consolidated group has a controlling interest, in accordance with U.S. GAAP.[100]

The Commission believes that the FCS concept offers a clear, bright-line test for identifying those non-U.S. CSEs whose uncleared swap activities present a greater supervisory interest relative to other non-U.S. CSEs. Under U.S. GAAP, an FCS' financial statements are consolidated with its U.S. ultimate parent entity by virtue of the parent's

consolidated group in which none of the other entities in the consolidated group has a controlling interest, in accordance with U.S. GAAP).

[84] Under U.S. GAAP, consolidated financial statements report the financial position, results of operations and statement of cash flows of a parent entity together with subsidiaries in which the parent entity has a controlling financial interest (which are required to be consolidated under U.S. GAAP).

[85] *See* Proposal, 80 FR at 41386. *See also* Prudential Regulators' Proposed Margin Rule, 79 FR at 57379.

[86] *See* AFR at 4–5; Better Markets at 5; IATP at 3, 5–6.

[87] *See* AFR at 4 (FCS concept ''economizes'' Commission resources by tying regulatory coverage to ''easily available'' accounting information). *See also* Better Markets at 5 (Guidance should be amended to apply FCS concept to all Title VII requirements).

[88] *See* AFR at 4. *See also* IATP at 3 (inclusion in another's consolidated financial statement indicates a potential risk to that entity).

[89] *See* AFR at 5 (prior to the passage of U.S. Financial Accounting Standards Board (''U.S. FASB'') Statements Nos. 166 and 167, U.S. GAAP accounting failed to properly require the consolidation of many securitization entities and such gaps could appear in the future).

[90] *See* IATP at 6 (reliance on IFRS should be predicated on the IFRS agreeing with U.S. FASB participation and offering improved handling of off-balance sheet entities compared to U.S. GAAP).

[91] *See* AFR at 4–5.

[92] *See* AFR at 4–5; IATP at 6 (it would not be ''inconceivable'' for U.S. CSE to spin off swaps trading activities as private partnerships).

[93] *See* AFR at 5.

[94] *See id.*

[95] *See, e.g.,* AIMA/IA at 3 (touting potential operational costs involved with obtaining counterparty representations regarding FCS status); FSR at 10 (FCS concept is ''not necessary'' because FCSs will be subject to foreign regulation); IIB/SIFMA at 19–20 (Commission should not distinguish FCSs from other non-U.S. CSEs).

[96] *See* IIB/SIFMA at 14 (''chain of intervening factors and events,'' including ''materiality'' of FCS to parent entity, that could affect a U.S. parent's decision to provide support is too long and uncertain).

[97] *See* FSR at 10 (a control test may not clearly identify the non-U.S. covered swap entities that are likely to raise greater supervisory concerns); IATP at 6; IIB/SIFMA at 19–20 (reliance on the familiar standards of U.S. GAAP would promote legal certainty); ISDA at 13 (a control test is not appropriate for the application of margin rules).

[98] *See* IIB/SIFMA at 19–20.

[99] *See* 17 CFR 23.160(a)(1).

[100] *See* 17 CFR 23.160(a)(6). The definition of ''Foreign Consolidated Subsidiary'' refers only to the U.S ultimate parent entity. The Commission believes that this is appropriate because consolidated financial statements are the financial statements of a group under the control of the ultimate parent entity. Where the ultimate parent entity is a non-U.S. person, the non-U.S. CSE is not categorized as an FCS and therefore would be eligible for the Exclusion (assuming that the other conditions of the Exclusion are satisfied), for the reasons discussed in section II.B.3.

controlling financial interest in the FCS. By virtue of having its financial statements consolidated with those of its U.S. ultimate parent, the financial position, operating results and statement of cash flows of an FCS are included in the financial statements of its U.S. ultimate parent entity and therefore affect the financial position, risk profile and market value of the U.S. ultimate parent. Because of the FCS' direct relationship with, and the possible negative impact of its swap activities on, its U.S. ultimate parent entity and the U.S. financial system, an FCS raises greater supervisory concern in the United States relative to other non-U.S. CSEs (in each case provided that the obligations under the relevant swap are not guaranteed by a U.S. person).[101]

Further, the Commission continues to believe that, in the absence of a direct recourse guarantee from a U.S. person, an FCS should not be treated in the same manner as a U.S. CSE or U.S. Guaranteed CSE. In contrast with a U.S. Guaranteed CSE, in the event of the FCS's default, the U.S. ultimate parent entity does not have a legal obligation to fulfill the obligations of the FCS. Rather that decision would depend on the business judgment of its parent.

By relying on a consolidation test, the FCS concept is intended to provide a clear, bright-line test for identifying those non-U.S. CSEs whose uncleared swaps are likely to raise greater supervisory concerns relative to other non-guaranteed non-U.S. CSEs. The Commission further believes that, as some commenters noted, reliance on familiar U.S. GAAP accounting standards will promote legal certainty. In particular, the Commission notes that consolidation accounting is a longstanding part of U.S. GAAP and that all non-U.S. CSEs with a U.S. ultimate parent entity currently prepare consolidated financial statements.

With respect to the definition's reliance on U.S. GAAP, the Commission notes that since the 2008 financial crisis, the U.S. FASB made significant changes to the consolidation model for variable interest entities (''VIEs'') and that as a result of these changes, more VIEs (including special purpose vehicles) are being consolidated with other entities (*i.e.,* their parent entities) under U.S. GAAP. Furthermore, because the U.S. GAAP consolidation requirement adequately addresses these VIEs, the Commission believes that the addition of IFRS as an option is likely to inject unnecessary complexity and costs in many circumstances.[102] Accordingly, the Commission believes that the U.S. GAAP consolidation test in the FCS definition is sufficiently similar to the IFRS consolidation standard with respect to VIEs so that additional reliance on the IFRS standard would be neither necessary nor beneficial.[103]

4. Counterparty Representations

The proposed rule provided that market participants should generally be permitted to reasonably rely on counterparty representations with regard to their status as a U.S. person. The Commission received comments regarding its proposed reliance standard[104] and a request that the Commission also permit reliance on counterparty representations with respect to the guarantee and FCS definitions.[105]

The Commission acknowledges that the information necessary for a swap counterparty to accurately assess the status of its counterparties as U.S. persons or FCSs, or to determine whether a non-U.S. counterparty's obligations under a swap are guaranteed by a U.S. person, may be unavailable, or available only through overly burdensome due diligence. For this reason, the Commission believes that a market participant should generally be permitted to reasonably rely on written counterparty representations in each of these respects. The Commission clarifies that, consistent with the reliance standard articulated in the Commission's external business conduct rules,[106] market participants may reasonably rely on such a counterparty representation unless it has information that would cause a reasonable person to question the accuracy of the representation.

B. Applicability of Margin Requirements to Cross-Border Uncleared Swaps

The following sections discuss the cross-border application of the margin requirements to swaps between CSEs and their counterparties, including when substituted compliance and the Exclusion are applicable. Section 1 provides a brief overview of the proposed rule; section 2 addresses the availability of substituted compliance; section 3 addresses the availability of the Exclusion; section 4 discusses a special provision in the Final Rule for non-segregation jurisdictions; and section 5 discusses a special provision in the Final Rule for non-netting jurisdictions.

1. Proposed Rule

Under the proposed rule, the application of substituted compliance and the scope of the Exclusion closely tracked the Prudential Regulators' Proposed Margin Rule.[107] Specifically:

- A U.S. CSE would be required to comply with the Commission's margin rules for all uncleared swaps but would be eligible for substituted compliance with respect to the requirement to post (but not the requirement to collect) initial margin for swaps with certain non-U.S. counterparties (referred to herein as ''partial substituted compliance'').[108]
- A U.S. Guaranteed CSE would receive the same treatment as a U.S. CSE.
- A non-U.S. CSE whose obligations under the relevant swap are not guaranteed by a U.S. person would be eligible for substituted compliance unless the counterparty to the swap is a U.S. CSE or U.S. Guaranteed CSE, in which case substituted compliance would be available with respect to the requirement to collect (but not the requirement to post) initial margin (also referred to as ''partial substituted compliance'').
- A non-U.S. CSE would be eligible for an exclusion from the Final Margin Rule when trading with a non-U.S. person counterparty provided that (a) neither party's obligations under the relevant swap are guaranteed by a U.S.

[101] The Commission notes that it has a relatively greater supervisory interest in FCSs than other non-U.S. CSEs, even if they have a U.S. subsidiary or affiliate, because an FCS's ultimate parent entity is a U.S. person.

[102] The Commission notes that the standards for consolidation under U.S. GAAP's VIE model are similar to the consolidation standards that would apply under IFRS, as both consider control over one entity by the other. The Commission further notes that it does not believe that special purpose vehicles are likely to be used to conduct swaps business. Even if such vehicles transact in swaps and, consequently, register as CSEs, the ultimate parent entity would likely exercise control over them because these vehicles typically rely on parental support or guarantees to maintain their credit standards. Such control would lead to consolidation under U.S. GAAP.

[103] The Commission notes that although privately held companies are not under a regulatory obligation to prepare and file consolidated financial statements pursuant to U.S. GAAP, they nevertheless are likely to prepare consolidated financial statements for other purposes (*e.g.,* to provide to creditors as a condition to loan or to private investors), in which case their foreign subsidiaries may fall within the parameters of the FCS definition.

[104] *See, e.g.,* SIFMA AMG at 12 (standard for reliance on counterparty representations with respect to U.S. person status is consistent with that articulated in Guidance and Commission's external business conduct rules; proposed rule could be read to require ''further, unnecessary diligence'').

[105] *See, e.g., id.*

[106] *See* 17 CFR 23.402(d).

[107] *See* 79 FR at 57379–81.

[108] U.S. CSEs would not be eligible for substituted compliance with respect to the requirement that they collect initial margin or the requirement to post or collect variation margin.

person; (b) neither party is an FCS; and (c) the swap is not conducted by or through a U.S. branch of a non-U.S. CSE.

The Commission requested comment on all aspects of the proposed rule, including how the rule should treat FCSs (*e.g.,* whether they should be offered the same treatment as U.S. Guaranteed CSEs or conversely be offered the Exclusion), whether U.S. branches should be eligible for the Exclusion, and whether the Commission should provide exceptions related to certain ''emerging markets'' or non-netting jurisdictions.[109]

2. Substituted Compliance

a. Comments

Most commenters argued for the greater availability of substituted compliance. Some requested that all CSEs, whether a U.S. persons or a non-U.S. person, be eligible for full substituted compliance with respect to all comparable foreign margin requirements, including any swap dealer in a BCBS–IOSCO framework-compliant jurisdiction.[110] Others phrased their requests in narrower terms, arguing for the broader availability of substituted compliance for U.S. CSEs and/or U.S. Guaranteed CSEs when trading with non-U.S. persons.[111] Commenters generally argued that requiring CSEs to comply with the Commission's margin requirements in the face of comparable foreign margin requirements would undermine international efforts to develop a consistent global swaps regime and impose unnecessary and costly compliance burdens, resulting in competitive disparities and market inefficiencies.[112] Several commenters also argued that the proposed rule would involve substantial operational costs, including categorizing market participants and developing appropriate documentation.[113]

With respect to U.S. CSEs and U.S. Guaranteed CSEs, IIB/SIFMA and ISDA argued that compliance with the Commission's margin requirements was not necessary to prevent the transmission of risk to the U.S. financial system because the risk would be adequately addressed by comparable foreign margin requirements.[114] IIB/SIFMA argued that the proposed substituted compliance regime could actually increase liquidity risk by discouraging non-U.S. counterparties from trading with U.S. CSEs and U.S. Guaranteed CSEs in order to avoid costs associated with understanding and complying with the Commission's margin requirements, and that the resulting increased concentration of bilateral credit exposures among U.S. CSEs and U.S. Guaranteed CSEs would increase the risk of contagion in U.S. markets.[115] ISDA further argued that ''[c]omity and respect for the supervisory interests of non-U.S. regulators'' argue in favor of full substituted compliance or exclusion for swaps involving non-U.S. person counterparties.[116] FSR argued that substituted compliance is at least necessary for foreign branches because they are likely to be subject to foreign margin requirements and pose the same concerns to foreign regulators as the U.S. branches of non-U.S. CSEs pose to U.S. regulators.[117]

Several commenters raised concerns with regard to the proposal to allow partial substituted compliance.[118] SIMFA AMG argued that partial substituted compliance would be ''inconsistent with the importance of bilateral margining,'' add unnecessary costs and complexity, and increase the potential for margin disputes.[119] AIMA/IA argued that developing a legal agreement allowing for the transfer of margin amounts according to more than one margin regime would be ''commercially and legally problematic.'' [120] As a result, market participants would default to complying with the Commission's margin requirements, negating the value of substituted compliance.[121] ISDA similarly argued that developing a standardized model for initial margin that could account for different margin rules in one netting set would be ''impractical'' in the available timeframe for compliance.[122] FSR argued that partial substituted compliance was not ''in the spirit of the International Standards'' [123] and pointed out that its usefulness may be questionable, given that no other foreign jurisdiction has proposed a similar approach.[124]

IATP, on the other hand, supported the proposed substituted compliance regime.[125] IATP agreed that FCSs should be granted substituted compliance but not U.S. Guaranteed Affiliates because losses from the swaps of an FCS may have a negative impact on the foreign jurisdiction's economy.[126] IATP also agreed that U.S. Guaranteed Affiliates should not be eligible for substituted compliance with respect to the requirement to collect

[109] *See* Proposal, 80 FR at 41387, 88–91.

[110] *See, e.g.,* AIMA/IA at 4–5 (substituted compliance should be ''all encompassing, and applicable to all parties to a transaction''); ICI Global at 2, 9 (substituted compliance should be made available ''without qualification'' wherever foreign jurisdiction's margin requirements are comparable); ISDA at 2, 7–8 (substituted compliance should be available for any transaction subject to foreign requirements comparable to BCBS–IOSCO framework); SIFMA AMG 4, 6–8 (market participants should be allowed ''to comply with a single set of substantive margin requirements for all uncleared swaps''). *See also* ABA/ABASA at 3 (market participants should be allowed to rely on substituted compliance ''to the greatest possible degree across the markets in and structures through which they operate'').

[111] *See, e.g.,* FSR at 7 (U.S. CSEs should be able to rely on substituted compliance for both posting and collecting of initial margin when trading with non-U.S. CSEs and their foreign branches be extended full substituted compliance); IIB/SIFMA at 4–9 (substituted compliance should be available for U.S. CSEs and U.S. Guaranteed CSEs with respect to all margin requirements, including posting and collecting both initial and variation margin); JBA at 8–9 (availability of substituted compliance for U.S. Guaranteed CSEs is too limited); PensionsEurope at 2 (''full substituted compliance,'' including collection of initial margin and variation margin, should be available for transactions between U.S. Guaranteed CSEs and ''financial institutions without a U.S. nexus'').

[112] *See, e.g.,* AIMA/IA at 1; FSR at 3–7; ICI Global at 8–9. *See also* Vanguard at 2 (applying substituted compliance on a ''transaction-by-transaction basis'' would undermine ''the fundamental risk mitigation tool of cross-transactional close-out netting'').

[113] *See, e.g.,* AIMA/IA at 1 (proposed rule would require a ''significant amount of replacement and additional documentation to account for different counterparty combinations''); ISDA at 5 (operational complexity of proposed substituted compliance regime would further increase operating costs); IIB/SIFMA at 7 (CSEs would not know sufficient information about businesses of their counterparties to categorize them, and non-U.S. counterparties would not be familiar with, and would be reluctant to hire counsel to determine, all U.S. laws relevant to making the determination); SIFMA AMG at 6 (highlighting complications in determining availability of substituted compliance on basis of counterparty status in context of block trades).

[114] *See* IIB/SIFMA at 5; ISDA at 6–7. *See also* ICI Global at 9 (by not permitting substituted compliance in certain instances, Commission would effectively be determining that foreign margin requirements are not ''good enough'' despite being found comparable).

[115] *See* IIB/SIFMA at 6–7.

[116] *See* ISDA at 6.

[117] *See* FSR at 7–8. *See also* AIMA/IA at 3 (absence of substituted compliance for foreign branches of U.S. CSEs is an ''apparent gap[ ]'').

[118] *See, e.g.,* AIMA/IA at 4; FSR at 7; ISDA at 3, 5; SIFMA AMG at 10.

[119] *See* SIFMA AMG at 10 (highlighting additional complexities in calculating margin for clients using multiple asset managers).

[120] *See* AIMA/IA at 4.

[121] *See id.*

[122] *See* ISDA at 9 (counterparties wanting to use a single custodian could face additional challenges, as the custodial arrangement would have to be drafted to accommodate overlapping and potentially inconsistent requirements for segregation).

[123] *See* proposed 17 CFR 23.160(a)(3) (defining ''International Standards'' as based on the BCBS–IOSCO framework).

[124] *See* FSR at 7.

[125] *See* IATP at 3–4 (proposed rule would provide ''the greatest opportunity for effective risk mitigation against swaps counterparty default'' and would be a ''critical step'' to ensuring that ''de-guaranteed'' swaps ''will not continue to elude effective regulation'').

[126] *See* IATP at 7.

initial margin from a non-U.S. counterparty.[127] AFR described the proposed rule as creating a ''very significant scope for substituted compliance'' with respect to non-U.S. CSEs, but suggested that the scope would not be a concern provided the substituted compliance were limited to foreign rules that are ''very similar'' to U.S. margin requirements.[128]

b. Final Rule

The Commission has determined to adopt a cross-border framework largely as proposed, but with certain modifications to address concerns raised by commenters and to further align the rule with the cross-border approach adopted by the Prudential Regulators. Generally speaking, the cross-border margin framework in the Final Rule reflects the Commission's efforts to carefully tailor the application of the Commission's margin requirements to address comity considerations and mitigate potential adverse impact on market efficiency and competition without compromising the safety and soundness of CSEs. The availability of substituted compliance under the Final Rule therefore depends on the degree of nexus the CSEs and their counterparties have to the U.S. financial system, as indicated by their status (*e.g.,* whether they are U.S. persons or non-U.S. persons whose obligations under the relevant swap are guaranteed by a U.S. person).

i. Uncleared Swaps of U.S. CSEs and U.S. Guaranteed CSEs

As a general rule, the Commission believes that, in light of their position in the U.S. financial system, U.S. persons and U.S. Guaranteed CSEs should be required to comply with the Commission's margin requirements. Under the Final Rule, however, U.S. CSEs and U.S. Guaranteed CSEs would be eligible for substituted compliance with respect to the requirement to post (but not the requirement to collect) initial margin provided that the counterparty is a non-U.S. person whose obligations under the relevant swap are not guaranteed by a U.S. person. By virtue of their being domiciled or organized in the United States, U.S. CSEs give rise to greater supervisory interests relative to other CSEs. U.S. Guaranteed CSEs create a similar supervisory interest because, as discussed in the proposed rule, the swap of a non-U.S. CSE whose obligations under the swap are guaranteed by a U.S. person is identical, in relevant aspects, to a swap entered into directly by a U.S. person.

Nevertheless, the Commission believes that, in the interest of comity, permitting substituted compliance for the limited requirement of posting initial margin would be reasonable. While requiring a CSE to post initial margin protects the counterparty in the event of default by the CSE, it also serves as a risk management tool because it limits the amount of leverage a CSE can incur by requiring that it have adequate eligible collateral to enter into an uncleared swap. Accordingly, when the counterparty is a non-U.S. person (whose obligations under the swap are not guaranteed by a U.S. person), the Commission believes that substituting the foreign margin requirements with regard to the initial margin posted would be reasonable. The Commission further believes that allowing substituted compliance in this limited instance may reduce transaction costs for U.S. CSEs when trading with non-U.S. counterparties[129] and thereby mitigate potential competitive disparities (relative to other CSEs and non-CFTC registered dealers operating in the foreign jurisdiction), while ensuring that the U.S. CSE is adequately protected in the event of default of the non-U.S. counterparty. The availability of substituted compliance is limited to circumstances where the non-U.S. counterparty's obligations under the relevant swap are not guaranteed by a U.S. person in order to avoid incentivizing market participants to structure their swaps solely for purposes of avoiding application of the Commission's margin requirements.[130]

The Commission does not believe that partial substituted compliance would prohibit the use of a single netting set for calculating initial margin. Under the Final Rule, a U.S. CSE can comply with the Commission's initial margin requirements by posting pursuant to comparable foreign margin requirements. Accordingly, from the Commission's perspective, one netting set could encompass swaps that comply with both foreign and CFTC initial margin requirements.[131]

The Commission understands that CSEs relying on partial substituted compliance may face certain costs or challenges not experienced by non-U.S. CSEs that are eligible for full substituted compliance. Nevertheless, as discussed above, the Commission believes that granting substituted compliance more broadly (*e.g.,* permitting both collection and posting of initial margin pursuant to the foreign requirements) would not be appropriate for a swap transaction involving a U.S. CSE or a U.S. Guaranteed CSE. Moreover, U.S. CSEs and U.S. Guaranteed CSEs that elect to rely on partial substituted compliance may realize savings in the form of reduced funding costs (to the extent that foreign jurisdiction requires less initial margin to be posted), and their non-U.S. counterparties may experience lower operational costs as a result of only having to comply with their home jurisdiction's requirements.

Finally, the Commission does not believe it would be appropriate to broaden the scope of substituted compliance available to swaps conducted through foreign branches of U.S. CSEs. A foreign branch is legally indistinguishable from the U.S. CSE itself, such that the whole U.S. CSE, and not merely the foreign branch, holds itself out to the market and assumes the risks of any uncleared swap transactions conducted by or through the foreign branch. Accordingly, swaps conducted through a foreign branch of a U.S. CSE are appropriately treated the same as swaps of the U.S. CSE as a whole. Moreover, if the Commission were to allow broader substituted compliance for swaps conducted through foreign branches than swaps conducted domestically, U.S. CSEs could be incentivized to conduct swap activity through foreign branches to avoid direct compliance with Commission's margin requirements.

ii. Uncleared Swaps of Non-U.S. CSEs (Including FCSs) Whose Obligations Under the Relevant Swap Are Not Guaranteed by a U.S. Person

Under the Final Rule, consistent with the Proposed Rule, non-U.S. CSEs (including FCSs) whose obligations under the relevant uncleared swap are

[127] *See id.*

[128] *See* AFR at 7. *See also id.* at 4 (scope of substituted compliance could become ''overbroad'' given that proposed rule included narrow definition of ''guarantee'' and limited Foreign Consolidated Subsidiaries to subsidiaries of registered CSEs).

[129] That is, if the initial margin amount required to be posted under the foreign rule is lower than the amount required under the Commission's Final Margin Rule, and the parties elect for the CSE to post margin pursuant to the foreign margin requirements, the lower margin may reduce the U.S. CSE's funding costs.

[130] For example, if partial substituted compliance were available for non-U.S. counterparties that are guaranteed by a U.S. person, a swap between a U.S. CSE and a U.S. counterparty could be restructured as a swap between a U.S. CSE and a non-U.S. counterparty that is guaranteed by a U.S. person in order to avoid application of the Commission's margin requirements.

[131] The Commission similarly does not expect that reliance on partial substituted compliance will hinder the development or use of a standardized model for initial margin, as the Commission believes that a single model could be developed to satisfy the initial margin requirements of multiple jurisdictions.

not guaranteed by a U.S. person may avail themselves of substituted compliance to a greater extent than U.S. CSEs and U.S. Guaranteed CSEs. Specifically, where the obligations of a non-U.S. CSE (including an FCS) under the relevant swap are not guaranteed by a U.S. person, substituted compliance is available with respect to its uncleared swaps with any counterparty, other than a U.S. CSE or a U.S. Guaranteed CSE.[132]

The broad substituted compliance framework available to this category of non-U.S. CSEs reflects the Commission's recognition of foreign jurisdictions' supervisory interest in CSEs that are domiciled and operating in their jurisdictions. In addition, the Commission understands that compliance with two sets of margin regulations may lead to costs and burdens for non-U.S. CSEs not faced by their competitors in the local jurisdiction and may provide disincentives for foreign clients to transact with a non-U.S. CSE. The Commission believes that making substituted compliance broadly available to non-U.S. CSEs that are not guaranteed by a U.S. person may help to reduce the potential adverse impact on market efficiency and competition, without compromising the protections for the non-U.S. CSE and the U.S. financial markets.

As discussed in the next section, a non-U.S. CSE that is not an FCS will be eligible for the Exclusion from the Commission's margin rules under certain circumstances. However, uncleared swaps entered into by an FCS will not be eligible for any exclusion because of its relationship with its U.S. ultimate parent entity, and because of the possible negative impact of its swap activities on its U.S. ultimate parent entity and the U.S. financial system. As explained in section II.A.3.c. above, the financial position, operating results, and statement of cash flows of an FCS are included in the financial statements of the U.S. ultimate parent entity and therefore have a direct impact on the consolidated entity's financial position, risk profile, and market value. The Commission is also concerned that extending the Exclusion to FCSs would incentivize U.S. entities to conduct their swap activities with non-U.S. counterparties through non-U.S. subsidiaries solely in order to avoid application of the Dodd-Frank Act margin requirements, leading to further bifurcation between U.S. and non-U.S. swap business.

The Commission recognizes that its decision not to extend the Exclusion to FCSs could put them at a disadvantage relative to other non-U.S. market participants/swap dealers (including those that are CSEs).[133] However, given the supervisory concerns raised by the nexus between FCSs and their U.S. ultimate parent entity, the Commission believes that extending the Exclusion to an FCS would not further the paramount statutory objective of ensuring the safety and soundness of a CSE and the stability of U.S. financial markets. The Commission notes that potential competitive disparities may be mitigated to the extent that the relevant foreign jurisdiction implements comparable margin requirements.

3. Exclusion

a. Comments

Several commenters supported the Exclusion because they believed that it recognized the absence of a U.S. jurisdictional nexus.[134] Nevertheless, these commenters requested that the Exclusion be expanded to include U.S. branches of non-U.S. CSEs and FCSs.[135]

With respect to U.S. branches, IIB/SIFMA argued that distinguishing them would not be necessary from a risk-mitigation perspective because the risk remains with the non-U.S. CSE outside the United States regardless of whether the non-U.S. CSE involves U.S. personnel.[136] ISDA and ICI Global further argued that treating U.S. branches differently from the rest of the CSE could create ''significant operational issues and credit risks.'' [137] ICI Global stated that the same ISDA Master Agreement typically governs all transactions involving both the U.S. and non-U.S. branches of a non-U.S. CSE, and that not granting the Exclusion to swaps between a non-U.S. person and a U.S. branch of a non-U.S. CSE (whose obligations are not guaranteed by a U.S. person) may require parties to document transactions with the U.S. branch under a separate master agreement, which could create operational difficulties.[138] ICI Global also expressed concern that disparate treatment of U.S. branches could lead to additional credit risk because counterparties might lose netting benefits under bankruptcy laws.[139]

With respect to FCSs, ICI Global argued that consolidation is insufficient to create a ''direct'' U.S. nexus because the U.S. ultimate parent is not under a legal obligation to support the FCS.[140] IIB/SIFMA added that foreign jurisdictions have not proposed to apply margin rules to foreign, non-guaranteed subsidiaries and that the Commission should extend the Exclusion to avoid overlapping requirements that could lead market participants to avoid trading with an FCS.[141] Although substituted compliance would potentially be available in place of the Exclusion, ISDA asserted that the difference between the Exclusion and substituted compliance is not costless, as affected swap dealers would incur costs of complying with any conditions imposed with respect to substituted compliance and with the Commission's exercise of its related examination authority, in addition to lost business that could result if substituted compliance is not ''seamless'' and counterparties are ''inconvenienced'' by its application.[142]

As an alternative to extending the Exclusion to FCSs, IIB/SIFMA suggested that the Commission grant an exclusion to FCSs operating without a U.S. guarantee when transacting with non-U.S. persons operating without a U.S. guarantee, up to an aggregate 5 percent limit on the notional trading volume in uncleared swaps entered into by commonly controlled FCSs under the exclusion relative to the total notional swap trading volume of entities within the common U.S. ultimate parent entity's consolidated group.[143] IIB/SIFMA argued that such a limited exclusion would achieve the Commission's risk mitigation objectives

[132] With respect to uncleared swaps of a non-U.S. CSE whose obligations under the swap are not guaranteed by a U.S. person, on the one hand, with a U.S. CSE or a U.S. Guaranteed CSE, on the other hand, substituted compliance would only be available for initial margin collected by the non-U.S. CSE whose obligations under the relevant swap are not guaranteed by a U.S. person, as discussed above.

[133] For example, a non-U.S. CSE relying on the Exclusion or non-CFTC registered swap dealers may be able to realize cost savings and offer better pricing terms to foreign clients.

[134] *See* ICI Global at 2, 5; IIB/SIFMA at 10.

[135] *See id. See also* ISDA at 3 (Exclusion should be expanded to include any swap between a non-U.S. CSE, whether or not guaranteed, and any non-U.S. person counterparty that is not guaranteed by a U.S. person).

[136] *See* IIB/SIFMA at 16.

[137] *See* IIB/SIFMA at 16; ICI Global at 10–11.

[138] *See* ICI Global at 10–11.

[139] *See also* ISDA at 11 (fragmenting netting sets could increase risk and discourage use and employment of U.S. personnel).

[140] *See* ICI Global at 11. *See also* IIB/SIFMA at 14 (CEA section 2(i) does not authorize the Commission to regulate a foreign subsidiary solely due to potential for support from and risk to a U.S. parent entity because, absent a legal obligation to provide support, the ''chain of intervening factors and events'' that might lead to such support would not satisfy ''direct'' requirement in CEA section 2(i)).

[141] *See* IIB/SIFMA at 15.

[142] *See id.* at 7.

[143] *See* IIB/SIFMA at 16.

without directly regulating wholly non-U.S. counterparties.[144]

Both AFR and Better Markets expressed support for the proposal not to extend the Exclusion to FCSs, describing it as a means of addressing the issue of de-guaranteeing.[145] AFR nevertheless expressed concern that the Exclusion would apply to a non-U.S. CSE when entering into a swap with a foreign subsidiary that is a financial end user that has a U.S. ultimate parent, and suggested that the Commission also deny the Exclusion in this case.[146] AFR also suggested that the Commission ''supplement'' its approach by further denying the Exclusion to a non-consolidated, non-U.S. subsidiary that could, based on the facts and circumstances, have a ''major impact on the financial well-being of the parent,'' including circumstances where the parent does not use U.S. GAAP accounting.[147]

b. Final Rule

The Commission has determined to adopt the Exclusion largely as proposed, with a modification that preserves the Commission's intent with respect to the treatment of inter-affiliate swaps under the Final Margin Rule. Under the Final Rule, an uncleared swap entered into by a non-U.S. CSE with a non-U.S. counterparty (including a non-U.S. CSE) is excluded from the Commission's margin rules, provided that neither counterparty's obligations under the relevant swap are guaranteed by a U.S. person and neither counterparty is an FCS.[148] This approach reflects the Commission's recognition of foreign jurisdictions' strong supervisory interest in the uncleared swaps of non-U.S. CSEs and their non-U.S. counterparties, both of which are domiciled and operate abroad. Under these circumstances, the Commission believes that it is appropriate to make a limited exception to the principle of firm-wide application of margin requirements, consistent with comity principles, so as to exclude a narrow class of uncleared swaps involving a non-U.S. CSE and a non-U.S. counterparty.[149]

The Commission notes that a non-U.S. CSE that can avail itself of the Exclusion is still subject to the Commission's margin rules with respect to all other uncleared swaps (*i.e.,* those that do not qualify for the Exclusion), with the possibility of substituted compliance. And any excluded swaps may be covered by the margin requirements of another jurisdiction that adheres to the BCBS–IOSCO framework.[150] Additionally, the non-U.S. CSE would be subject to the Commission's capital requirements, which, as proposed, would impose a capital charge for uncollateralized exposures.[151]

The Commission considered comments urging a broader scope of the Exclusion to include, for example, any FCSs so long as their swaps are not guaranteed by a U.S. person or alternatively, do not exceed a ''de minimis'' level of swap activity. However, the Commission does not believe that extending the Exclusion to uncleared swaps of FCSs is appropriate given the nature of their relationship to their U.S. ultimate parent entity. The limited scope of the Exclusion reflects that the benefits of the margin requirement are achieved when it is applied to all CSEs and on a firm-wide basis and therefore, any exception needs to be carefully tailored to avoid creating a significant supervisory gap and inappropriate levels of risk to the CSE and the U.S. financial system.

The Commission also disagrees with comments that the Exclusion is overly broad because it would extend to a swap between a non-U.S. CSE and a foreign subsidiary of a U.S. financial end user.[152] The Commission notes that such a foreign subsidiary would not be an FCS even if it is consolidated with its U.S. parent because it is not a CSE. The Commission believes that a swap between such a foreign subsidiary and a non-U.S. CSE should be eligible for the Exclusion because financial end users are not covered swap entities and are likely to include many entities that do not conduct a significant level of swap activities; as such, their swap activities would not have the same effect on the U.S. ultimate parent entity as would a covered swap entity's. Therefore, the Exclusion applies to qualifying non-U.S. CSEs when transacting with foreign subsidiaries that are financial end users that have a U.S. ultimate parent entity.

Under the Final Margin Rule, a CSE is not required to collect initial margin from its affiliate, provided, among other things, that affiliate collects initial margin on its market-facing swaps or is subject to comparable initial margin collection requirements (in the case of non-U.S. affiliates that are financial end users) on its own market-facing swaps. In order to preserve the Commission's intent with respect to the treatment of inter-affiliate swaps under the Final Margin Rule, the Exclusion is not available if the market-facing swap of the non-U.S. CSE (that is otherwise eligible for the Exclusion) is not subject to comparable initial margin collection requirements in the home jurisdiction and any of the risk associated with the uncleared swap is transferred, directly or indirectly, through inter-affiliate transactions, to a U.S. CSE or a U.S. Guaranteed CSE. This condition is intended to ensure that inter-affiliate swaps are not used to avoid the requirement to collect initial margin from third-parties.[153] The limitation on the Exclusion is consistent with that rationale.

Under the Final Rule, uncleared swaps of a U.S. branch of a non-U.S. CSE are not eligible for the Exclusion. The Commission does not believe extending the Exclusion to U.S. Branches would be appropriate. Generally speaking, U.S. branches of foreign banks [154] have a Prudential Regulator and must therefore comply with the Prudential Regulators' margin rules. The Prudential Regulators' Final Margin Rule does not grant an exclusion for the uncleared swaps of such U.S. branches on the basis that U.S. branches of foreign banks clearly operate within the United States and could pose risk to

[144] *See id.*

[145] *See* AFR at 2 (proposed rule would go ''some distance'' toward limiting evasion of Commission's margin requirements); Better Markets at 5 (proposed rule ''adequately captures'' many foreign affiliates that may have escaped U.S. margin requirements through de-guaranteeing).

[146] *See* AFR at 8 (foreign subsidiary of a U.S. financial end user that is not a CSE would not be defined as an FCS even if consolidated).

[147] *See* AFR at 3. *See also* Better Markets at 2 (Exclusion is needlessly complicated and indirect and Commission should address issue more completely by reverting to and updating approach in Guidance).

[148] The Exclusion also does not apply if the counterparty is a U.S. branch of a non-U.S. CSE. *See* 17 CFR 23.160(b)(2)(ii).

[149] The Commission disagrees that the Commission lacks a jurisdictional nexus with respect to swaps subject to the Exclusion. To the contrary, as discussed above, by the terms of the relevant statutory provision, CEA section 4s(e), and the underlying purpose of that provision, the Commission's authority to adopt margin rules applies to all CSEs, U.S. and non-U.S., and extends to all of their uncleared swaps, regardless of the counterparties' domicile or the location of the swaps transaction.

[150] In this regard, the Commission notes that, as indicated in *supra* note 23, representatives of 26 regulatory authorities (comprising 17 nations) participated in the WGMR that developed the BCBS–IOSCO framework. As of today, 24 of these 26 regulatory authorities that participated in the WGMR have proposed a regulatory framework for margin for uncleared swaps, all of which are consistent with the BCBS–IOSCO framework. In addition, these 24 regulatory authorities have jurisdiction over more than 90% of the swaps activities in the world by any measure.

[151] *See* Proposed Capital Rule, 76 FR 27802.

[152] The term ''financial end user'' is defined in section 23.150 of the Final Margin Rule.

[153] *See* 17 CFR 23.159.

[154] *See* Prudential Regulators' Final Margin Rule, 80 FR at 74901 (setting forth the definition of ''foreign bank'' for purposes of the Prudential Regulators' Final Margin Rule).

the U.S. financial system.[155] To the extent that a U.S. branch of a non-U.S. CSE is subject to the Commission's requirements rather than a Prudential Regulator, the Final Rule appropriately harmonizes with the Prudential Regulators.[156] Additionally, given that U.S. branches operate within the United States, allowing their swaps to be excluded from application of the Commission's margin requirements could disadvantage U.S. CSEs when competing with U.S. branches for U.S. clients [157] and create incentives for CSEs to operate through U.S. branches solely for purposes of avoiding the Dodd-Frank Act margin requirements. Accordingly, the Commission believes that a non-U.S. CSE should be subject to the Commission's margin requirements when conducting swap activities from within the United States by or through a U.S. branch.[158]

4. Special Provision for Non-Segregation Jurisdictions [159]

a. Comments

Several commenters supported the creation of a de minimis exception similar to the emerging markets exemption set out in the Guidance.[160] Specifically, commenters recommended that U.S. CSEs be exempt from the margin requirements when trading with ''emerging market counterparties'' provided that the aggregate notional volume of its uncleared swaps with emerging market counterparties does not exceed 5 percent of the CSEs' total notional swap trading volume, both cleared and uncleared.[161] They further recommended defining ''emerging market counterparty'' as a non-U.S. person that is (a) not a registered CSE, (b) not guaranteed by a U.S. person, and (c) not located in a jurisdiction covered by a comparability determination for uncleared swaps margin rules issued by the Commission.[162] Commenters generally agreed that the exception should apply to foreign branches of U.S. CSEs,[163] but some commenters also recommended that it be extended to U.S. Guaranteed CSEs [164] and FCSs.[165] For swaps between U.S. Guaranteed CSEs and emerging market counterparties, ABA/ABASA and IIB/SIFMA recommended that the de minimis threshold apply to the aggregate volume of uncleared swaps guaranteed by a particular U.S. person, rather than to the trading volume of the U.S. Guaranteed CSE itself.[166]

In support of such an exception, commenters argued that legal and operational constraints in emerging market jurisdictions could make compliance with margin rules difficult, if not impossible.[167] As a result, broad application of the margin requirements to these swaps could negatively impact the competitiveness of registered CSEs.[168] Commenters argued that by limiting the exception to CSEs with a de minimis level of swaps activity, the Commission could accomplish the goal of ensuring a CSE's safety and soundness but with less disruption to existing business relationships than the exchange of initial and variation margin would impose.[169] IIB/SIFMA also argued that the exception would be consistent with CEA section 2(i), and encouraged the Commission to coordinate with foreign regulators to develop a consistent global approach to swaps with emerging market counterparties.[170]

b. Final Rule

The Commission is adopting a special provision for swaps with counterparties in foreign jurisdictions where limitations in the legal or operational infrastructure of the jurisdiction make it impracticable for the CSE and its counterparty to comply with the custodial arrangement requirements in the Final Margin Rule (''non-segregation jurisdictions'').[171] The Commission understands that CSEs may transact swaps with counterparties located in foreign jurisdictions that do not have legal or operational infrastructures to support custodial arrangements required under the Final Margin Rule.[172] In the face of these legal and operational impediments, FCSs and foreign branches of U.S. CSEs would be forced to discontinue their swaps business with clients located in these jurisdictions. Taking these factors into consideration, the Commission has determined to include a special provision to accommodate this unique circumstance. The Commission notes that the Prudential Regulators adopted a similar provision in their final margin rules.

Under section 23.160(e) of the Final Rule, an FCS or a foreign branch of a U.S. CSE would be eligible to engage in

[155] *See* Prudential Regulators' Final Margin Rule, 80 FR at 74883.

[156] Under the International Banking Act of 1978, 12 U.S.C. 3101 *et seq.,* U.S. branches are generally treated the same as national banks operating in that same location and are subject to the same laws, regulations, policies, and procedures that apply to national banks.

[157] That is, a U.S. branch of a non-U.S. CSE that is permitted to operate outside of the Commission's margin requirements may, by virtue of being subject to reduced or even no margin requirements, be able to offer a more competitive price to U.S. clients than a U.S. CSE.

[158] As noted above in section II.B.3.a., some commenters suggested that not extending the Exclusion to U.S. branches of non-U.S. CSEs could require non-U.S. CSEs to document transactions with the U.S. branch under a separate ISDA Master Agreement, creating operational challenges. However, because such U.S. branches are eligible for substituted compliance, use of a separate credit support agreement to document transactions with a non-U.S. CSE's U.S. branch should only be necessary where foreign margin requirements are not comparable. Although the Commission acknowledges that the non-U.S. CSE may need to use a separate credit support agreement for U.S. branch transactions in this limited case, the Commission nevertheless believes that it would not be appropriate to extend the Exclusion to U.S. branches of non-U.S. CSEs for the reasons discussed above.

[159] The term ''emerging market'' is not used in the Final Rule because some jurisdictions covered by this provision of the Final Rule are not aptly described by that term.

[160] *See, e.g.,* ABA/ABASA at 3–5; IIB/SIFMA at 3, 11–13; ISDA at 2, 9–10; JBA at 10.

[161] *See* ABA/ABASA at 5. *See also* ISDA at 9–10 (further recommending that Commission impose recordkeeping requirement as condition to exemption, as was included in Guidance).

[162] *See* ABA/ABASA at 4–5; IIB/SIFMA at 13. *See also* ISDA at 9 (''emerging market counterparty'' should be defined as any non-U.S. person that is not guaranteed by a U.S. person and that is not located in one of six jurisdictions identified in Guidance as having submitted requests for comparability determinations).

[163] *See* ABA/ABASA at 1 n.5 (exemption should apply to ''U.S.-based banking organizations, however they are operating in emerging markets, including, but not limited to, through a foreign branch of a prudentially-regulated CSE''); IIB/SIFMA; ISDA.

[164] *See* ABA/ABASA at 1 n.5, 3; IIB/SIFMA at 12; ISDA at 9.

[165] *See* ISDA at 10 (availability of the exemption should be extended to FCSs if Commission does not otherwise make Exclusion available to them).

[166] *See* ABA/ABASA at 5; IIB/SIFMA at 13 (approach would be appropriate given that risk to U.S. guarantor provides basis for extraterritorial application of margin rules to U.S. Guaranteed CSEs).

[167] *See, e.g.,* ABA/ABASA at 4 (local banking sector may lack operational infrastructure to support daily exchange of margin or third-party custodial arrangements); IIB/SIFMA (local legal regime may not recognize concept of netting); ISDA at 4 (emerging market counterparties may be unable to comply with U.S. margin requirements).

[168] *See* ABA/ABASA at 4 (absent an exemption, U.S. CSEs could lose not only derivatives business but associated commercial and investment banking relationships); IIB/SIFMA at 12 (emerging market counterparties are likely to move business away from U.S. CSEs and U.S. Guaranteed CSEs in order to avoid being subject to margin requirements); ISDA at 10 (dealing activities that would fall within exemption may be an ''integral element'' of CSEs' global business).

[169] *See* ABA/ABASA at 3; IIB/SIFMA at 12–13; ISDA at 10.

[170] *See* IIB/SIFMA at 12 (arguing that de minimis nature of exemption ensures that nexus of swap activity to the United States is not ''significant'').

[171] For convenience, the term ''non-segregation jurisdiction'' is used in the preamble of this release.

[172] The Final Margin Rule addresses the manner in which the margin collected or posted by a CSE must be held and requires, among other things, that the CSE must have a custodial agreement prohibiting rehypothecation or otherwise transfer the initial margin held by the custodian. *See* 17 CFR 23.157. The custodial requirements are critical to ensuring the proper segregation and protection of CSE funds.

uncleared swaps with certain non-U.S. counterparties in non-segregation jurisdictions, without complying with either the requirement to post initial margin [173] or the custodial arrangement requirements that pertain to initial margin collected by a CSE under the Final Margin Rule,[174] subject to certain conditions.[175] This special provision reflects the Commission's recognition that CSEs would otherwise be precluded from engaging in any uncleared swaps in these foreign jurisdictions as they cannot satisfy the custodial requirements of the Final Margin Rule. The Commission clarifies that the special provision for non-segregation jurisdictions only provides relief from the specified requirements; all other margin rules in part 23 of the Commission's regulations (with the exception of the special provision for non-netting jurisdictions) would continue to apply.[176]

This provision is narrowly tailored to limit its availability to FCSs (and foreign branches of U.S. CSEs) in foreign jurisdictions where compliance with the Final Margin Rule's custodial requirements is effectively precluded due to impediments inherent in the relevant foreign jurisdiction.[177] In addition, this provision is only available in such jurisdictions if the following conditions are satisfied. First, the CSE's counterparty must be a non-U.S. person that is not a CSE, and the counterparty's obligations under the swap must not be guaranteed by a U.S. person.[178] Second, the CSE must collect initial margin in cash on a gross basis, and post and collect variation margin in cash, in accordance with the Final Margin Rule.[179] The collection of margin on a gross basis ensures that the CSE has adequate collateral in the event of a counterparty or custodial default; similarly, not requiring the CSE to post initial margin minimizes the amount of collateral that may not be recovered if the CSE's counterparty defaults. Third, for each broad risk category set out in section 23.154(b)(2)(v) of the Final Margin Rule,[180] the total outstanding notional value of all uncleared swaps in that broad risk category, as to which the CSE is relying on section 23.160(e), may not exceed 5 percent of the CSE's total outstanding notional value for all uncleared swaps in the same broad risk category. Accordingly, a 5 percent limit applies to each of the four broad risk categories set forth in section 23.154(b)(2)(v): Credit, equity, foreign exchange and interest rates (considered together as a single asset class), and commodities. Fourth, the CSE must have policies and procedures ensuring that it is in compliance with all of the requirements of this exception. Fifth, the CSE must maintain books and records properly documenting that all of the requirements of this exception are satisfied.[181]

In adopting this provision, the Commission considered the various alternatives endorsed by commenters, including the adoption of a blanket exclusion, subject to a transactional volume limit (*e.g.,* using a 5 percent limit patterned after a limited exclusion for certain jurisdictions in the Guidance, as discussed in section II.B.4.a. above). However, given the importance of the Final Margin Rule's requirements to the protection of CSEs and the broader financial system, and the potential for a blanket exclusion to incentivize market participants to structure their swap business solely to avoid application of the Commission's margin requirements, the Commission believes that a more targeted approach that provides relief from only from the requirement to post initial margin and the custodial arrangement requirements that pertain to initial margin collected by a CSE, as described above, is appropriate. While the Commission believes that the relief provided by the special provision is appropriate because FCSs and foreign branches of U.S. CSEs would otherwise be effectively precluded from entering swaps in non-segregation jurisdictions, the Commission also believes that, in order to protect the safety and soundness of FCSs and foreign branches of U.S. CSEs relying on the special provision, the exception from the specified requirements is appropriately limited, as these CSEs are integral to the stability of the U.S. financial system.

Therefore, rather than provide an exception from all of the Commission's margin requirements to CSEs that engage in swaps activities in non-segregation jurisdictions up to a 5% limit, as suggested by some commenters, the special provision only excepts qualifying FCSs and foreign branches of U.S. CSEs from certain specified requirements, subject to specified conditions (including a 5 percent limit in each of four broad risk categories set forth in § 23.154(b)(2)(v)), as described above. The Commission believes that imposing a 5 percent limit in each of the four broad risk categories set out in § 23.154(b)(2)(v) is necessary because the FCS (or foreign branch of a U.S. CSE) may have a large notional amount outstanding in the foreign exchange and interest rate category (which is considered together as a single class) which would effectively eviscerate any limit in other lower notional risk categories.

The Commission believes that the total outstanding notional value of all

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173 *See* 17 CFR 23.152(b).

174 *See* 17 CFR 23.157(b). The Commission notes that with respect to initial margin collected by a qualifying CSE in a non-segregation jurisdiction in reliance on § 23.160(e), § 23.157(c) also would not apply to initial margin that is collected by the CSE. Section 23.157(c) requires a CSE to enter a custodial agreement meeting specified requirements with respect to any funds that the CSE holds (*i.e.,* initial margin posted or collected by the CSE). Because CSEs that rely on § 23.160(e) are not required to hold collateral in accordance with § 23.157(b) for initial margin that they collect, they also would not be required to comply with § 23.157(c) with respect to initial margin that they collect.

175 This provision only provides relief from the custodial requirement for collection of initial margin in § 23.157(b). Accordingly, FCSs and foreign branches of U.S. CSEs remain subject to the requirements of § 23.157(a) and (c) of the Final Margin Rule with respect to initial margin that is posted in a non-segregation jurisdiction (which the CSE would be unable to comply with in a non-segregation jurisdiction).

176 If the special provision for non-segregation jurisdictions is available, then the special provision for non-netting jurisdictions (discussed in the next section) would not be available even if the relevant foreign jurisdiction is also a ''non-netting jurisdiction.'' As explained in *supra* note 174, because CSEs that rely on § 23.160(e) are not required to hold collateral in accordance with § 23.157(b) for initial margin that they collect, they would not be required to comply with § 23.157(c) with respect to initial margin that they collect.

177 The special provision applies where inherent limitations in the legal or operational infrastructure in the applicable foreign jurisdiction make it impracticable for the FCS (or foreign branch of a U.S. CSE) and its counterparty to post initial margin in compliance with the custodial requirements of § 23.157 of the Final Margin Rule. The special provision does not apply if the CSE that is subject to the foreign regulatory restrictions is permitted to post collateral for the uncleared swap in compliance with the custodial arrangements of § 23.157 in the United States or a jurisdiction for which the Commission has issued a comparability determination with respect to § 23.157. *See* 17 CFR 23.160(e)(1) and (2).

178 The Commission would expect the CSE's counterparty to be a local financial end user that is required to comply with the foreign jurisdiction's laws and that is prevented by regulatory restrictions in the foreign jurisdiction from posting collateral for the uncleared swap in compliance with the custodial arrangements of § 23.157 in the United States or a jurisdiction for which the Commission has issued a comparability determination under the Final Rule, even using an affiliate.

179 The CSE must collect initial margin in accordance with § 23.152(a) on a gross basis, in the form of cash pursuant to § 23.156(a)(1)(i) and post and collect variation margin in accordance with § 23.153(a) in the form of cash pursuant to § 23.156(a)(1)(i). *See* § 23.160(e)(4) of the Final Rule.

180 Section 23.154(b)(2)(v) of the Final Margin Rule permits a CSE to use an internal initial margin model that reflects offsetting exposures, diversification, and other hedging benefits within four broad risk categories: Credit, equity, foreign exchange and interest rates (considered together as a single asset class), and commodities when calculating initial margin for a particular counterparty if the uncleared swaps are executed under the same ''eligible master netting agreement.'' *See* 17 CFR 23.154(b)(2)(v).

181 *See* 17 CFR 23.160(e).

uncleared swaps as to which an FCS relies on § 23.160(e) should not exceed 5 percent of the FCS's total outstanding notional amount of uncleared swaps (in each of the four broad risk categories), rather than the total notional outstanding amount of uncleared swaps of its ultimate parent entity. Using the ultimate parent entity's swap activity as the basis for the formula could allow the FCS to engage in significant levels of swap activity in non-segregation jurisdictions based on swap activities of its affiliates, rendering the 5 percent limit meaningless. In addition, as an FCS is a registered CSE, its swap activities with U.S. persons were sufficient to require its registration in the United States, and therefore its swap activity in the non-segregation jurisdiction would never account for all of the CSE's swap dealing activity.

5. Special Provision for Non-Netting Jurisdictions

a. Comments

Commenters generally agreed that, at a minimum, the Commission should provide an exception for swaps with counterparties located in jurisdictions in which netting, collateral or third party custodial arrangements may not be legally effective, including in a counterparty's insolvency.[182] ISDA and JBA proposed that an exception for non-netting jurisdictions should apply up to 5 percent of the aggregate notional amount of a CSE's uncleared swaps.[183] They argued that, without enforceable netting and collateral arrangements, a bankruptcy administrator could ''cherry pick'' when determining the return of posted collateral in the event of insolvency.[184] ISDA further argued that imposing margin in such cases could severely limit swaps activity in non-netting jurisdictions and cause significant disruptions in financial markets.[185]

ISDA and JBA further recommended that, absent an exception for non-netting jurisdictions, CSEs should have at least some exception from the requirement to collect or post margin.[186] According to ISDA, without such an exception, a CSE could be prevented from applying collateral to the obligations of the counterparty and face difficulties in recovering it.[187] ISDA argued that posting margin could therefore increase risk to the CSE, while an exception could bypass segregation problems in the non-netting jurisdiction.[188]

b. Final Rule

The Commission is adopting a special provision, also included in the Prudential Regulators' Final Margin Rule, for non-netting jurisdictions.[189] Under the Final Rule, a CSE that cannot conclude, with a well-founded basis, that the netting agreement with a counterparty in a foreign jurisdiction meets the definition of an ''eligible master netting agreement'' set forth in the Final Margin Rule may nevertheless net uncleared swaps in determining the amount of margin that it posts, provided that certain conditions are met.[190] In order to avail itself of this special provision, the CSE must treat the uncleared swaps covered by the agreement on a gross basis in determining the amount of initial and variation margin that it must collect, but may net those uncleared swaps in determining the amount of initial and variation margin it must post to the counterparty, in accordance with the netting provisions of the Final Margin Rule.[191] Requiring CSEs to calculate and collect initial margin on a gross basis is intended to ensure that the CSE can obtain the collateral posted with the counterparty in the event of counterparty default. As with the special provision for non-segregation jurisdictions in section 23.160(e) of the Final Rule, this provision is carefully tailored to allow CSEs to enter into uncleared swaps in ''non-netting'' jurisdictions but without abandoning the key protections behind the netting requirement under the Final Margin Rule. A CSE that enters into uncleared swaps in ''non-netting'' jurisdictions in reliance on this provision must have policies and procedures ensuring that it is in compliance with the special provision's requirements, and maintain books and records properly documenting that all of the requirements of this exception are satisfied.[192]

The Commission considered ISDA's request that it adopt a blanket exclusion, subject to a percentage limitation based on the level of swap activity. However, the Commission believes that a blanket exclusion, even with a transactional limit, presents a significant risk that the safety and soundness of a CSE engaged in swaps in non-netting jurisdictions would be insufficiently protected because, without the collection of sufficient margin, the CSE could be unduly exposed to counterparty default. The Commission also considered, but determined to not adopt, ISDA's request that posting to counterparties in non-netting jurisdictions not be required.[193] Because the posting requirement serves to limit the ability of a CSE to assume excessive risk, the Commission believes that CSEs should be required to post margin in order to advance the objectives of the margin mandate.

C. Comparability Determinations

As discussed above, consistent with CEA section 2(i) and comity principles, the Final Rule permits eligible CSEs to rely on substituted compliance to the extent that the Commission determines the relevant foreign jurisdiction's margin requirements are comparable to the Commission's. Specifically, the Final Rule outlines a framework for the Commission's comparability determinations, including eligibility and submission requirements for requesters and the Commission's standard of review for making comparability determinations.[194]

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[182] *See* ABA/ABASA at 5 n.14; IIB/SIFMA at 13 n.44; ISDA at 10 (requesting an exemption for jurisdictions where getting a ''clean'' netting or collateral opinion is ''not possible''); JBA at 10.

[183] *See* ISDA at 10; JBA at 10.

[184] *See* ISDA at 10 (further arguing that a CSE may not be able to effectively foreclose on margin in event of a counterparty default); JBA at 10.

[185] *See* ISDA at 10.

[186] *See* ISDA at 10–11 (requesting exemption from requirement to post initial margin); JBA at 10 (requesting exemption from both initial and variation margin requirements because, under such conditions, amount of variation margin to be posted or collected cannot be fixed).

[187] *See* ISDA at 11.

[188] *See id.*

[189] As used in this release, a ''non-netting jurisdiction'' is a jurisdiction in which a CSE cannot conclude, with a well-founded basis, that the netting agreement with a counterparty in that foreign jurisdiction meets the definition of an ''eligible master netting agreement'' set forth in the Final Margin Rule. *See* 17 CFR 23.151.

[190] The Final Margin Rule permits offsets in relation to either initial margin or variation margin calculation when (among other things), the offsets related to swaps are subject to the same eligible master netting agreement. This ensures that CSEs can effectively foreclose on the margin in the event of a counterparty default, and avoids the risk that the administrator of an insolvent counterparty will ''cherry-pick'' from posted collateral to be returned.

[191] As noted above, in the event that the special provision for non-segregation jurisdictions applies to a CSE, then the special provision for non-netting jurisdictions would not apply to the CSE even if the relevant jurisdiction is also a ''non-netting jurisdiction.'' In this circumstance, the CSE must collect the gross amount of initial margin in cash (but would not be required to post initial margin), and post and collect variation margin in cash in accordance with the requirements of the special provision for non-segregation jurisdictions, as discussed in section II.B.4.b.

[192] *See* § 23.160(d) of the Final Rule.

[193] The Commission agrees with commenters that without enforceable netting and collateral arrangements, there is a risk that the administrator of an insolvent counterparty will ''cherry-pick'' from posted collateral to be returned in the event of insolvency. This would result in an increase in the risk in posting collateral, because a CSE may not be able to effectively foreclose on the margin in the event its counterparty defaults.

[194] *See* 17 CFR 23.160(c).

1. Proposed Rule

As proposed, section 23.160(c) established a process for requesting comparability determinations. Specifically, the proposed rule identified persons eligible to request a comparability determination (CSEs eligible to rely on substituted compliance and any relevant foreign regulatory authorities) and the information and documentation they should provide the Commission, including how the relevant foreign jurisdiction's margin requirements address the various elements of the Commission's margin regime (*e.g.,* the products and entities subject to margin requirements).

The proposed rule also identified several factors the Commission would consider in making a comparability determination, such as how the relevant foreign margin requirements compare to International Standards [195] and whether they achieve comparable outcomes to the Commission's requirements. The Commission explained that its analysis would follow an outcome-based approach, one that would focus on evaluating the outcomes and objectives of the foreign margin requirements and not require them to be identical to the Commission's margin requirements.[196] The Commission further explained that it would review a foreign margin regime's comparability on an element-by-element basis, such that a foreign jurisdiction's margin requirements could be deemed comparable with respect to some elements of the Commission's margin requirements and not others.[197] The Commission made clear, however, that consistent with its outcome-based approach, a comparability determination could be appropriate even if the foreign jurisdiction approaches an element differently.[198]

The proposed rule concluded by explaining the regulatory effect of complying with a foreign jurisdiction's margin requirements in reliance on a comparability determination, such that a violation of a foreign margin requirement could constitute a violation of the Commission's corresponding requirement. It also codified the Commission's authority to condition or otherwise modify any comparability determination it issues.

The Commission requested comment on all aspects of proposed § 23.160(c).[199]

2. Comments

Commenters generally focused on the Commission's proposed approach to evaluating the comparability of a foreign jurisdiction's margin regime.[200] Commenters supported an approach that would focus on the regulatory objectives and outcomes of the relevant margin regimes and not require uniformity with the Commission's rule provisions.[201] JBA, for instance, urged the Commission not to deny a comparability determination because a Commission rule is ''stricter,'' but to focus on whether the substance of the foreign jurisdiction's rules effectively achieves the objective of mitigating risk.[202]

Commenters expressed concern, however, that the Commission's proposed approach was overly complicated and would undermine an outcome-based approach.[203] IIB/SIFMA described the Commission's proposed approach as too ''granular,'' requiring ''consistency at a level of detail that ignores the overall risk mitigating impact'' of a foreign jurisdiction's margin regime.[204] IIB/SIFMA suggested that the ''test for comparability'' should be ''whether differences between the regimes would, in the aggregate, create a significant and unacceptable level of risk to CSEs or the U.S. financial system.'' [205]

Commenters also expressed concern that issuing comparability determinations with respect to some but not all of a foreign jurisdiction's margin requirements would be challenging and costly to implement.[206] As a result, market participants would either default to the Commission's margin requirements, undercutting the benefits of substituted compliance,[207] or modify their cross-border activities to avoid Commission regulation, increasing market fragmentation.[208] ISDA further argued that an element-by-element approach would be inconsistent with the goals of the BCBS–IOSCO framework to avoid ''duplicative or conflicting margin requirements'' and ensuring ''substantial certainty'' as to which country's margin rules apply.[209] Commenters urged the Commission to evaluate and issue a comparability determination for a foreign jurisdiction's margin regime as a whole.[210]

A majority of commenters also encouraged the Commission to make consistency with the BCBS–IOSCO framework the primary focus of its comparability determinations.[211] FSR

[195] *See* proposed 17 CFR 23.160(a)(3) (defining ''International Standards'' as based on the BCBS–IOSCO framework).

[196] *See* Proposal, 80 FR at 41389.

[197] *See id.*

[198] *See id.* (''[T]he Commission would evaluate whether a foreign jurisdiction has rules and regulations that achieve comparable outcomes. If it does, the Commission believes that a comparability determination may be appropriate, even if there may be differences in the specific elements of a particular regulatory provision.'').

[199] The Commission also requested comment on the scope of the Commission's proposed substituted compliance regime, whether the Commission should develop an interim process for comparability determinations that would take into account differing implementation timeliness for margin rules by other foreign jurisdictions, and the need for an emerging markets exception. Comments received in response to these questions were addressed above.

[200] *See* proposed 17 CFR 23.160(c)(2)–(3); Proposal, 80 FR at 41389–90.

[201] *See, e.g.,* AIMA/IA at 3–4 (absent ''automatic substituted compliance'' for any transaction involving an entity from a jurisdiction that participated in the WGMR, Commission should make comparability determinations based ''on broad comparability of requirements rather than detailed correspondence of rules''); ICI Global at 9–10; IIB/SIFMA at 3; ISDA at 7; JBA at 9; Vanguard at 3.

[202] *See* JBA at 9 (for example, while Commission's proposed margin rule with respect to eligible collateral for variation margin was narrower in scope than rule proposed by European or Japanese authorities, foreign regulations are not necessarily less effective from a risk mitigation perspective).

[203] *See, e.g.,* ICI Global at 10 (proposed approach to determining comparability is ''unnecessarily complicated'' and effectively requires comparability with respect to ''each particular aspect'' of the foreign jurisdiction's margin regime); ISDA at 7 (''complexity and specificity'' of Commission's proposed approach is ''not consistent with a general outcome-based approach'').

[204] *See* IIB/SIFMA at 9 (element-by-element approach would result in ''stricter-rule-applies'' approach).

[205] *See id.* at 10 (margin regimes that comply with International Standards would likely satisfy such a test).

[206] *See, e.g.,* PensionsEurope at 2 (there are ''some benefits'' to an element-by-element approach but, by creating potential for partial comparability determinations, proposed rule would add ''a significant amount of complexity'' and ''likely create more problems than it solves''); SIFMA AMG at 8 (''the potential for piecemeal comparability determinations'' would lead to ''uncertainty, compliance difficulties and the potential for margin disputes''); Vanguard at 4–5 (market participants would be required to develop and implement a new system designed to apply the Commission's comparability determinations and ensure simultaneous compliance with two sets of rules).

[207] *See, e.g.,* ICI Global at 10; IIB/SIFMA at 9; SIFMA at 8 (Commission's prior issuance of partial comparability determinations with respect to swap trading relationship documentation led to confusion and disagreements regarding which rule sections may be complied with via substituted compliance).

[208] *See* IIB/SIFMA at 9; SIFMA AMG at 7.

[209] *See* ISDA at 8 (highlighting background discussion of element 7 of the BCBS–IOSCO framework (interaction of national regimes in cross-border transactions), which encourages cooperation among regulatory regimes to produce ''sufficiently consistent and non-duplicative'' margin requirements).

[210] *See, e.g.,* ICI Global at 2, 10 (Commission should ''consider [] the margin rules of a jurisdiction in their entirety'' and not ''mak[e] determinations for each element of the margin rules''); IIB/SIFMA at 9–10; SIFMA AMG at 8; Vanguard at 4–5.

[211] *See, e.g.,* AIMA/IA at 3; FSR at 2–5; ISDA at 7; SIFMA AMG at 8; Vanguard at 5.

suggested that the Commission ignore whether the foreign margin requirements achieve comparable outcomes to the Commission's margin requirements [212] and make consistency with International Standards the sole basis of its analysis.[213] FSR argued that the "purpose and driving force" of the BCBS–IOSCO framework was to create a "uniform global standard" and that the Commission would undermine that goal if it were to deny a comparability determination when the foreign margin regime conforms to International Standards.[214] Thus, FSR recommended that the Commission issue a comparability determination to any regime that complies with the International Standards despite any divergence from the Commission's rules.[215] IIB/SIFMA argued that margin regimes that adhere to the BCBS–IOSCO framework are "highly unlikely" to demonstrate "material differences" in the degree to which they reduce aggregate risk,[216] adding that issuing comparability determinations based on consistency with the BCBS–IOSCO framework would further the goal of international harmonization promoted by BCBS–IOSCO and Congress.[217]

AFR, on the other hand, argued that foreign margin rules should not qualify for substituted compliance on the basis that they follow International Standards alone.[218] AFR stated that the Commission's proposed margin rules evidenced "a number of important differences" from the BCBS–IOSCO framework and that, given the broad availability of substituted compliance in the proposed rule, issuing comparability determinations solely on the basis of consistency with International Standards could lead to "excessive opportunities for substituted compliance." [219]

3. Final Rule

After a careful review of the comments, the Commission is adopting § 23.160(c) as proposed, but is providing some additional clarifications in response to commenters. The rule begins by identifying persons eligible to request a comparability determination with respect to the Commission's margin requirements, including any CSE that is eligible for substituted compliance under rule § 23.160 [220] and any foreign regulatory authority that has direct supervisory authority over one or more CSEs and that is responsible for administering the relevant foreign jurisdiction's margin requirements.[221] Eligible persons may request a comparability determination individually or collectively and with respect to some or all of the Commission's margin requirements. Eligible CSEs may wish to coordinate with their home regulators and other CSEs in order to simplify and streamline the process. The Commission will make comparability determinations on a jurisdiction-by-jurisdiction basis.

Persons requesting comparability determinations should provide the Commission with certain documents and information in support of their request. Notably, the Final Rule provides that requesters should provide copies of the relevant foreign jurisdiction's margin requirements [222] and descriptions of their objectives,[223] how they differ from the International Standards,[224] and how they address the elements of the Commission's margin requirements.[225] With regard to how the foreign margin requirements address the elements of the Commission's margin requirements, the description should identify the specific legal and regulatory provisions that correspond to each element and, if necessary, whether the relevant foreign jurisdiction's margin requirements do not address a particular element.[226] Requesters should also provide a description of the ability of the relevant foreign regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's margin requirements [227] and any other information and documentation the Commission deems appropriate.[228]

The Final Rule identifies certain key factors that the Commission will consider in making a comparability determination. Specifically, the Commission will consider the scope and objectives of the relevant foreign jurisdiction's margin requirements; [229] whether the relevant foreign jurisdiction's margin requirements achieve comparable outcomes to the Commission's corresponding margin requirements; [230] and the ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's margin requirements.[231]

As indicated in the proposed rule, the Final Rule reflects an outcome-based approach to assessing the comparability of a foreign jurisdiction's margin

[212] *See* proposed 17 CFR 23.160(c)(3)(iii).

[213] *See* FSR at 5–6.

[214] *See id.* at 3–4 (pointing to differences in the approaches proposed by the European Market Infrastructure Regulation and the Commission with regard to certain topics (*e.g.,* eligible collateral for variation margin) and expressing concern that, under the Proposal, the Commission would reject comparability even though both proposed approaches are consistent with BCBS–IOSCO framework).

[215] *See id.* at 3. *See also* Vanguard at 5 ("unique local legal or market structure issues" may render certain individual elements of a foreign jurisdiction's margin regime not comparable to Commission's margin rules but foreign regime's "overall outcome" may nevertheless be consistent with BCBS–IOSCO framework).

[216] *See id.* at 2 (BCBS–IOSCO framework-compliant regimes would impose "full, daily variation margin requirements and stringent initial margin requirements").

[217] *See id.* at 3 (citing Dodd-Frank section 752(a)). *See also* SIFMA AMG 7.

[218] *See* AFR at 7.

[219] *See id. See also* IATP at 4 (provide appendix illustrating "comparable and quantitative outcomes of swaps margining in other jurisdictions with those under Commission authority, once margining requirements and margin calculation methodology are agreed in those jurisdictions").

[220] *See* 17 CFR 23.160(c)(1)(i).

[221] *See* 17 CFR 23.160(c)(1)(ii).

[222] *See* 17 CFR 23.160(c)(2)(v).

[223] *See* 17 CFR 23.160(c)(2)(i).

[224] *See* 17 CFR 23.160(c)(2)(iii). *See also* 17 CFR 23.160(a)(3) (defining "International Standards" as based on the BCBS–IOSCO framework).

[225] *See* 17 CFR 23.160(c)(2)(ii) (identifying the elements as: (A) The products subject to the foreign jurisdiction's margin requirements; (B) the entities subject to the foreign jurisdiction's margin requirements; (C) the treatment of inter-affiliate derivative transactions; (D) the methodologies for calculating the amounts of initial and variation margin; (E) the process and standards for approving models for calculating initial and variation margin models; (F) the timing and manner in which initial and variation margin must be collected and/or paid; (G) any threshold levels or amounts; (H) risk management controls for the calculation of initial and variation margin; (I) eligible collateral for initial and variation margin; (J) the requirements of custodial arrangements, including segregation of margin and rehypothecation; (K) margin documentation requirements; and (L) the cross-border application of the foreign jurisdiction's margin regime). Section 23.160(c)(2)(ii) largely tracks the elements of the BCBS–IOSCO framework, but breaks them down into their components as appropriate to ensure ease of application.

[226] *See id.*

[227] *See* 17 CFR 23.160(c)(2)(iv) (requesting that such description discuss the powers of the foreign regulatory authority or authorities to supervise, investigate, and discipline entities for compliance with the margin requirements and the ongoing efforts of the regulatory authority or authorities to detect and deter violations of the margin requirements).

[228] *See* 17 CFR 23.160(c)(2)(vi). *See also* 17 CFR 23.160(c)(7) (delegating authority to request additional information and/or documentation to the Director of the Division of Swap Dealer and Intermediary Oversight, or such other employee or employees as the Director may designate from time to time).

[229] *See* 17 CFR 23.160(c)(3)(i). *See also* 17 CFR 23.160(a)(3) (defining "International Standards" as based on the BCBS–IOSCO framework).

[230] *See* proposed 17 CFR 23.160(c)(3)(ii). As discussed above, the Commission's Final Margin Rule is based on the International Standards; therefore, the Commission expects that the relevant foreign margin requirements would conform to the International Standards at minimum in order to be deemed comparable to the Commission's corresponding margin requirements.

[231] *See* 17 CFR 23.160(c)(3)(iii). *See also supra* note 227; 17 CFR 23.160(c)(3)(iv) (indicating the Commission would also consider any other relevant facts and circumstances).

requirements. Instead of demanding strict uniformity with the Commission's margin requirements, the Commission will evaluate the objectives and outcomes of the foreign margin requirements in light of foreign regulator(s)' supervisory and enforcement authority. Recognizing that jurisdictions may adopt different approaches to achieving the same outcome, the Commission will focus on whether the foreign jurisdiction's margin requirements are comparable to the Commission's in purpose and effect, not whether they are comparable in every aspect or contain identical elements.

As commenters noted, the Commission was actively involved in developing the BCBS–IOSCO framework, and the Commission believes that the minimum standards it establishes are consistent with the objectives of the Commission's own margin requirements. However, while the BCBS–IOSCO framework establishes minimum standards that are consistent with the objectives of the Commission's own margin requirements, the Commission notes that just because a foreign jurisdiction's margin requirements are consistent with International Standards does not necessarily mean that they will be comparable to the Commission's requirements.[232] Consequently, in the Commission's view, consistency with International Standards is necessary but may not be sufficient to finding comparability.[233]

As stated in the proposed rule, the Commission will review the foreign margin requirements on an element-by-element basis.[234] Margin regimes are complex structures made up of a number of interrelated components, and differences in how jurisdictions approach and assemble those components are inevitable, even among jurisdictions that base their margin requirements on the principles and requirements set forth in the BCBS–IOSCO framework. In order to arrive at a meaningful and complete comparability determination, the Commission must therefore engage in a fact-specific analysis to develop a clear understanding of the elements of the foreign margin regime and how they interact. The Commission believes this level of review will support its outcome-based approach by aiding its assessment of whether such differences affect comparability.

As indicated in the proposed rule, the Commission is allowing for the possibility that a comparability determination may not include all elements of a foreign jurisdiction's margin regime.[235] The Commission believes that this position is preferable to an all-or-nothing approach, in which the Commission would be unable to make a comparability determination for an entire jurisdiction if one or more aspects of the foreign jurisdiction's margin regime results in an outcome that is critically different from that of the Commission's.

The Final Rule provides that any CSE that, in accordance with a comparability determination, complies with a foreign jurisdiction's margin requirements will be deemed in compliance with the Commission's corresponding margin requirements.[236] Accordingly, if the Commission determines that a CSE has failed to comply with the relevant foreign margin requirements, it could initiate an action for a violation of the Commission's margin requirements. In addition, all CSEs remain subject to the Commission's examination and enforcement authority regardless of whether they rely on a comparability determination. Although the Final Rule does not obligate the Commission to consult with or rely on the advice of the foreign regulatory authority in making its determination regarding whether a violation of foreign margin requirements has occurred, the Commission notes that Commission staff may consult with the relevant foreign regulatory authority to assist the Commission in making its determination.

The Final Rule concludes by codifying the Commission's authority to impose any terms and conditions it deems appropriate in issuing a comparability determination,[237] and to further condition, modify, suspend, terminate or otherwise restrict any comparability determination it has issued in its discretion.[238]

Comparability determinations issued by the Commission will require that the Commission be notified of any material changes to information submitted in support of a comparability determination, including, but not limited to, changes in the relevant foreign jurisdiction's supervisory or regulatory regime. The Commission also expects that the relevant foreign regulator will enter into, or will have entered into, an appropriate memorandum of understanding (''MOU'') or similar arrangement with the Commission in connection with a comparability determination.[239]

As stated above, the Commission recognizes that systemic risks arising from the global and interconnected swap market must be addressed through coordinated regulatory requirements for margin across international jurisdictions. Accordingly, the Commission will continue its practice of actively engaging market participants and consulting closely with foreign regulators to encourage the international harmonization and coordination of margin requirements for uncleared swaps and to minimize market disruptions.

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA'') requires that agencies consider whether the regulations they propose will have a significant economic impact on a substantial number of small

[232] The BCBS–IOSCO framework leaves certain elements open to interpretation (*e.g.,* the definition of ''derivative'') and expressly invites regulators to build on certain principles as appropriate. *See, e.g.,* Element 4 (eligible collateral) (national regulators should ''develop their own list of eligible collateral assets based on the key principle, taking into account the conditions of their own markets''); Element 5 (initial margin) (the degree to which margin should be protected would be affected by ''the local bankruptcy regime, and would vary across jurisdictions''); Element 6 (transactions with affiliates) (''Transactions between a firm and its affiliates should be subject to appropriate regulation in a manner consistent with each jurisdiction's legal and regulatory framework.'').

[233] As the Commission noted above, the Final Margin Rule included substantial modifications from the Proposed Margin Rule that further aligned the Commission's margin requirements with International Standards and, as a result, the potential for conflict with foreign margin requirements should be reduced. *See supra* note 29. The Commission further notes that whether a particular margin requirement in a foreign jurisdiction is comparable to the Commission's corresponding requirement entails a fact-specific analysis.

[234] *See* 17 CFR 23.160(c)(2) (specifying that persons requesting comparability determinations should provide the Commission with documentation and information relating to each element of the Commission's margin requirements).

[235] For example, the Commission may determine that a foreign jurisdiction's margin regime is comparable with respect to its variation margin requirements but not with respect to custodial arrangements, including segregation and rehypothecation requirements.

[236] See 17 CFR 23.160(c)(4).

[237] *See* 17 CFR 23.160(c)(5).

[238] *See* 17 CFR 23.160(c)(6). For instance, a comparability determination may require modification or termination if a key basis for the determination ceases to be true.

[239] Under Commission regulations 23.203 and 23.606, registered swap dealers and major swap participants must maintain all records required by the CEA and the Commission's regulations in accordance with Commission regulation 1.31 and keep them open for inspection by representatives of the Commission, the United States Department of Justice, or any applicable prudential regulator. *See* 17 CFR 23.203, 23.606. The Commission further expects that prompt access to books and records and the ability to inspect and examine a non-U.S. CSE will be a condition to any comparability determination.

entities.[240] The Commission previously has established certain definitions of ''small entities'' to be used in evaluating the impact of its regulations on small entities in accordance with the RFA.[241] The final regulation establishes a mechanism for CSEs [242] to satisfy margin requirements by complying with comparable margin requirements in the relevant foreign jurisdiction as described in paragraph (c) of the Final Rule,[243] but only to the extent that the Commission makes a determination that complying with the laws of such foreign jurisdiction is comparable to complying with the corresponding margin requirement(s) for which the determination is sought.

The Commission previously has determined that swap dealers and major swap participants are not small entities for purposes of the RFA.[244] Thus, the Commission is of the view that there will not be any small entities directly impacted by this rule.

The Commission notes that under the Final Margin Rule, swap dealers and major swap participants would only be required to collect and post margin on uncleared swaps when the counterparties to the uncleared swaps are either other swap dealers and major swap participants or financial end users. As noted above, swap dealers and major swap participants are not small entities for RFA purposes. Furthermore, any financial end users that may be indirectly [245] impacted by the Final Rule would be similar to eligible contract participants (''ECPs''), and, as such, they would not be small entities.[246] Further, to the extent that there are any foreign financial entities that would not be considered ECPs, the Commission expects that there would not be a substantial number of these entities significantly impacted by the Final Rule. As noted above, most foreign financial entities would likely be ECPs to the extent they would transact in uncleared swaps. The Commission expects that only a small number of foreign financial entities that are not ECPs, if any, would transact in uncleared swaps. In addition, the material swaps exposure threshold for financial end users in the Final Margin Rule reinforces the Commission's expectation that only a small number of entities would be affected by the Final Rule.

Accordingly, the Commission finds that there will not be a substantial number of small entities impacted by the Final Rule. Therefore, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed regulations will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (''PRA'') [247] imposes certain requirements on Federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA. This final rulemaking will result in the collection of information requirements within the meaning of the PRA, as discussed below. Responses to these collections of information will be required to obtain or retain benefits. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. One of the collections of information required by this final rulemaking, which is described below under the heading ''Information Collection—Comparability Determinations,'' was previously included in the proposed rule and discussed in the Proposal. Accordingly, the Commission requested from the Office of Management and Budget (''OMB'') a control number for that information collection. OMB assigned OMB control number 3038–0111. The title for this collection of information is ''Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants; Comparability Determinations with Margin Requirements.'' No comments were received on the paperwork burden associated with this information collection request. In addition, this final rulemaking includes two additional collections of information that were not previously proposed, which are described below under the headings ''Information Collection—Non-Segregation Jurisdictions'' and ''Information Collection—Non-Netting Jurisdictions,'' respectively. Accordingly, the Commission, by separate notice published in the **Federal Register** concurrently with this Final Rule, will request approval by OMB of this new information collection under OMB Control Number 3038–0111.

1. Information Collection—Comparability Determinations

Section 731 of the Dodd-Frank Act amended the CEA to add, as section 4s(e) thereof, provisions concerning the setting of initial and variation margin requirements for swap dealers and major swap participants. Each swap dealer and major swap participant for which there is a Prudential Regulator, as defined in section 1a(39) of the CEA, must meet margin requirements established by the applicable Prudential Regulator, and each CSE must comply with the Commission's regulations governing margin. With regard to the cross-border application of the swap provisions enacted by Title VII of the Dodd-Frank Act, section 2(i) of the CEA provides the Commission with express authority over activities outside the United States relating to swaps when certain conditions are met. Section 2(i) of the CEA provides that the CEA's provisions relating to swaps enacted by Title VII of the Dodd-Frank Act (including Commission rules and regulations promulgated thereunder) shall not apply to activities outside the United States unless those activities (1) have a direct and significant connection with activities in, or effect on, commerce of the United States or (2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of Title VII.[248] Because margin requirements are critical to ensuring the safety and soundness of a CSE and supporting the stability of the U.S. financial markets, the Commission believes that its margin rules should

[240] 5 U.S.C. 601 *et seq.*

[241] *See* 47 FR 18618 (Apr. 30, 1982) (finding that designated contract markets, future commission merchants, commodity pool operators and large traders are not small entities for RFA purposes).

[242] *See* 17 CFR 23.151 (defining ''CSE'' as a swap dealer or major swap participant for which there is no Prudential Regulator).

[243] *See* 17 CFR 23.160(c).

[244] *See* 77 FR 30596, 30701 (May 23, 2012); 77 FR 2613, 2620 (Jan. 19, 2012) (noting that like future commission merchants, swap dealers will be subject to minimum capital requirements, and are expected to be comprised of large firms, and that major swap participants should not be considered to be small entities for essentially the same reasons that it previously had determined large traders not to be small entities).

[245] The RFA focuses on direct impact to small entities and not on indirect impacts on these businesses, which may be tenuous and difficult to discern. *See Mid-Tex Elec. Coop., Inc.* v. *FERC,* 773 F.2d 327, 340 (D.C. Cir. 1985); *Am. Trucking Assns.* v. *EPA,* 175 F.3d 1027, 1043 (D.C. Cir. 1985).

[246] As noted in paragraph (1)(xii) of the definition of ''financial end user'' in § 23.151 of the Final Margin Rule, a financial end user includes a person that would be a financial entity described in paragraphs (1)(i)–(xi) of that definition, if it were organized under the laws of the United States or any State thereof. *See* 17 CFR 23.151. The Commission believes that this prong of the definition of financial end user captures the same type of U.S. financial end users that are ECPs, but for them being foreign financial entities. Therefore, for purposes of the Commission's RFA analysis, these foreign financial end users will be considered ECPs and therefore, like ECPs in the U.S., not small entities.

[247] 44 U.S.C. 3501 *et seq.*

[248] 7 U.S.C. 2(i).

apply on a cross-border basis in a manner that effectively addresses risks to the registered CSE and the U.S. financial system.

As noted above, the Final Rule establishes margin requirements for uncleared swaps of CSEs, with substituted compliance available in certain circumstances, except as to a narrow class of uncleared swaps between a non-U.S. CSE and a non-U.S. counterparty that fall within the Exclusion. The Final Rule also establishes a procedural framework in which the Commission will consider permitting compliance with comparable margin requirements in a foreign jurisdiction to substitute for compliance with the Commission's margin requirements in certain circumstances. The Commission will consider whether the requirements of such foreign jurisdiction with respect to margin of uncleared swaps are comparable to the Commission's margin requirements.

Specifically, the Final Rule provides that a CSE that is eligible for substituted compliance may submit a request, individually or collectively, for a comparability determination.[249] Persons requesting a comparability determination may coordinate their application with other market participants and their home regulators to simplify and streamline the process. Once a comparability determination is made for a jurisdiction, it will apply for all entities or transactions in that jurisdiction to the extent provided in the determination, as approved by the Commission. In providing information to the Commission for a comparability determination, applicants must include, at a minimum, information describing any differences between the relevant foreign jurisdiction's margin requirements and International Standards,[250] and the specific provisions of the foreign jurisdiction that govern: (A) The products subject to the foreign jurisdiction's margin requirements; (B) the entities subject to the foreign jurisdiction's margin requirements; (C) the treatment of inter-affiliate derivative transactions; (D) the methodologies for calculating the amounts of initial and variation margin; (E) the process and standards for approving models for calculating initial and variation margin models; (F) the timing and manner in which initial and variation margin must be collected and/or paid; (G) any threshold levels or amounts; (H) risk management controls for the calculation of initial and variation margin; (I) eligible collateral for initial and variation margin; (J) the requirements of custodial arrangements, including segregation of margin and rehypothecation; (K) margin documentation requirements; and (L) the cross-border application of the foreign jurisdiction's margin regime.[251]

In addition, the Commission expects the applicant, at a minimum, to describe how the foreign jurisdiction's margin requirements address each of the above-referenced elements, and identify the specific legal and regulatory provisions that correspond to each element (and, if necessary, whether the relevant foreign jurisdiction's margin requirements do not address a particular element). Further, the applicant must describe the objectives of the foreign jurisdiction's margin requirements, the ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the foreign jurisdiction's margin requirements, including the powers of the foreign regulatory authority or authorities to supervise, investigate, and discipline entities for noncompliance with the margin requirements and the ongoing efforts of the regulatory authority or authorities to detect and deter violations of the margin requirements. Finally, the applicant must furnish copies of the foreign jurisdiction's margin requirements (including an English translation of any foreign language document) and any other information and documentation that the Commission deems appropriate.[252]

In issuing a comparability determination, the Commission may impose any terms and conditions it deems appropriate. In addition, the Final Rule will provide that the Commission may, on its own initiative, further condition, modify, suspend, terminate, or otherwise restrict a comparability determination in the Commission's discretion. This could result, for example, from a situation where, after the Commission issues a comparability determination, the basis of that determination ceases to be true. In this regard, the Commission will require an applicant to notify the Commission of any material changes to information submitted in support of a comparability determination (including, but not limited to, changes in the foreign jurisdiction's supervisory or regulatory regime) as the Commission's comparability determination may no longer be valid.[253]

The collection of information that is proposed by this rulemaking is necessary to implement section 4s(e) of the CEA, which mandates that the Commission adopt rules establishing minimum initial and variation margin requirements for CSEs on all swaps that are not cleared by a registered derivatives clearing organization, and section 2(i) of the CEA, which provides that the provisions of the CEA relating to swaps that were enacted by Title VII of the Dodd-Frank Act (including any rule prescribed or regulation promulgated thereunder) apply to activities outside the United States that have a direct and significant connection with activities in, or effect on, commerce of the United States. Further, the information collection is necessary for the Commission to determine whether the requirements of the foreign rules are comparable to the Commission's rules.

As noted above, any CSE who is eligible for substituted compliance may make a request for a comparability determination. Currently, there are approximately 106 swap entities provisionally registered with the Commission. The Commission further estimates that of the approximately 106 swap entities that are provisionally registered, approximately 54 are CSEs that are subject to the Commission's margin rules as they are not subject to a Prudential Regulator. The Commission notes that any foreign regulatory agency that has direct supervisory authority over one or more CSEs and that is responsible to administer the relevant foreign jurisdiction's margin requirements may also apply for a comparability determination. Further, once a comparability determination is made for a jurisdiction, it will apply for all entities or transactions in that jurisdiction to the extent provided in the determination, as approved by the Commission. The Commission estimates that it will receive requests for a comparability determination from 17 jurisdictions, consisting of the 16 jurisdictions within the G20, plus Switzerland, and that each request will impose an average of 10 burden hours.

Based upon the above, the estimated hour burden for collection is calculated as follows:

[249] A CSE may apply for a comparability determination only if the uncleared swap activities of the CSE are directly supervised by the authorities administering the foreign regulatory framework for uncleared swaps. Also, a foreign regulatory agency may make a request for a comparability determination only if that agency has direct supervisory authority to administer the foreign regulatory framework for uncleared swaps in the requested foreign jurisdiction.

[250] *See* 17 CFR 23.160(a)(3) (defining ''International Standards'' as based on the BCBS–IOSCO framework).

[251] *See* 17 CFR 23.160(c)(2)(ii).

[252] *See* 17 CFR 23.160(c)(2)(v) and (vi).

[253] The Commission expects to impose this obligation as one of the conditions to the issuance of a comparability determination.

Number of respondents: 17.

Frequency of collection: Once.

Estimated annual responses per registrant: 1.

Estimated aggregate number of annual responses: 17.

Estimated annual hour burden per registrant: 10 hours.

Estimated aggregate annual hour burden: 170 hours (17 registrants × 10 hours per registrant).

2. Information Collection—Non-Segregation Jurisdictions

Section 23.160(e) of the Final Rule provides that, in certain foreign jurisdictions where inherent limitations in the legal or operational infrastructure of the jurisdiction make it impracticable for the CSE and its counterparty to post initial margin for the uncleared swap pursuant to custodial arrangements that comply with the Commission's margin rules, an FCS or a foreign branch of a U.S. CSE may be eligible to engage in uncleared swaps with certain non-U.S. counterparties without complying with the requirement to post initial margin, and without complying with the requirement to hold initial margin collected by the CSE with one or more custodians that are not the CSE, its counterparty, or an affiliate of the CSE or its counterparty, pursuant to section 23.157(b) of the Final Margin Rule,[254] but only if certain conditions are satisfied.[255] In order to rely on this provision, an FCS or foreign branch of a U.S. CSE will need to satisfy all of the conditions of the rule, including that (1) inherent limitations in the legal or operational infrastructure of the foreign jurisdiction make it impracticable for the CSE and its counterparty to post any form of eligible initial margin collateral for the uncleared swap pursuant to custodial arrangements that comply with the Commission's margin rules; (2) foreign regulatory restrictions require the CSE to transact in uncleared swaps with the counterparty through an establishment within the foreign jurisdiction and do not permit the posting of collateral for the swap in compliance with the custodial arrangements of section 23.157 of the Final Margin Rule in the United States or a jurisdiction for which the Commission has issued a comparability determination under the Final Rule with respect to section 23.157; (3) the CSE's counterparty is not a U.S. person and is not a CSE, and the counterparty's obligations under the uncleared swap are not guaranteed by a U.S. person;[256] (4) the CSE collects initial margin in cash on a gross basis, in cash, and posts and collects variation margin in cash, for the uncleared swap in accordance with the Final Margin Rule;[257] (5) for each broad risk category, as set out in section 23.154(b)(2)(v) of the Final Margin Rule, the total outstanding notional value of all uncleared swaps in that broad risk category, as to which the CSE is relying on section 23.160 (e), may not exceed 5 percent of the CSE's total outstanding notional value for all uncleared swaps in the same broad risk category; (6) the CSE has policies and procedures ensuring that it is in compliance with the requirements of this provision; and (7) the CSE maintains books and records properly documenting that all of the requirements of this provision are satisfied.[258]

3. Information Collection—Non-Netting Jurisdictions

Section 23.160(d) of the Final Rule includes a special provision for non-netting jurisdictions. This provision allows CSEs that cannot conclude after sufficient legal review with a well-founded basis that the netting agreement with a counterparty in a foreign jurisdiction meets the definition of an ''eligible master netting agreement'' set forth in the Final Margin Rule to nevertheless net uncleared swaps in determining the amount of margin that they post, provided that certain conditions are met. In order to avail itself of this special provision, the CSE must treat the uncleared swaps covered by the agreement on a gross basis in determining the amount of initial and variation margin that it must collect, but may net those uncleared swaps in determining the amount of initial and variation margin it must post to the counterparty, in accordance with the netting provisions of the Final Margin Rule. A CSE that enters into uncleared swaps in ''non-netting'' jurisdictions in reliance on this provision must have policies and procedures ensuring that it is in compliance with the special provision's requirements, and maintain books and records properly documenting that all of the requirements of this exception are satisfied.[259]

As noted above, the Commission is publishing a separate notice in the **Federal Register** concurrently with this final rule requesting comments on the burden estimates of both new information collections to amend OMB Control Number 3038–0111.

C. Cost-Benefit Considerations

1. Introduction

As discussed above, the Final Rule addresses the cross-border application of the Commission's margin requirements. Specifically, the Final Rule establishes certain key definitions (''U.S. person,'' ''guarantee,'' and ''Foreign Consolidated Subsidiary''); allows CSEs to rely on substituted compliance where appropriate; provides a limited Exclusion for certain transactions between non-U.S. persons; includes special provisions for ''non-segregation jurisdictions'' [260] and ''non-netting jurisdictions;'' [261] and establishes a framework for making comparability determinations.

In the sections that follow, the Commission discusses the costs and benefits associated with the Final Rule on CSEs and affected market participants and any reasonable alternatives.[262] Given a general lack of useful data regarding the costs and benefits of the Final Rule, from commenters or otherwise, and the considerable uncertainty given that foreign jurisdictions are at different

[254] As explained further in note 174, because CSEs that rely on section 23.160(e) are not required to hold collateral in accordance with section 23.157(b) for initial margin that they collect, they also would not be required to comply with 23.157(c) with respect to initial margin that they collect.

[255] CSEs that are not FCSs or foreign branches of U.S. CSEs and are not otherwise excluded from the Final Margin Rule could not engage in swap transactions in these jurisdictions.

[256] As noted above, the Commission would expect the CSE's counterparty to be a local financial end user that is required to comply with the foreign jurisdiction's laws and that is prevented by regulatory restrictions in the foreign jurisdiction from posting collateral for the uncleared swap in the United States or a jurisdiction for which the Commission has issued a comparability determination under the Final Rule, even using an affiliate.

[257] As noted above, the CSE must collect initial margin in accordance with § 23.152(a) on a gross basis, in the form of cash pursuant to § 23.156(a)(1)(i) and post and collect variation margin in accordance with section 23.153(a) in the form of cash pursuant to section 23.156(a)(1)(i). *See* § 23.160(e)(4) of the Final Rule.

[258] *See* 17 CFR 23.160(e).

[259] *See* § 23.160(d) of the Final Rule.

[260] As used in this release, a ''non-segregation jurisdiction'' is a jurisdiction where inherent limitations in the legal or operational infrastructure of the foreign jurisdiction make it impracticable for the CSE and its counterparty to post initial margin pursuant to custodial arrangements that comply with the Final Margin Rule, as further described in section II.B.4.b.

[261] As used in this release, a ''non-netting jurisdiction'' is a jurisdiction in which a CSE cannot conclude, with a well-founded basis, that the netting agreement with a counterparty in that foreign jurisdiction meets the definition of an ''eligible master netting agreement'' set forth in the Final Margin Rule, as described in section II.B.5.b.

[262] As stated above, the Commission estimates that the Final Rule will affect approximately 54 registered swap dealers and major swap participants. The Commission further estimates that it will receive requests for a comparability determination from 17 jurisdictions.

stages in implementing their regimes, the costs and benefits of the Final Rule are generally considered in qualitative terms.

The baseline against which the costs and benefits of this Final Rule are being compared is the status quo, *i.e.,* the swap market as it exists as if the Final Margin Rule is in full effect.[263] The cost-benefit considerations section of the Final Margin Rule made clear that CEA section 4s(e), read together with CEA section 2(i), applies the margin rules to a CSE's swap activities outside the United States, regardless of the domicile of the CSE or its counterparties.[264] Accordingly, in considering the costs and benefits of this Final Rule, the Commission focused on the impact of permitting substituted compliance and certain exclusions from the Final Margin Rule.[265]

The Commission is mindful of the potentially significant tradeoffs inherent in the Final Rule. As discussed above, given the highly-interconnected, global swap market, overseas risk can quickly manifest in the United States. The cross-border application of the Commission's margin rules is therefore important to protecting the U.S. financial system from this risk. At the same time, competitive distortions and market inefficiencies can result—and the benefits of the Commission's cross-border framework could be reduced—if due consideration is not given to comity principles. The Commission considered these tradeoffs and worked to carefully tailor the cross-border approach in the Final Rule to address comity considerations, mitigate the potential for undue market distortions, and promote global coordination without compromising the safety and soundness of CSEs.

Although commenters generally did not comment on the cost-benefit discussion in the proposed rule itself,[266] they did discuss various costs and benefits associated with the Commission's proposal. These comments are further addressed in the context of the Commission's cost-benefit considerations below.

2. Key Definitions

The extent to which the Commission's margin requirements apply—and the availability of substituted compliance and the Exclusion—depends on whether the relevant swap involves a U.S. person, a guarantee by a U.S. person, or a Foreign Consolidated subsidiary. As discussed above, the Final Rule adopts definitions of ''U.S. person,'' ''guarantee,'' and ''Foreign Consolidated Subsidiary'' solely for purposes of the margin rules. The costs and benefits associated with these definitions, and any reasonable alternatives, are discussed below. In general, the Commission believes that the clear, objective nature of these terms, along with the ability to rely on related written counterparty representations, will promote legal certainty and help minimize the costs associated with applying the Final Rule.

a. U.S. Person

As discussed in section II.A.1., the term ''U.S. person'' identifies individuals or entities whose activities have a significant nexus to the U.S. market by virtue of being organized or domiciled in the United States or the depth of their connection to the U.S. market, even if they are domiciled or organized outside the United States. The Final Rule generally follows a traditional, territorial approach to defining a U.S. person, and the Commission believes that this definition provides an objective and clear basis for determining those individuals or entities that should be identified as a U.S. person. Accordingly, the Commission does not believe market participants will face significant costs in assessing their own U.S. person status, particularly given the broad similarities between how the Final Rule defines ''U.S. person'' and how the term is defined in the SEC's rules. The Final Rule also makes clear that market participants may reasonably rely on counterparty representations regarding their U.S. person status absent indications to the contrary, which should further reduce any operational costs associated with assessing U.S. person status.

The Final Rule addresses many of the concerns commenters raised regarding the costs and benefits of its proposed approach to defining ''U.S. person.'' As discussed above, the Final Rule does not include a U.S. majority-owned prong, which commenters argued would create operational burdens for assessing U.S. person status and result in regulatory overlap. Nor does it include a catchall provision, limiting the Rule's application to a list of enumerated persons.

The Commission recognizes that, as commenters pointed out, legal entities that fall within the unlimited U.S. responsibility prong may also be subject to regulation under a foreign margin regime, creating the potential for overlapping requirements. However, as discussed in section II.A.1.c., the Commission believes that the unique nature of the relationship between the legal entity and its U.S. person owner(s) facilitates the legal entity's swap business and creates a significant nexus between the legal entity and U.S. financial markets. While the Commission understands that limiting application of the prong to circumstances where the U.S. persons are majority owners of the legal entity could mitigate the potential for overlapping requirements, as the Commission explained above, the U.S. person owner(s) responsibility for the legal entity's obligations and liabilities is unlimited regardless of the amount of equity it owns in the legal entity. Furthermore, excluding such legal entities from the scope of the U.S. person definition could create incentives for U.S. persons to establish such legal entities and use them as a pass-through for their own swap activities solely for purposes of avoiding the margin requirements of the Dodd-Frank Act.

The Commission also recognizes that further narrowing the differences between the Final Rule's U.S. person definition and either the SEC's definition or the ''U.S. person'' interpretation in the Guidance could provide certain benefits. Namely, market participants could enjoy reduced operational costs by relying on existing systems and U.S. person status

[263] 81 FR 636 (Jan. 6, 2016) (codified at 17 CFR parts 23 and 140). As the Commission noted above, the Final Margin Rule included substantial modifications from the Proposed Margin Rule that further aligned the Commission's margin requirements with International Standards and, as a result, the potential for conflict with foreign margin requirements should be reduced. *See supra* note 29.

[264] *See* Final Margin Rule, 81 FR at 682. The Commission notes that to the extent there may be differences in the particulars of costs to foreign CSEs or financial end users, the Commission had not been provided with information that would permit the evaluation of any such differences.

[265] As noted in the Final Margin Rule, as foreign jurisdictions adopt their own margin rules, the existence of those rules may affect the costs and benefits of the Final Margin Rule. *See* Final Margin Rule, 81 FR at 682, n.359. For example, if certain transactions become subject to duplicative foreign regulation, that could increase costs, or reduce benefits, of compliance with the Final Margin Rule. Because of the still developing state of foreign law in this area and the absence of specific information on the subject in the record, it was not possible to evaluate such effects in detail in the Final Margin Rule release. In this rulemaking, the same limitations do not permit a detailed evaluation of such possible effects in the present proceeding and therefore, the Commission discusses these possible effects in general qualitative terms.

[266] *But see* IATP at 7 (Commission's assumptions about costs and benefits of the Proposal were accurate considering the current ''stage of foreign jurisdiction rulemaking'' relating to margin requirements); ABA/ABASA at 3 (Proposal did not adequately take into account the costs of the proposed approach); ISDA at 5 (Proposal did not give ''due weight'' to its impact on price discovery, risk management, increased compliance and liquidity costs, market fragmentation, or comity).

determinations and not having to support multiple meanings of the term ''U.S. person.'' As discussed above, however, the Commission believes that the Final Rule's ''U.S. person'' definition is appropriate in the context of the margin rule. The Commission further believes that the objective and clear definition set out in the Final Rule will result in a lower overall cost for assessing U.S. person status going forward.

b. Guarantees

As explained in section II.A.2.c., under the Final Rule, the term ''guarantee'' is defined to include arrangements, pursuant to which one party to an uncleared swap has rights of recourse against a guarantor, with respect to its counterparty's obligations under the uncleared swap. The Final Rule further defines what it means for a party to have rights of recourse, and further encompasses any arrangement pursuant to which the guarantor itself has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from any other guarantor with respect to the counterparty's obligations under the uncleared swap.[267] As further explained in section II.B.2.b.i, ''U.S. Guaranteed CSEs'' [268] are eligible for substituted compliance, but are ineligible for the Exclusion and the special provision for non-segregation jurisdictions, to the same extent as U.S. CSEs (except that foreign branches of U.S. CSEs may be eligible for the special provision for non-segregation jurisdictions, as described in section II.B.4.b.).[269]

As commenters noted, limiting the scope of guarantees in the context of the margin requirements to arrangements that include a right of recourse offers the benefit of legal certainty, making the definition relatively easy to apply and helping keep down the cost of determining whether a transaction involves a U.S. Guaranteed CSE. Allowing market participants to rely on counterparty representations with regard to the presence of guarantees should also help market participants keep costs down. Although the Final Rule adopts a definition of guarantee that is different than the existing interpretation in the Guidance, which may result in market participants incurring additional costs to update their current systems, those operational challenges may be mitigated given that the definition is straight-forward and similar to that previously adopted by the SEC. In addition, while the inclusion of language that addresses indirect guarantees may result in some added operational challenges or assessment costs, the Commission believes the provision is necessary to avoid creating incentives for market participants to structure guarantee arrangements in order to avoid application of the Dodd-Frank margin requirements. The Final Rule also achieves substantial benefits in harmonizing with the guarantee definitions adopted by the Prudential Regulators.

The Commission recognizes that, as discussed in section II.B.2 and as pointed out by commenters, the definition of ''guarantee'' adopted in the Final Rule does not encompass all forms of financial arrangements or support that may result in a direct transfer of risk to the U.S. financial markets, such as keepwells and liquidity puts. Nor would it include instances in which a parent and a subsidiary entity are closely related and the parent faces strong reputational incentives to support the subsidiary. As discussed above, however, the Commission believes that, in the context of the Final Rule, non-U.S. CSEs benefitting from such other forms of U.S. financial support will likely meet the definition of an FCS and thus be adequately covered by the Commission's margin requirements. Given the further inclusion of language that addresses indirect guarantees and the mandate to coordinate with the Prudential Regulators, the Commission believes that a more limited ''guarantee'' definition is appropriate in the context of the cross-border application of the margin requirements and will not undermine the safety and soundness of CSEs or the U.S. financial markets.

c. Foreign Consolidated Subsidiary

As explained in section II.B.3, the Final Rule uses the term ''Foreign Consolidated Subsidiary'' to identify non-U.S. CSEs whose uncleared swaps raise substantial supervisory concern in the United States by virtue of their relationship with their U.S. ultimate parent entity and because their financial position, operating results, and statement of cash flows have a direct impact on the financial position, risk profile and market value of their U.S. ultimate parent entity. FCSs are not eligible for the Exclusion but are otherwise treated the same as any other non-U.S. CSEs whose obligations under the relevant swap are not guaranteed by a U.S. person.

As commenters noted, the Final Rule's use of a consolidation test that relies on U.S. GAAP to define ''Foreign Consolidated Subsidiary'' promotes legal certainty by articulating a clear, familiar, bright-line test. The Commission also took into account that the consolidation test is already being used in preparing financial statements, and as a result, should not result in more costs to market participants.[270] The Commission further believes that allowing market participants to rely on counterparty representations with respect to their status as an FCS will reduce any operational costs that may be associated with determining whether a counterparty is an FCS, especially given that the Prudential Regulators adopted a similar definition for purposes of their margin rules.

3. Application

Section II.B describes the application of the Commission's margin rules to cross-border uncleared swaps between CSEs and their counterparties, including the availability of substituted compliance and the Exclusion. The Final Rule also includes special provisions for non-segregation

[267] *See* 17 CFR 23.160(a)(2). As noted above, under the Final Rule, the term ''guarantee'' applies whenever a party to the swap has a legally enforceable right of recourse against a guarantor with respect to its counterparty's obligations under the swap, regardless of whether such right of recourse is conditioned upon the counterparty's insolvency or failure to meet its obligations under the relevant swap, or whether the counterparty seeking to enforce the guarantee is required to make a demand for payment or performance from its counterparty before proceeding against the U.S. guarantor.

[268] This release uses the term ''U.S. Guaranteed CSE'' for convenience only. Whether a non-U.S. CSE falls within the meaning of the term ''U.S. Guaranteed CSE'' varies on a swap-by-swap basis, such that a non-U.S. CSE may be considered a U.S. Guaranteed CSE for one swap and not another, depending on whether the non-U.S. CSE's obligations under such swap are guaranteed by a U.S. person.

[269] As further discussed above, the Final Rule generally treats uncleared swaps of non-U.S. CSEs, where the non-U.S. CSE's obligations under the uncleared swap are guaranteed by a U.S. person, the same as uncleared swaps of a U.S. CSE. In addition, guarantees may affect whether full or partial substituted compliance is available. Further, under the Final Rule, the Exclusion is not available if either party's obligations under the swap are guaranteed by a U.S. person. In addition, in order for an FCS or foreign branch of a U.S. CSE to engage in uncleared swaps in non-segregation jurisdictions as provided in section 23.160(e) of the Final Rule, one of the conditions that must be satisfied is that the counterparty to the swap cannot be a U.S. person and its obligations under the uncleared swap cannot be guaranteed by a U.S. person.

[270] As discussed in greater detail in section II.A.3, although commenters suggested various modifications to the FCS definition, such as relying on IFRS instead of U.S. GAAP or including non-U.S. CSEs whose U.S. parent meets standards for consolidation, but is not required to prepare consolidated financial statements under U.S. GAAP, the Commission does not believe such modifications would offer substantial benefits.

jurisdictions and non-netting jurisdictions.

a. Substituted Compliance

As described in section II.B.2.b and as set out in Table A, the extent to which substituted compliance is available under the Final Rule depends on whether the relevant swap involves a U.S. person, a guarantee by a U.S. person, or an FCS. U.S. CSEs and U.S. Guaranteed CSEs are eligible for substituted compliance only with respect to the requirement to post (but not the requirement to collect) initial margin, provided that their counterparty is a non-U.S. person (including a non-U.S. CSE) whose obligations under the swap are not guaranteed by a U.S. person.[271] On the other hand, non-U.S. CSEs whose obligations under the relevant swap are not guaranteed by a U.S. person are broadly eligible for substituted compliance (including for their swaps with U.S. persons that are not CSEs); however, only partial substituted compliance would be available for such non-U.S. CSE's swaps with U.S. CSEs or U.S. Guaranteed CSEs.[272]

The Commission recognizes that the decision to offer any substituted compliance in the first instance carries certain trade-offs. Given the global and highly-interconnected nature of the swap market, where risk does not respect national borders, market participants are likely to be subject to the regulatory interest of more than one jurisdiction. As commenters have pointed out, allowing compliance with foreign margin requirements as an alternative to domestic requirements can therefore reduce the application of duplicative or conflicting requirements, resulting in lower compliance costs and facilitating a more level playing field. Substituted compliance also helps preserve the benefits of an integrated, global swap market by fostering and advancing efforts among U.S. and foreign regulators to collaborate in establishing robust regulatory standards, as envisioned by the BCBS–IOSCO framework. If not properly implemented, however, the Commission's margin regime could lose some of its effectiveness. Accordingly, as commenters have recognized, the ultimate costs and benefits of substituted compliance are affected by the standard under which it is granted and the extent to which it is applied. The Commission was mindful of this dynamic in structuring a substituted compliance regime for the margin requirements and believes the Final Rule strikes an appropriate balance, enhancing market efficiency and fostering global coordination of margin requirements without compromising the safety and soundness of CSEs and the U.S. financial system.

The Commission also understands that, as commenters pointed out, by not offering substituted compliance equally to all CSEs, the Final Rule may lead to certain competitive disparities between CSEs and between CSEs and non-CFTC registered dealers. For example, to the extent that non-U.S. CSEs whose obligations are not guaranteed by a U.S. person can rely on substituted compliance that is not available to U.S. CSEs or U.S. Guaranteed CSEs, they may enjoy certain cost advantages (*e.g.,* avoiding the costs of potentially duplicative or inconsistent regulation, which could allow them to develop one enterprise-wide set of compliance and operational infrastructures). The non-U.S. CSEs may then be able to pass on these cost savings to their counterparties in the form of better pricing or some other benefit. U.S. CSEs and U.S. Guaranteed CSEs, on the other hand, could, depending on the extent to which foreign margin requirements apply, be subject to both U.S. and foreign margin requirements, and therefore be at a competitive disadvantage. Counterparties may also be incentivized to transact with CSEs that are offered substituted compliance in order to avoid being subject to duplicative or conflicting margin requirements, which could lead to increased market inefficiencies.[273]

Nevertheless, the Commission does not believe it is appropriate to make substituted compliance broadly available to all CSEs. As discussed above, the Commission has a strong supervisory interest in the uncleared swaps activity of all CSEs, including non-U.S. CSEs, by virtue of their registration with the Commission. Furthermore, U.S. CSEs and U.S. Guaranteed CSEs are particularly key swap market participants and their safety and soundness is critical to a well-functioning U.S. swap market and the stability of the U.S. financial system. Accordingly, in light of the Commission's supervisory interest in the activities of U.S. persons and its statutory obligation to ensure the safety and soundness of CSEs and the U.S. financial markets in the context of uncleared swaps, the Commission believes that substituted compliance is generally not appropriate for U.S. CSEs and U.S. Guaranteed CSEs given their importance to the U.S. financial markets.[274] With respect to other non-U.S. CSEs (including FCSs) that are not subject to a U.S. guarantee, however, the Commission believes that, in the interest of international comity, making substituted compliance broadly available is appropriate.

As further discussed in section II.B.2.b.i., the Commission determined that partial substituted compliance is appropriate for U.S. CSEs and U.S. Guaranteed CSEs in the limited case of posting (but not collecting) initial margin. Contrary to commenters' assertions, the Commission does not believe that partial substituted compliance is impractical or will hinder the development of a standardized model for initial margin. As discussed above, the Commission does not expect a CSE to have two netting sets as a result of partial substituted compliance, given that the U.S. CSE is always required to collect initial margin according to the Commission's margin requirements while it has the option to post according to the Commission's or its counterparty's foreign margin requirements. If substituted compliance is elected, the U.S. CSE will be deemed to satisfy the Commission's margin requirements by meeting the foreign jurisdiction's margin requirements, which will result in one netting set. Furthermore, the Commission believes that permitting partial substituted compliance allows market participants to avoid some costs associated with complying with duplicative or conflicting requirements.

The Commission acknowledges that foreign branches may, for the reasons raised by commenters and discussed above, be at a competitive disadvantage compared to non-U.S. CSEs, with whom they may compete in the countries in which they are established, by virtue of not being eligible for substituted compliance. However, as discussed in section II.B.2.b.i., the swap activities of a foreign branch of a U.S. CSE are

[271] Similarly, a non-U.S. CSE (including an FCS) is eligible for substituted compliance with respect to the requirement to collect initial margin if its counterparty is a U.S. CSE or a U.S. Guaranteed CSE.

[272] A subset of these non-U.S. CSEs may qualify for the Exclusion, as described in section II.B.3.b above.

[273] The Commission recognizes that its framework may impose certain initial operational costs, as CSEs will be required to determine the status of their counterparties in order to determine the extent to which substituted compliance is available. The Commission however believes the ability to obtain and rely on counterparty representations should help mitigate such costs.

[274] As discussed in section II.B.2.b.i above, because uncleared swaps of U.S. Guaranteed CSEs are identical in relevant respects to a swap entered directly by a U.S. person, the Final Rule treats these uncleared swaps the same as uncleared swaps of U.S. CSEs.

legally indistinguishable from the swap activities of the U.S. CSE. Permitting more favorable treatment to foreign branches of U.S. CSEs than the principal U.S. entity could create an easy way for U.S. CSEs to circumvent the Commission's margin requirements, which could undermine the safety and soundness of the U.S. CSE and the U.S. financial system.[275]

b. Exclusion

Under the Final Rule, the Commission excludes from its margin requirements uncleared swaps entered into by a non-U.S. CSE with a non-U.S. counterparty (including a non-U.S. CSE), provided that neither counterparty's obligations under the relevant swap are guaranteed by a U.S. person and neither counterparty is an FCS nor a U.S. branch of a non-U.S. CSE. As discussed in section II.B.3.b above, the Commission believes that it is appropriate to tailor the application of margin requirements in the cross-border context, consistent with section 4s(e) of the CEA and comity principles, so as to exclude this narrow class of uncleared swaps involving a non-U.S. CSE and a non-U.S. counterparty.

The Commission believes that such non-U.S. CSEs may benefit from the Exclusion because it allows them to avoid duplicative or conflicting regulations where a transaction is subject to more than one uncleared swap margin regime. On the other hand, to the extent the Exclusion allows a non-U.S. CSE to rely on foreign margin requirements that are not comparable to the Commission's, the Exclusion could result in a less rigorous margin regime for such CSE or, in the extreme, the absence of any margin requirements. This would not only increase the risk posed by that CSE's swaps activities, but could create competitive disparities between non-U.S. CSEs relying on the Exclusion and other CSEs that are not eligible for the Exclusion. That is, the Exclusion could allow these non-U.S. CSEs to offer better pricing or other terms to their non-U.S. clients and put them in a better position (than CSEs ineligible for the Exclusion) to compete with non-CFTC registered dealers in the relevant foreign jurisdiction for foreign clients. The degree of competitive disparity will depend on the degree of disparity between the Commission's margin framework and that of the relevant foreign jurisdiction.

The Commission does not generally expect that the Exclusion will result in a significant diminution in the safety and soundness of the non-U.S. CSE, as discussed in section II.B.3.b above. This is based on several considerations. First, the Commission understands that most swaps are currently transacted in jurisdictions that have agreed to adhere to the BCBS–IOSCO framework, which covers financial entities.[276] Accordingly, the Commission anticipates that many excluded swaps will nevertheless be subject to margin requirements in a jurisdiction that adheres to the BCBS–IOSCO framework. Second, the potential adverse effect on a non-U.S. CSE would be mitigated by the Commission's capital requirements which, as proposed, would impose a capital charge for uncollateralized exposures.[277]

Third, a non-U.S. CSE that can avail itself of the Exclusion will still be subject to the Commission's margin rules with respect to all uncleared swaps not meeting the criteria for the Exclusion, albeit with the possibility of substituted compliance. That the non-U.S. CSE will be subject to U.S. or comparable margin requirements when entering into a swap with U.S. counterparties reduces the possibility of a cascading event affecting U.S. counterparties and the U.S. financial markets more broadly as a result of a default by the non-U.S. CSE.

The unavailability of the Exclusion to FCSs could disadvantage them relative to other non-U.S. CSEs that are eligible for the Exclusion or non-CFTC registered dealers within a foreign jurisdiction. As commenters noted, non-U.S. CSEs that rely on the Exclusion or non-CFTC registered dealers could realize a cost advantage over FCSs and thus have the potential to offer better pricing terms to foreign clients. The competitive disparity between non-U.S. CSEs that rely on the Exclusion and FCSs, however, may be somewhat mitigated to the extent that the relevant foreign jurisdiction implements the BCBS–IOSCO framework.[278]

As noted above in section II.B.3.a., some commenters suggested that treating U.S. branches of non-U.S. CSEs differently from the rest of the CSE with respect to eligibility for the Exclusion could present operational challenges, requiring non-U.S. CSEs to document transactions with the U.S. branch under a separate ISDA Master Agreement. However, as explained in section II.B.3.b., in most cases the Commission does not believe a separate credit support agreement will be necessary;[279] furthermore, in those cases where it is required, the Commission nevertheless believes that extending the Exclusion to U.S. branches of non-U.S. CSEs would not be appropriate for the reasons discussed in section II.B.3.b above.[280] In addition, allowing U.S. branches to rely on the Exclusion would enable them to offer more competitive terms to non-U.S. clients than U.S. CSEs, thereby gaining an advantage when dealing with non-U.S. clients relative to other CSEs operating within the United States (*i.e.,* U.S. CSEs). On the other hand, for the same reason, the Final Rule could put non-U.S. CSEs that conduct swaps business through their U.S. branches at a disadvantage relative either to non-U.S. CSEs that are eligible for the Exclusion or non-CFTC registered dealers that conduct swaps business overseas. The Commission recognizes that while substituted compliance will be broadly available to such U.S. branches of non-U.S. CSEs, more compliance costs could be incurred by these entities than if the Exclusion were made available if a foreign jurisdiction's margin requirements are not comparable.[281]

In order to effectuate the Commission's treatment of inter-affiliate swaps under the Final Margin Rule, the Exclusion is not available if the market-facing transaction of the non-U.S. CSE (that is otherwise eligible for the Exclusion) is not subject to comparable initial margin collection requirements in the home jurisdiction and any of the

[275] The Commission notes that the potential competitive disparities could be minimized to the degree foreign margin requirements are harmonized or otherwise comparable to the Commission's.

[276] Element 2 of BCBS–IOSCO framework states: ''All covered entities (*i.e.* financial firms and systemically important non-financial entities) that engage in non-centrally cleared derivatives must exchange initial and variation margin as appropriate to the counterparty risks posed by such transactions.''

[277] *See* Proposed Capital Rule, 76 FR 27802.

[278] As discussed above, a commenter's suggestion to exclude transactions between an FCS and another non-guaranteed non-U.S. person up to an aggregate 5 percent notional trading limit would be difficult to monitor and could create incentives to ''cherry-pick'' and exclude uncleared swaps presenting the highest margin requirement, which could thereby introduce undue risk into the system.

[279] *See supra* note 158.

[280] The Prudential Regulators' Final Margin Rule does not grant an exclusion for the uncleared swaps of such U.S. branches on the basis that U.S. branches of foreign banks clearly operate within the United States and could pose risk to the U.S. financial system, and the Commission believes that harmonization with the Prudential Regulators' Final Margin Rule is appropriate. For further discussion of the reasons that the Exclusion does not extend to U.S. branches of non-U.S. CSEs, *see* section II.B.3.b above.

[281] As noted above, U.S. branches of foreign banks (as ''foreign bank'' is defined in section __.2 of the Prudential Regulators' Final Margin Rule (12 CFR part 237)) must comply with the Prudential Regulators' margin rules, as these U.S. branches have a Prudential Regulator, as defined in 1(a)(39) of the CEA.

risk associated with the uncleared swap is transferred, directly or indirectly, through inter-affiliate transactions, to a U.S. CSE. As a consequence, the affected non-U.S. CSEs may be placed at a cost disadvantage relative to non-U.S. CSEs that can rely on the Exclusion as well as non-CFTC registered dealers operating in the foreign jurisdiction that are not subject to similarly rigorous initial margin collection requirements. The Commission, however, believes that this limitation is necessary to ensure that the Exclusion does not facilitate the transfer of risk to a U.S. CSE through the use of inter-affiliate transactions that, per the Final Margin Rule, are generally not subject to the collection of initial margin.

c. Non-Segregation Jurisdictions and Non-Netting Jurisdictions

The Final Rule includes a special provision for non-segregation jurisdictions, where custodial arrangements that comply with the Commission's requirements set out in Commission Regulation 23.157 [282] are impracticable due to the legal or operational infrastructure of the foreign jurisdiction.[283] Specifically, an FCS or a foreign branch of a U.S. CSE may, in certain circumstances, be excepted from the requirement to post initial margin for the uncleared swap in compliance with the custodial requirements of the Final Margin Rule in certain foreign jurisdictions where inherent limitations in the legal or operational infrastructure of the jurisdiction make it impracticable for the CSE and its counterparty to comply with that requirement, subject to certain conditions.

The Commission understands from commenters that inherent legal and operational constraints in certain jurisdictions could make compliance with the custodial requirements of the Final Margin Rule impracticable. Accordingly, absent the exception, FCSs and foreign branches of U.S. CSEs would be unable to conduct uncleared swap business with clients based in such jurisdictions, contributing to further market inefficiencies. The Commission further agrees with commenters that an exception from the requirement to post (but not from the requirement to collect) initial margin when transacting with clients in non-segregation jurisdictions will accomplish the goal of ensuring a CSE's safety and soundness but with less disruption to existing business relationships than the exchange of initial and variation margin would impose.

After careful consideration, the Commission is adding a special provision so that FCSs and foreign branches of U.S. CSEs will not be foreclosed from engaging in uncleared swaps business in non-segregation jurisdictions, with appropriate conditions, including a 5 percent limitation, as discussed in section II.B.4.b above, to avoid compromising the safety and soundness of CSEs. The Commission does not believe a blanket de minimis exception from the Commission's margin requirements, as suggested by commenters, is appropriate. Rather, the Commission believes that carefully tailored relief from the Final Margin Rule's requirement to post initial margin and the custodial arrangement requirements that pertain to initial margin collected by a CSE will accomplish the goal of allowing FCSs and foreign branches of U.S. CSEs to carry on their swaps business in non-segregation jurisdictions without creating the risks that would attend wholesale exemption from margin requirements in these jurisdictions. In addition, in light of the importance of FCSs and foreign branches of U.S. CSEs to the U.S. financial system, the special provision includes certain conditions that are designed to appropriately limit the swap activities conducted by these CSEs in these jurisdictions in order to help ensure their safety and soundness. Although these conditions may place affected entities at a relative cost disadvantage when compared to non-U.S. CSEs that can rely on the Exclusion and non-CFTC registered dealers engaged in swaps activity in non-segregation jurisdictions, and may limit the overall swap dealing activity of affected entities in these jurisdictions, the Commission believes that the special provision provides a substantial benefit to the affected entities by allowing them to conduct a limited level of swaps business in non-segregation jurisdictions where they would otherwise be foreclosed. While permitting FCSs and foreign branches of U.S. CSEs to carry on their swaps business in non-segregation jurisdictions in accordance with this special provision is not without some risk, in that the initial margin collected by FCSs and foreign branches of U.S. CSEs in reliance on this provision is not subject to the custodial arrangement requirements of the Final Margin Rule, the Commission believes that the conditions to using this provision (including the 5 percent limit in each of four broad risk categories set forth in § 23.154(b)(2)(v)) should be sufficient to prevent undue risk arising from uncleared swaps by FCSs and foreign branches of U.S. CSEs relying on this provision.

The Final Rule also includes a special provision for ''non-netting'' jurisdictions.[284] In order to avail itself of this provision, the CSE must treat the uncleared swaps covered by the netting agreement on a gross basis in determining the amount of initial and variation margin that it must collect, but may net those uncleared swaps in determining the amount of initial and variation margin it must post to the counterparty, in accordance with the netting provisions of the Final Margin Rule. The Commission agrees that, as suggested by commenters, without enforceable netting and collateral arrangements, there is a risk that a CSE may not be able to effectively foreclose on the margin in the event of a counterparty default, and a risk that the administrator of an insolvent counterparty will ''cherry-pick'' from posted collateral to be returned in the event of insolvency, which could result in an increase in the risk in posting collateral. As with the provision for non-segregation jurisdictions, this provision is carefully tailored to allow CSEs to conduct swap transactions in ''non-netting'' jurisdictions without abandoning the key protections behind the netting requirement under the Final Margin Rule.[285] If the Commission were not to adopt this special provision, then a CSE would have to collect and post margin on a gross basis, which would result in greater costs to the CSE and result in additional credit risk, and put them at a competitive disadvantage. It is possible that this would lead to CSEs

[282] *See* 17 CFR 23.157.

[283] As used in this release, a ''non-segregation jurisdiction'' is a jurisdiction where inherent limitations in the legal or operational infrastructure of the foreign jurisdiction make it impracticable for the CSE and its counterparty to post initial margin pursuant to custodial arrangements that comply with the Final Margin Rule, as further described in section II.B.4.b.

[284] As used in this release, a ''non-netting jurisdiction'' is a jurisdiction in which a CSE cannot conclude, with a well-founded basis, that the netting agreement with a counterparty in that foreign jurisdiction meets the definition of an ''eligible master netting agreement'' set forth in the Final Margin Rule, as described in section II.B.5.b.

[285] The Commission considered a broader provision, including, as requested by commenters, excluding these transactions from its margin rule. However, as netting provisions are critical to the overall goal of margin requirements and the Commission is not requiring CSEs to post margin on a gross basis, the Commission believes that the regulatory gap that a broader provision would create would be inconsistent with the Commission's mandate to protect the safety and soundness of CSEs.

being effectively precluded from doing business in these jurisdictions.

4. Comparability Determinations

As noted in section II.C above, any CSE eligible for substituted compliance may make a request for a comparability determination. Currently, there are approximately 106 swap entities provisionally registered with the Commission. The Commission further estimates that of the 106 swap entities that are registered, approximately 54 are subject to the Commission's margin rules, as they are not supervised by a Prudential Regulator. However, the Commission notes that any foreign regulatory agency that has direct supervisory authority to administer the foreign regulatory framework for margin of uncleared swaps in the requested foreign jurisdiction may apply for a comparability determination. Further, once a comparability determination is made for a jurisdiction, it will apply for all entities or transactions in that jurisdiction to the extent provided in the determination, as approved by the Commission.

Although there is uncertainty regarding the number of requests for comparability determinations that will be made under the Final Rule, the Commission estimates that it will receive applications for comparability determinations from 17 jurisdictions representing 61 separate registrants, and that each request will impose an average of 10 burden hours per registrant.

Based on the above, the Commission estimates that the preparation and filing of submission requests for comparability determinations should take no more than 170 hours annually in the aggregate (17 registrants × 10 hours). The Commission further estimates that the total aggregate cost of preparing such submission requests will be $64,600, based on an estimated cost of $380 per hour for an in-house attorney.[286]

As summarized in section II.C.2, several commenters complained that the costs and burdens to market participants associated with the Commission's proposed framework and standard for making comparability determinations would be minimized if the Commission were to rely on the BCBS–IOSCO framework as the sole basis for its comparability analysis and take a ''holistic'' approach to determining comparability. As the Commission explained above, however, while the BCBS–IOSCO framework establishes minimum standards that are consistent with the objectives of the Commission's own margin requirements, consistency with International Standards is necessary but may not be sufficient to finding comparability.[287] Furthermore, allowing for a comparability determination to be made based on comparable outcomes and objectives notwithstanding differences in foreign jurisdictions' requirements ensures that substituted compliance is made available to the fullest extent possible. While the Commission recognizes that, to the extent that a foreign margin regime is not deemed comparable in all respects, CSEs eligible for substituted compliance may experience costs from being required to comply with more than one set of specified margin requirements, the Commission believes that this approach is preferable to an all-or-nothing approach, in which market participants may be forced to comply with both margin regimes in their entirety.

5. Section 15(a) Factors

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors.

a. Protection of Market Participants and the Public

As described above, CEA section 4s(e)(2)(A) requires the Commission to develop rules designed to ensure the safety and soundness of CSEs and the U.S. financial system. On the one hand, full application of the Commission's margin requirements to all uncleared swaps of CSEs would help to ensure the safety and soundness of CSEs and the U.S. financial system by reducing counterparty credit risk and the threat of contagion. On the other hand, extending substituted compliance to certain cross-border swaps reduces the potential for conflicting or duplicative requirements, which would, in turn, reduce market distortions and promote global harmonization. In addition, where exceptions have been permitted (*i.e.,* under the Exclusion and the special provisions for non-segregation and non-netting jurisdictions), the Commission has limited their availability to strike a balance between international comity and the continuation of important business activity by qualifying CSEs, on the one hand, and limiting risk to CSEs and the U.S. financial system, on the other hand. While the Final Rule will allow CSEs to comply with foreign margin requirements as an alternative to the Commission's requirements in certain circumstances, such margin requirements must be comparable in outcome and objectives, and the Commission retains the authority to modify or condition the availability of substituted compliance as necessary. Furthermore, substituted compliance is available on a more limited basis for U.S. CSEs and U.S. Guaranteed CSEs. Additionally, while the Final Rule also excludes certain uncleared swap transactions involving non-U.S. CSEs whose obligations under the relevant swap are not subject to a U.S. guarantee from the Final Margin Rule and excepts qualifying CSEs from certain requirements in non-segregation jurisdictions and non-netting jurisdictions, the Exclusion and special provisions are narrowly tailored and include safeguards to protect market participants and the public. Overall, the Commission believes that the Final Rule takes proper account of significant, and sometimes competing, factors in order to effectively address the risk posed to the safety and soundness of CSEs while creating a workable cross-border framework that reduces the potential for undue market disruptions and promoting global harmonization, thereby benefiting market participants and the public.

[286] Although different registrants may choose to staff preparation of the comparability determination request with different personnel, Commission staff estimates that, on average, an initial request could be prepared and submitted with 10 hours of an in-house attorney's time. To estimate the hourly cost of an in-house attorney's attorney time, Commission staff reviewed data in SIFMA's Report on *Management and Professional Earnings in the Securities Industry 2013,* modified by Commission staff to account for an 1800-hour work-year and multiplied by a factor of 5.35 to account for firm size, employee benefits and overhead. Commission staff believes that use of a 5.35 multiplier here is appropriate because some persons may retain outside advisors to assist in making the determinations under the rules.

[287] *See supra* notes 232 and 233 and accompanying text. Also, as the Commission noted above, the Final Margin Rule included substantial modifications from the Proposed Margin Rule that further aligned the Commission's margin requirements with International Standards and, as a result, the potential for conflict with foreign margin requirements should be reduced. *See supra* note 29.

b. Efficiency, Competitiveness, and Financial Integrity

As discussed above, the Final Rule may have both a positive and negative effect on market efficiency and competitiveness. As an initial matter, substituted compliance and the Exclusion should improve resource allocation efficiency by allowing market participants to avoid potentially duplicative or conflicting requirements, reducing the aggregate cost to the market of dealing uncleared swaps. By granting this relief to some CSEs and not others, however, the Final Rule may afford such CSEs a cost advantage compared to other CSEs that may be required to comply with potentially duplicative or conflicting requirements. Non-U.S. counterparties may also be incentivized to transact with CSEs that are eligible for substituted compliance in order to avoid complying with more than one margin regime (or the Commission's margin regime alone), which could contribute to market inefficiencies. In addition, as the Exclusion is not provided to all CSEs, those that are not permitted to use the Exclusion may be at a competitive disadvantage when competing in foreign jurisdictions that do not have comparable margin rules. The Commission notes, however, that to the extent that non-U.S. CSEs are domiciled in jurisdictions with comparable requirements, this may mitigate possible regulatory arbitrage by these CSEs.

At the same time, however, the Commission understands that if it did not provide special accommodations for certain CSEs to enter into certain markets, such CSEs would be disadvantaged and even prohibited from engaging in swaps in these jurisdictions.

Furthermore, the Commission believes that the Final Rule ensures that substituted compliance and the Exclusion are extended in a tailored fashion that is consistent with protecting the integrity of the swaps market. Substituted compliance is only provided in the event that the relevant foreign jurisdiction has a comparable margin rule; if not, the CSE must comply with the Commission's margin rule. Even in instances where the Exclusion is available, the Commission notes that: (1) The Final Margin Rule will cover many of the swaps of the non-U.S. CSEs (eligible for the Exclusion) with other counterparties, namely, all U.S. counterparties; (2) the Exclusion is limited to a narrow set of swaps by non-U.S. CSEs; and (3) the excluded swaps may be covered by another foreign regulator's margin rule that is based on the BCBS–IOSCO framework.

c. Price Discovery

The Commission generally believes that substituted compliance, by reducing the potential for duplicative or conflicting regulations, could reduce impediments to transact uncleared swaps on a cross-border basis. This, in turn, may enhance liquidity as more market participants may be willing to enter into uncleared swaps, thereby possibly improving price discovery—and ultimately reducing market fragmentation. Alternatively, if substituted compliance or the Exclusion were not made available, CSEs could be incentivized to consider setting up their swap operations outside the Commission's jurisdiction, and as a result, increase the potential for market fragmentation. Additionally, exceptions for non-segregation and non-netting jurisdictions could increase price discovery in such jurisdictions by opening such markets to CSEs where, by virtue of the application of the Commission's margin requirements, such CSEs would otherwise be unable to deal uncleared swaps.

d. Sound Risk Management Practices

The Commission believes that the Final Rule is consistent with sound risk management practices. The Final Margin Rule promotes sound risk management practices, and this Final Rule requires U.S. CSEs and U.S. Guaranteed CSEs to apply that rule in its entirety for most cross-border transactions. To the extent substituted compliance is available in limited fashion to these entities and more broadly to non-U.S. CSEs, the foreign margin requirements must be comparable to the Commission's in outcome and objectives. That should ensure that margin's critical risk management function is unaffected. Although the Exclusion could potentially lead to weaker risk management for eligible non-U.S. CSEs to the extent that they are not otherwise subject to comparable foreign margin requirements, the Commission notes that in jurisdictions that are BCBS–IOSCO compliant, such CSEs will be subject to margin requirements that satisfy the minimum International Standards established by the BCBS–IOSCO framework.[288] Furthermore, while the Commission recognizes that a special provision in the Final Rule will excuse CSEs that are FCSs and foreign branches of U.S. CSEs from the requirement to post initial margin pursuant to custodial arrangements that comply with the Final Margin Rule, the Commission believes that the impact to risk management will be mitigated by the relatively small volume of such transactions, the conditions required to rely on this special provision, including a limit on the overall swaps using the special provision, and the continued applicability of other requirements, including margin with respect to other uncleared swaps of such FCSs and foreign branches and broader capital requirements.[289] The Commission similarly believes that the risk management implications of the special provision for non-netting jurisdictions will be limited. As explained above, CSEs will still be required to calculate and collect initial margin on a gross basis to ensure that the CSE can obtain the collateral posted with the counterparty in the event of counterparty default.

e. Other Public Interest Considerations

The Commission has not identified any additional public interest considerations related to the costs and benefits of the Final Rule.

List of Subjects in 17 CFR Part 23

Swaps, Swap dealers, Major swap participants, Capital and margin requirements.

For the reasons discussed in the preamble, the Commodity Futures Trading Commission amends 17 CFR part 23 as set forth below:

PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

■ 1. The authority citation for part 23 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b–1, 6c, 6p, 6r, 6s, 6t, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21.

Section 23.160 also issued under 7 U.S.C. 2(i); Sec. 721(b), Pub. L. 111–203, 124 Stat. 1641 (2010).

■ 2. Add § 23.160 to read as follows:

§ 23.160 Cross-border application.

(a) *Definitions.* For purposes of this section only:

(1) *Foreign Consolidated Subsidiary* means a non-U.S. CSE in which an ultimate parent entity that is a U.S. person has a controlling financial interest, in accordance with U.S. GAAP, such that the U.S. ultimate parent entity includes the non-U.S. CSE's operating results, financial position and statement

[288] As indicated in *supra* note 23, representatives of 26 regulatory authorities participated in the WGMR that developed the BCBS–IOSCO framework.

[289] *See* Proposed Capital Rule, 76 FR 27802.

of cash flows in the U.S. ultimate parent entity's consolidated financial statements, in accordance with U.S. GAAP.

(2) *Guarantee* means an arrangement pursuant to which one party to an uncleared swap has rights of recourse against a guarantor, with respect to its counterparty's obligations under the uncleared swap. For these purposes, a party to an uncleared swap has rights of recourse against a guarantor if the party has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from the guarantor with respect to its counterparty's obligations under the uncleared swap. In addition, in the case of any arrangement pursuant to which the guarantor has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from any other guarantor with respect to the counterparty's obligations under the uncleared swap, such arrangement will be deemed a guarantee of the counterparty's obligations under the uncleared swap by the other guarantor.

(3) *International standards* mean the margin policy framework for non-cleared, bilateral derivatives issued by the Basel Committee on Banking Supervision and the International Organization of Securities in September 2013, as subsequently updated, revised, or otherwise amended, or any other international standards, principles or guidance relating to margin requirements for non-cleared, bilateral derivatives that the Commission may in the future recognize, to the extent that they are consistent with United States law (including the margin requirements in the Commodity Exchange Act).

(4) *Non-U.S. CSE* means a covered swap entity that is not a U.S. person. The term ''non-U.S. CSE'' includes a ''Foreign Consolidated Subsidiary'' or a U.S. branch of a non-U.S. CSE.

(5) *Non-U.S. person* means any person that is not a U.S. person.

(6) *Ultimate parent entity* means the parent entity in a consolidated group in which none of the other entities in the consolidated group has a controlling interest, in accordance with U.S. GAAP.

(7) *United States* means the United States of America, its territories and possessions, any State of the United States, and the District of Columbia.

(8) *U.S. CSE* means a covered swap entity that is a U.S. person.

(9) *U.S. GAAP* means U.S. generally accepted accounting principles.

(10) *U.S. person* means:

(i) A natural person who is a resident of the United States;

(ii) An estate of a decedent who was a resident of the United States at the time of death;

(iii) A corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund or any form of entity similar to any of the foregoing (other than an entity described in paragraph (a)(10)(iv) or (v) of this section) (a ''legal entity''), in each case that is organized or incorporated under the laws of the United States or that has its principal place of business in the United States, including any branch of such legal entity;

(iv) A pension plan for the employees, officers or principals of a legal entity described in paragraph (a)(10)(iii) of this section, unless the pension plan is primarily for foreign employees of such entity;

(v) A trust governed by the laws of a state or other jurisdiction in the United States, if a court within the United States is able to exercise primary supervision over the administration of the trust;

(vi) A legal entity (other than a limited liability company, limited liability partnership or similar entity where all of the owners of the entity have limited liability) that is owned by one or more persons described in paragraphs (a)(10)(i) through (v) of this section and for which such person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity, including any branch of the legal entity; or

(vii) An individual account or joint account (discretionary or not) where the beneficial owner (or one of the beneficial owners in the case of a joint account) is a person described in paragraphs (a)(10)(i) through (vi) of this section.

(b) *Applicability of margin requirements.* The requirements of §§ 23.150 through 23.161 apply as follows.

(1) *Uncleared swaps of U.S. CSEs or Non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person*—(i) *Applicability of U.S. margin requirements; availability of substituted compliance for requirement to post initial margin.* With respect to each uncleared swap entered into by a U.S. CSE or a non-U.S. CSE whose obligations under the swap are guaranteed by a U.S. person, the U.S. CSE or non-U.S. CSE whose obligations under the swap are guaranteed by a U.S. person shall comply with the requirements of §§ 23.150 through 23.161 of this part, provided that the U.S. CSE or non-U.S. CSE whose obligations under the swap are guaranteed by a U.S. person may satisfy its requirement to post initial margin to certain counterparties to the extent provided in paragraph (b)(1)(ii) of this section.

(ii) *Compliance with foreign initial margin collection requirement.* A covered swap entity that is covered by paragraph (b)(1)(i) of this section may satisfy its requirement to post initial margin under this part by posting initial margin in the form and amount, and at such times, that its counterparty is required to collect initial margin pursuant to a foreign jurisdiction's margin requirements, but only to the extent that:

(A) The counterparty is neither a U.S. person nor a non-U.S. person whose obligations under the relevant swap are guaranteed by a U.S. person;

(B) The counterparty is subject to such foreign jurisdiction's margin requirements; and

(C) The Commission has issued a comparability determination under paragraph (c) of this section (''Comparability Determination'') with respect to such foreign jurisdiction's requirements regarding the posting of initial margin by the covered swap entity (that is covered in paragraph (b)(1) of this section).

(2) *Uncleared swaps of Non-U.S. CSEs whose obligations under the relevant swap are not guaranteed by a U.S. person*—(i) *Applicability of U.S. Margin requirements except where an exclusion applies; Availability of substituted compliance.* With respect to each uncleared swap entered into by a non-U.S. CSE whose obligations under the relevant swap are not guaranteed by a U.S. person, the non-U.S. CSE shall comply with the requirements of §§ 23.150 through 23.161 except to the extent that an exclusion is available under paragraph (b)(2)(ii) of this section, provided that a non-U.S. CSE whose obligations under the relevant swap are not guaranteed by a U.S. person may satisfy its margin requirements under this part to the extent provided in paragraphs (b)(2)(iii) and (b)(2)(iv) of this section.

(ii) *Exclusion.* (A) Except as provided in paragraph (b)(2)(ii)(B) of this section, a non-U.S. CSE shall not be required to comply with the requirements of §§ 23.150 through 23.161 with respect to each uncleared swap it enters into to the extent that the following conditions are met:

(*1*) The non-U.S. CSE's obligations under the relevant swap are not guaranteed by a U.S. person;

(*2*) The non-U.S. CSE is not a U.S. branch of a non-U.S. CSE;

(*3*) The non-U.S. CSE is not a Foreign Consolidated Subsidiary; and

(*4*) The counterparty to the uncleared swap is a non-U.S. person (excluding a Foreign Consolidated Subsidiary or the U.S. branch of a non-U.S. CSE), whose obligations under the relevant swap are not guaranteed by a U.S. person.

(B) Notwithstanding paragraph (b)(2)(ii)(A) of this section, any uncleared swap of a non-U.S. CSE that meets the conditions for the Exclusion set forth in paragraph (b)(2)(ii)(A) must nevertheless comply with §§ 23.150 through 23.161 if:

(*1*) The uncleared swap of the non-U.S. CSE is not covered by a Comparability Determination with respect to the initial margin collection requirements in the relevant foreign jurisdiction in accordance with paragraph (c) of this section; and

(*2*) The non-U.S. CSE enters into an inter-affiliate swap(s), transferring any risk arising out of the uncleared swap described in paragraph (b)(2)(ii)(B)(*1*) of this section directly or indirectly, to a margin affiliate (as the term ''margin affiliate'' is defined in § 23.151 of this part) that is a U.S. CSE or a U.S. Guaranteed CSE.

(iii) *Availability of substituted compliance where the counterparty is not a U.S. CSE or a non-U.S. CSE whose obligations under the relevant swap are guaranteed by a U.S. person.* Except to the extent that an exclusion is available under paragraph (b)(2)(ii) of this section, with respect to each uncleared swap entered into by a non-U.S. CSE whose obligations under the relevant swap are not guaranteed by a U.S. person with a counterparty (except where the counterparty is either a U.S. CSE or a non-U.S. CSE whose obligations under the relevant swap are guaranteed by a U.S. person), the non-U.S. CSE whose obligations under the relevant swap are not guaranteed by a U.S. person may satisfy margin requirements under this part by complying with the margin requirements of a foreign jurisdiction to which such non-U.S. CSE (whose obligations under the relevant swap are not guaranteed by a U.S. person) is subject, but only to the extent that the Commission has issued a Comparability Determination under paragraph (c) of this section for such foreign jurisdiction.

(iv) *Availability of substituted compliance where the counterparty is a U.S. CSE or a non-U.S. CSE whose obligations under the relevant swap are guaranteed by a U.S. person.* With respect to each uncleared swap entered into by a non-U.S. CSE whose obligations under the relevant swap are not guaranteed by a U.S. person with a counterparty that is a U.S. CSE or a non-U.S. CSE whose obligations under the relevant swap are guaranteed by a U.S. person, the non-U.S. CSE (whose obligations under the relevant swap are not guaranteed by a U.S. person) may satisfy its requirement to collect initial margin under this part by collecting initial margin in the form and amount, and at such times and under such arrangements, that the non-U.S. CSE (whose obligations under the relevant swap are not guaranteed by a U.S. Person) is required to collect initial margin pursuant to a foreign jurisdiction's margin requirements, provided that:

(A) The non-U.S. CSE (whose obligations under the relevant swap are not guaranteed by a U.S. person) is subject to the foreign jurisdiction's regulatory requirements; and

(B) The Commission has issued a Comparability Determination with respect to such foreign jurisdiction's margin requirements.

(c) *Comparability determinations*—(1) *Eligibility requirements.* The following persons may, either individually or collectively, request a Comparability Determination with respect to some or all of the Commission's margin requirements:

(i) A covered swap entity that is eligible for substituted compliance under this section; or

(ii) A foreign regulatory authority that has direct supervisory authority over one or more covered swap entities and that is responsible for administering the relevant foreign jurisdiction's margin requirements.

(2) *Submission requirements.* Persons requesting a Comparability Determination should provide the Commission (either by hard copy or electronically):

(i) A description of the objectives of the relevant foreign jurisdiction's margin requirements;

(ii) A description of how the relevant foreign jurisdiction's margin requirements address, at minimum, each of the following elements of the Commission's margin requirements. Such description should identify the specific legal and regulatory provisions that correspond to each element and, if necessary, whether the relevant foreign jurisdiction's margin requirements do not address a particular element:

(A) The products subject to the foreign jurisdiction's margin requirements;

(B) The entities subject to the foreign jurisdiction's margin requirements;

(C) The treatment of inter-affiliate derivative transactions;

(D) The methodologies for calculating the amounts of initial and variation margin;

(E) The process and standards for approving models for calculating initial and variation margin models;

(F) The timing and manner in which initial and variation margin must be collected and/or paid;

(G) Any threshold levels or amounts;

(H) Risk management controls for the calculation of initial and variation margin;

(I) Eligible collateral for initial and variation margin;

(J) The requirements of custodial arrangements, including segregation of margin and rehypothecation;

(K) Margin documentation requirements; and

(L) The cross-border application of the foreign jurisdiction's margin regime.

(iii) A description of the differences between the relevant foreign jurisdiction's margin requirements and the International Standards;

(iv) A description of the ability of the relevant foreign regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's margin requirements. Such description should discuss the powers of the foreign regulatory authority or authorities to supervise, investigate, and discipline entities for compliance with the margin requirements and the ongoing efforts of the regulatory authority or authorities to detect and deter violations of, and ensure compliance with, the margin requirements; and

(v) Copies of the foreign jurisdiction's margin requirements (including an English translation of any foreign language document);

(vi) Any other information and documentation that the Commission deems appropriate.

(3) *Standard of review.* The Commission will issue a Comparability Determination to the extent that it determines that some or all of the relevant foreign jurisdiction's margin requirements are comparable to the Commission's corresponding margin requirements. In determining whether the requirements are comparable, the Commission will consider all relevant factors, including:

(i) The scope and objectives of the relevant foreign jurisdiction's margin requirements;

(ii) Whether the relevant foreign jurisdiction's margin requirements achieve comparable outcomes to the Commission's corresponding margin requirements;

(iii) The ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's margin requirements; and

(iv) Any other facts and circumstances the Commission deems relevant.

(4) *Reliance.* Any covered swap entity that, in accordance with a Comparability Determination, complies with a foreign jurisdiction's margin requirements, would be deemed to be in compliance with the Commission's corresponding margin requirements. Accordingly, if the Commission determines that a covered swap entity has failed to comply with the foreign jurisdiction's margin requirements, it could initiate an action for a violation of the Commission's margin requirements. All covered swap entities, regardless of whether they rely on a Comparability Determination, remain subject to the Commission's examination and enforcement authority.

(5) *Conditions.* In issuing a Comparability Determination, the Commission may impose any terms and conditions it deems appropriate.

(6) *Modifications.* The Commission reserves the right to further condition, modify, suspend, terminate or otherwise restrict a Comparability Determination in the Commission's discretion.

(7) *Delegation of authority.* The Commission hereby delegates to the Director of the Division of Swap Dealer and Intermediary Oversight, or such other employee or employees as the Director may designate from time to time, the authority to request information and/or documentation in connection with the Commission's issuance of a Comparability Determination.

(d) *Non-netting jurisdiction requirements.* Except as provided in paragraph (e) of this section, if a CSE cannot conclude after sufficient legal review with a well-founded basis that the netting agreement described in § 23.152(c) meets the definition of ''eligible master netting agreement'' set forth in § 23.151, the CSE must treat the uncleared swaps covered by the agreement on a gross basis for the purposes of calculating and complying with the requirements of § 23.152(a) and § 23.153(a) to collect margin, but the CSE may net those uncleared swaps in accordance with § 23.152(c) and § 23.153(d) for the purposes of calculating and complying with the requirements of this part to post margin. A CSE that relies on this paragraph (d) must have policies and procedures ensuring that it is in compliance with the requirements of this paragraph, and maintain books and records properly documenting that all of the requirements of this paragraph (d) are satisfied.

(e) *Jurisdictions Where Compliance with Custodial Arrangement Requirements is Unavailable.* Sections 23.152(b), 23.157(b), and paragraph (d) of this section do not apply to an uncleared swap entered into by a Foreign Consolidated Subsidiary or a foreign branch of a U.S. CSE if:

(1) Inherent limitations in the legal or operational infrastructure in the applicable foreign jurisdiction make it impracticable for the CSE and its counterparty to post any form of eligible initial margin collateral recognized pursuant to § 23.156 in compliance with the custodial arrangement requirements of § 23.157;

(2) The CSE is subject to foreign regulatory restrictions that require the CSE to transact in uncleared swaps with the counterparty through an establishment within the foreign jurisdiction and do not accommodate the posting of collateral for the uncleared swap in compliance with the custodial arrangements of § 23.157 in the United States or a jurisdiction for which the Commission has issued a comparability determination under paragraph (c) of this section with respect to § 23.157;

(3) The counterparty to the uncleared swap is a non-U.S. person that is not a CSE, and the counterparty's obligations under the uncleared swap are not guaranteed by a U.S. person;

(4) The CSE collects initial margin for the uncleared swap in accordance with § 23.152(a) in the form of cash pursuant to § 23.156(a)(1)(i), and posts and collects variation margin in accordance with § 23.153(a) in the form of cash pursuant to § 23.156(a)(1)(i);

(5) For each broad risk category, as set out in § 23.154(b)(2)(v), the total outstanding notional value of all uncleared swaps in that broad risk category, as to which the CSE is relying on this paragraph (e), may not exceed 5% of the CSE's total outstanding notional value for all uncleared swaps in the same broad risk category;

(6) The CSE has policies and procedures ensuring that it is in compliance with the requirements of this paragraph (e); and

(7) The CSE maintains books and records properly documenting that all of the requirements of this paragraph (e) are satisfied.

Issued in Washington, DC, on May 24, 2016, by the Commission.

Christopher J. Kirkpatrick,

Secretary of the Commission.

Note: The following table and appendices will not appear in the Code of Federal Regulations.

Table A—Application of the Final Rule

The following table should be read in conjunction with the rest of the preamble and the text of the Final Rule, as well as the footnotes at the end of the table.

CSE	Counterparty	Applicable margin requirements
U.S. CSE or Non-U.S. CSE (including U.S. branch of a non-U.S. CSE and a Foreign Consolidated Subsidiary (''FCS'')) whose obligations under the relevant swap *are* guaranteed by a U.S. person.	• U.S. person (including U.S. CSE) • Non-U.S. person (including non-U.S. CSE, FCS, and U.S. branch of a non-U.S. CSE) whose obligations under the relevant swap are guaranteed by a U.S. person.	U.S. (All).
	• Non-U.S. person (including non-U.S. CSE, FCS and U.S. branch of a non-U.S. CSE) whose obligations under the relevant swap are not guaranteed by a U.S. person.	U.S. (Initial Margin collected by CSE in column 1). Substituted Compliance (Initial Margin posted by CSE in column 1). U.S. (Variation Margin).
FCS whose obligations under the relevant swap *are not* guaranteed by a U.S. person. or U.S. branch of a non-U.S. CSE whose obligations under the relevant swap *are not* guaranteed by a U.S. person.	• U.S. CSE • Non-U.S. CSE (including U.S. branch of a non-U.S. CSE and FCS) whose obligations under the relevant swap are guaranteed by a U.S. person.	U.S. (Initial Margin posted by CSE in column 1). Substituted Compliance (Initial Margin collected by CSE in column 1). U.S. (Variation Margin).

CSE	Counterparty	Applicable margin requirements
	• U.S. person (except as noted above for a CSE). • Non-U.S. person whose obligations under the swap are guaranteed by a U.S. person (except a non-U.S. CSE, U.S. branch of a non-U.S. CSE, and FCS whose obligations are guaranteed, as noted above). • Non-U.S. person (including non-U.S. CSE, U.S. branch of a non-U.S. CSE, and a FCS) whose obligations under the relevant swap are not guaranteed by a U.S. person.	Substituted Compliance (All).
Non-U.S. CSE (that is not an FCS or a U.S. branch of a non-U.S. CSE) whose obligations under the relevant swap *are not* guaranteed by a U.S. person.	• U.S. CSE	U.S. (Initial Margin posted by CSE in column 1). Substituted Compliance (Initial Margin collected by CSE in column 1). U.S. (Variation Margin).
	• Non-U.S. CSE (including U.S. branch of a non-U.S. CSE and FCS) whose obligations under the swap are guaranteed by a U.S. person. • U.S. person (except as noted above for a CSE). • Non-U.S. person whose obligations under the swap are guaranteed by a U.S. person (except a non-U.S. CSE whose obligations are guaranteed, as noted above). • U.S. branch of a non-U.S. CSE or FCS, in each case whose obligations under the relevant swap are not guaranteed by a U.S. person.	Substituted Compliance (All).
	• Non-U.S. person (including a non-U.S. CSE, but not an FCS or a U.S. branch of a non-U.S. CSE) whose obligations under the relevant swap are not guaranteed by a U.S. person.	Excluded (except in connection with certain inter-affiliate swaps).

[1] The term "U.S. person" is defined in § 23.160(a)(10) of the Final Rule. A "non-U.S. person" is any person that is not a "U.S. person." The term swap means an uncleared swap and is defined in § 23.151 of the Final Margin Rule. *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016).

[2] As used in this table, the term "Foreign Consolidated Subsidiary" or "FCS" refers to a non-U.S. CSE in which an ultimate parent entity that is a U.S. person has a controlling financial interest, in accordance with U.S. GAAP, such that the U.S. ultimate parent entity includes the non-U.S. CSE's operating results, financial position and statement of cash flows in the U.S. ultimate parent entity's consolidated financial statements, in accordance with U.S. GAAP. The term "ultimate parent entity" means the parent entity in a consolidated group in which none of the other entities in the consolidated group has a controlling interest, in accordance with U.S. GAAP.

[3] Under § 23.160(e) of the Final Rule, in certain foreign jurisdictions where inherent limitations in the legal or operational infrastructure of the jurisdiction make it impracticable for the CSE and its counterparty to post initial margin for the uncleared swap in compliance with the custodial arrangement requirements of the Final Margin Rule, an FCS (or non-U.S. branch of a U.S. CSE) may be eligible to engage in uncleared swaps with certain non-U.S. counterparties, subject to a limit, but only if certain conditions are satisfied. Under the limit, for each broad risk category set out in § 23.154(b)(2)(v), the total outstanding notional value of all uncleared swaps in that broad risk category, as to which the CSE is relying on § 23.160(e), may not exceed 5% of the CSE's total outstanding notional value for all uncleared swaps in the same broad risk category. The specified conditions include collecting the gross amount of initial margin in cash, and posting and collecting variation margin in cash, in accordance with the Final Margin Rule. The CSE's counterparty must be a non-U.S. person that is not a CSE, and the counterparty's obligations under the swap must not be guaranteed by a U.S. person. This provision does not apply if the CSE that is subject to the foreign regulatory restrictions is permitted to post collateral for the uncleared swap in compliance with the custodial arrangements of § 23.157 in the United States or a jurisdiction for which the Commission has issued a comparability determination with respect to § 23.157. An FCS (or non-U.S. branch of a U.S. CSE) that relies on this special provision would not post initial margin in qualifying foreign jurisdictions, and would not be required to hold initial margin that they collect with one or more custodians that are not the CSE, its counterparty, or an affiliate of the CSE or its counterparty as would otherwise be required by § 23.157(b) of the Final Margin Rule. CSEs that rely on this special provision must have policies and procedures to ensure compliance and maintain books and records properly documenting that all of the requirements of this provision are satisfied.

If a CSE cannot conclude after sufficient legal review with a well-founded basis that the netting agreement with a counterparty in a foreign jurisdiction meets the definition of an "eligible master netting agreement" set forth in the Final Margin Rule, the CSE must treat the uncleared swaps covered by the netting agreement on a gross basis in determining the amount of initial and variation margin that it must collect, but the CSE may net those uncleared swaps in accordance with the netting provisions of the Final Margin Rule in determining the amount of initial and variation margin that it must post to the counterparty. The CSE must have policies and procedures to ensure compliance and maintain books and records properly documenting that all of the requirements of this provision are satisfied.

[4] In order to preserve the Commission's intent with respect to the treatment of inter-affiliate swaps under the Final Margin Rule, the Exclusion is not available if the market-facing swap of the non-U.S. CSE (that is otherwise eligible for the Exclusion) is not subject to comparable initial margin collection requirements in the home jurisdiction and any of the risk associated with the uncleared swap is transferred, directly or indirectly, through inter-affiliate swaps, to a U.S. CSE or a U.S. Guaranteed CSE. Under the Final Margin Rule, a CSE is not required to collect initial margin from its affiliate, provided, among other things, that affiliate collects initial margin on its market-facing swaps or is subject to comparable initial margin collection requirements (in the case of non-U.S. affiliates that are financial end-users) on their own market-facing swaps.

Appendices to Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements—Commission Voting Summary, Chairman's Statement, and Commissioners' Statements

Appendix 1—Commission Voting Summary

On this matter, Chairman Massad and Commissioner Bowen voted in the affirmative. Commissioner Giancarlo voted in the negative.

Appendix 2—Statement of Chairman Timothy G. Massad

I am pleased that today, the Commission has adopted a cross-border approach to our rule setting margin for uncleared swaps.

Our margin rule is one of the most important elements of swaps market regulation set forth in the Dodd-Frank Act. Margin requirements help ensure that uncleared swaps, which will always remain a sizable portion of the market, do not generate excessive uncollateralized risk. Last December, the Commission adopted a strong and sensible margin rule. It requires swap dealers and major swap participants to post and collect margin in their transactions with one another, and with financial entities with which they have significant exposures.

The risks our margin rule seeks to prevent do not only originate in the United States. The interconnected nature of the global swaps market means that risks created across the globe have the potential to flow back into the United States. We recognize that having a global swaps market is beneficial to all users. Therefore, one of the most important objectives we already accomplished was to ensure our margin rule is substantially similar to comparable international rules. Harmonization is critical to creating a sound international framework for regulation.

We also recognize that not all jurisdictions will adopt strong margin rules. And even where rules are substantially harmonized, there will still be some differences. Because cross-border transactions are commonplace, we must clarify which rules apply in different situations. Today, the Commission has acted to provide that clarification.

First, we have drawn a clear, reasonable line as to when the CFTC should take offshore risk into account. Today's action ensures that our rule, or a comparable international measure, applies to swap dealers that are foreign consolidated subsidiaries of a U.S. parent. This helps address the risk that can flow back into the United States from that offshore activity, even when the subsidiary is not explicitly guaranteed by the U.S. parent. This treatment of foreign consolidated subsidiaries—and our general cross-border approach—is also consistent with the approach taken by the U.S. prudential regulators.

At the same time, to further our efforts toward harmonization, and to avoid conflicts with the rules of other jurisdictions, we have provided for a broad scope of substituted compliance. Not only will non-U.S. swap dealers be eligible for substituted compliance, so will U.S. swap dealers with respect to the margin they post to non-U.S. persons. This approach is an appropriate response to the complex world created by the swap industry, where global swap dealers can book a swap in a variety of ways. Dealers may book swaps through different subsidiaries, branches or affiliates all over the world, and they may do so based on a number of considerations, such as the most favorable legal treatment. Our approach is intended to protect our markets against risk coming from these cross-border transactions, while taking into account the interests of other regulators.

The process for conducting a comparability assessment of another jurisdiction's rules is similar to what we have done in other areas. The rule specifies the various factors that should be considered, and indeed there is no reasonable way one can make a determination without evaluating those factors. One important consideration will be compliance with the international framework developed by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions. Our approach will look at the elements of each jurisdiction's rule set with an eye towards a flexible, outcome-based determination. The process of making comparability assessments can take time. In light of the impending September 1 compliance date, I have asked the CFTC staff to work closely with other domestic and international regulators, as well as industry participants, and endeavor to effect a smooth transition.

The approach we have finalized today helps ensure the safety and soundness of registered swap dealers, and reduces the potential for conflict with the rules of other international regulators. I thank all those who provided us with important feedback on these issues. I also thank CFTC staff for their work on this rule, and my fellow Commissioners for their careful consideration of this measure.

Appendix 3—Concurring Statement of Commissioner Sharon Y. Bowen

Margin and Capital as the Pillars of Market Safety

Margin and capital are two of the most important tools for risk mitigation for the derivatives markets. Thus it is very important that we get our rules on margin and capital right in order to accomplish the reform required under the Dodd-Frank Wall Street Reform and Consumer Protection Act.[290] As many of you know, last December, I voted against the final margin for uncleared swaps rule because I did not believe that it was strong enough to fully protect our system. As I said in December, adequate margin is fundamental to market safety as it is a ''critical shock absorber for the bumps and potholes of our financial markets and for the risk of contagion and spillovers.'' [291] I am even more confident in that view today.

Today we vote on a critical supplement to that margin rule. Specifically, today's rule would allow registered dealers to substitute the margin rules of comparable jurisdictions for our rules, when dealing with non-US counterparties, under certain conditions. Needless to say, cross-border regulation is central to our margin rule functioning effectively since our markets are global.

I intend to vote yes for this cross-border rule because I want to give the market legal certainty, as the first compliance date for our margin rules, as well as those of regulators across jurisdictions—September 1, 2016—looms.[292] It is important that market participants have enough time to prepare in advance of this date so as to minimize market instability. We also want to minimize the risk of creating regulatory arbitrage across jurisdictions. While my concerns about our margin regime remain, I recognize that there is no opportunity in today's cross-border margin decision to remedy those errors.

One of the major drawbacks of our margin rulemaking is that it was not done in conjunction with our capital rulemaking. Margin and capital are intertwined—if our margin rule is weak, our capital rule needs to be stronger to compensate. If both are strong, investors and consumers can be confident that we have learned the lessons of the past, and have placed adequate protections in place against future financial instability. But, if both are weak, we have surrendered our best defenses against contagion. We put the interests of our investors at risk when we view regulation in a piecemeal and non-comprehensive fashion, because we are not seeing the whole picture. So, as I vote today on cross-border margin, my mind is on our upcoming capital rule proposal.

Any firm that aspires to be a swap dealer is aspiring to be a significant player in our economy. They must have the capacity to not only stand ready to be the buyer to each seller and the seller to each buyer, but to maintain those positions over years. Their creditworthiness must be above reproach. In that way, market participants, *including commercial end-users who need to hedge,* can be confident that their dealer will be there during times of stability and crisis. It is therefore critical to the health of our economy that the market trusts, and with good reason, that our dealers are robust and steadfast—that they are able to withstand the financial swings that are endemic to today's economy. Thus while strong capital rules may prevent some entities from entering the dealing business, they ultimately benefit the dealers, their customers and the whole economy.

In order to create a capital rule that appropriately manages risk for the American people and our critical economy, our capital rule proposal must:

(1) *Not Be Weaker Than Our Comparable Prudential Regulators' Rule:* The capital proposal, and subsequent final rule, must be as strong as those of the Prudential Regulators. We are required under law to establish minimum capital requirements that are ''comparable'' to our Prudential Regulator counterparts ''to the maximum extent

[290] Public Law 111–203, 124 Stat. 1376 (2010).

[291] *http://www.cftc.gov/PressRoom/SpeechesTestimony/bowenstatement121615a.*

[292] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636, 675 (Jan. 6, 2016).

practicable.'' [293] Not only is this our legal obligation, but it is a sensible one as it prevents entities from gaming the system, and organizing their businesses in order to have the lowest capital requirements possible. We do not want our regulatory framework to be an escape hatch from strong risk management.

(2) *Account for the Entire Risk to the Dealer:* The capital proposal should also require dealers to hold sufficient capital to cover the *entirety* of the risk posed by the full gamut of derivatives products that they hold—including those products, which, for various reasons, we did not impose a margin requirement, such as inter-affiliate swaps and swaps with financial counterparties that are below the $8 billion threshold. This is consistent with our mandate under law to ''take into account the risks associated with other types of swaps or classes of swaps or categories of swaps engaged in and the other activities conducted by that person that are not otherwise subject to regulation. . . .'' [294] This is an important requirement. The Congressional authors understood that just because a particular category of swaps that a dealer holds are not subject to a regulatory requirement, does not mean that the dealers, and therefore their customers, are not vulnerable to the risk posed by them.

(3) *Include Effective Elements of Strong Capital Models:* Our capital proposal should take into consideration respected, and effective capital models from other regulators. As of now, we have two well-regarded capital models: The Basel rules for banks, and the Securities and Exchange Commission's (SEC's) rule for Broker-Dealers. The Basel rule has many positive attributes—including the fact that it not only has strong capital requirements but also a liquidity, leverage and funding ratio.[295] We need look no further than financial companies before the 2008 crisis to understand the need for leverage requirements. For instance, it was estimated that, prior to the crisis, some firms had debt that was 30 to 40 times their net capital.[296] And we have very present examples of commercial companies that evidence the need for funding requirements.[297] The SEC's broker dealer rule also has its positives including that it does not allow for internal models, which came under fire after the crisis for allowing excessive leverage,[298] and it is liquidity-based such that the dealer is obligated to maintain highly liquid assets to cover its liabilities.[299] Our capital rule proposal should be as strong, if not stronger, than these models.

(4) *Address Risks Posed by Swap-Dealing of Non-Financial Companies:* Some commercial entities are also registered as swap dealers, and others may decide to do so in the future. Having commercial end-users that are engaging in more than a de minimis amount of swap dealing may increase market risk. Thus it is important that we are able to isolate their swap dealing business from the regular business, so that we can properly track their activities as a dealer.

(5) *Be Based on Data-Driven Risk Assessment, Not Industry Preference:* As a regulator, anything that we propose needs to be based on our data-driven risk assessment, not on the desire to ensure that all entities that want to be dealers are able to maintain their current business models without any changes. In response to our proposal, market participants are then free to provide data to explain why our risk assessment may be inappropriate and to inform us of the pragmatic restraints. While encouraging more entrants into the market maybe *a* regulatory goal, doing all we can to prevent the next catastrophic financial crisis that wipes out pensions, is our *fundamental* goal.

Experience has taught us that comprehensive, well-considered review is critical when considering major regulations. Ten years ago, too many people in industry did not engage in such well-considered review when crafting complicated financial deals. In the end, that lack of consideration came back to haunt us all when the mortgage bubble burst and unexpectedly exposed many large financial institutions to massive losses that threatened the entire financial system. In the end, the American public had to save the system at great expense, and the ensuing rescue left many angry, alienated, and disaffected. Today, nearly eight years later, that anger still exists. We all pay a great price when we move forward in finance with insufficient analysis and review.

Thus, for the sake of market certainty, I am voting yes to this rule. But I encourage my fellow Commissioners to work with me to develop a strong, comprehensive capital rule so that the American people can have the appropriate safeguards to secure our economy. Thank you.

[293] Commodity Exchange Act (CEA) 6s(e)(3)(D).

[294] CEA 6s(e)(2)(C).

[295] With the exception of the capital charge to the segregated customer funds that have been set aside to secure cleared products. *See* ''Speech of Commissioner Sharon Y. Bowen at George Washington Law, 2016 Manuel F. Cohen Lecture,'' Feb. 4, 2016, *available at http://www.cftc.gov/PressRoom/SpeechesTestimony/opabowen-8.*

[296] E.g., Julie Satow, ''Ex-SEC Official Blames Agency for Blow-Up of Broker-Dealers,'' The New York Sun (September 18, 2008) (''[B]roker dealers . . . [had] debt-to-net-capital ratios, sometimes, as in the case of Merrill Lynch, to as high as 40-to-1.''), *available at http://www.nysun.com/business/ex-sec-official-blames-agency-for-blow-up/86130/*; Alan S. Blinder, ''Six Errors on the Path to the Financial Crisis,'' New York Times (January 25, 2009) (stating that in 2008, securities firms had leverage ratios of ''33 to 1''), *available at http://www.nytimes.com/2009/01/25/business/economy/25view.html?_r=0.*

[297] Jasmine Ng and David Yong, ''Noble Group Gets $3 Billion in Credit Facilities,'' Bloomberg.com (May 12, 2016), *available at http://www.bloomberg.com/news/articles/2016-05-12/noble-group-agrees-3-billion-credit-facilities-with-lenders. See also* Sarah Kent, Scott Patterson, and Margot Patrick, ''Glencore Discloses More Details on Financing,'' The Wall Street Journal (October 7, 2015), *available at http://www.wsj.com/articles/glencore-reveals-financing-deals-to-fend-off-critics-1444137982.*

[298] *See supra* note 7.

[299] Securities Exchange Act (SEA) Rule 15c3–1.

Appendix 4—Statement of Dissent by Commissioner J. Christopher Giancarlo

I respectfully dissent from the final rule on the cross-border application of margin requirements for uncleared swaps.

In September 2009, the leaders of the G–20 countries agreed to launch a framework for ''strong, sustainable and balanced global growth'' to generate ''a durable recovery that creates the good jobs our people need.'' [1] The agreement included a commitment ''to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage.'' [2]

In keeping with that agreement, representatives of more than 20 regulatory authorities, including the CFTC, participated in consultations with the Basel Committee on Banking Supervision (''BCBS'') and the Board of the International Organization of Securities Commissions (''IOSCO'') to develop an international framework setting margin standards for uncleared derivatives (''BCBS–IOSCO framework'').[3] That 2013 framework stresses the importance of developing consistent requirements across jurisdictions to avoid conflicting or duplicative standards.[4]

Today, instead of recognizing and building upon the strong foundation for mutual recognition of foreign regulatory regimes created by the G–20 commitments and the BCBS–IOSCO framework, as well as the CFTC's own history of using a principles-based, holistic approach to comparability determinations,[5] the Commission is adopting a set of preconditions to substituted

[1] G–20 Leaders' Statement, The Pittsburgh Summit, Preamble at par. 13 (Sept. 24–25, 2009).

[2] *Id.* at par. 12.

[3] Margin Requirements for Non-centrally Cleared Derivatives (Sept. 2013), *available at http://www.bis.org/publ/bcbs261.pdf*, revised Mar. 2015, *available at http://www.bis.org/bcbs/publ/d317.pdf.*

[4] *Id.* at 23.

[5] The CFTC has a long history of working collaboratively with foreign regulators to facilitate cross-border business. For example, under Commission Regulation 30.10, adopted in 1987, if the CFTC determines that a foreign regulatory regime offers comparable protections to U.S. customers transacting in foreign futures and options, and there is an appropriate information-sharing arrangement in place, the CFTC has allowed foreign brokers to comply with their home-country regulations in lieu of Commission regulations. Similarly, since 1996 the Commission has permitted direct access by U.S. customers to foreign boards of trade (''FBOTs'') without requiring the FBOT to register with the CFTC as a derivatives contract market (''DCM''). In determining the comparability of the foreign regulatory regime the Commission does not engage in a line-by-line examination of the foreign regulator's approach to supervising the FBOT it regulates. Rather, the Commission conducts a principles-based review to determine whether the foreign regime supports and enforces regulatory oversight of the FBOT and its clearing organization in a substantially equivalent manner as that used by the CFTC in its oversight of DCMs and clearing organizations. *See* Registration of Foreign Boards of Trade, 76 FR 80674, 80680 (Dec. 23, 2011).

compliance that is overly complex, unduly narrow and operationally impractical.

First, the rule establishes a complicated matrix of potential cross-border counterparties under which substituted compliance is either not permitted, is partially permitted, or is fully permitted, depending upon the category in which the particular transaction fits. Next, where permitted, the CFTC will conduct an ''element-by-element'' analysis of CFTC and foreign margin rules under which a transaction may be subject to a patchwork of U.S. and foreign regulation.[6] The CFTC will follow this ''element-by-element'' approach instead of assessing a foreign authority's margin regime as a whole.

In response to commenters who observed that today's approach will undermine the BCBS–IOSCO framework, the Commission acknowledges that consistency with the framework is necessary, but argues that the framework leaves certain elements open to interpretation by each regulator, including the CFTC.[7] For these elements, the Commission undertakes to use an outcome-based analysis, but will also engage in a fact-specific inquiry of each legal and regulatory provision that corresponds to each element.

In effect, the Commission's approach is somewhat principles-based, except when it is rules-based and somewhat objective, except when it is subjective.

Today's muddled methodology invites foreign regulators to respond in kind. It may well set us off down the same protracted, circuitous and uncertain path that the CFTC and the European Union took in the context of U.S. central counterparty clearinghouse equivalence. The approach is impractical, unnecessary and contrary to the cooperative spirit of the 2009 G–20 Pittsburgh Accords.[8]

Rather than conducting a granular rule-by-rule comparison, the CFTC should focus on whether a foreign regulator's margin regime, in the aggregate, provides a sufficient level of risk mitigation in connection with the execution of uncleared swaps. The BCBS–IOSCO framework does just that. Compliance with it should be straightforward and unconditional to prevent the ''fragmentation of markets, protectionism, and regulatory arbitrage'' that global regulators were charged to avoid.

As confusing as this rule is, what is important is not that hard to understand. American workers need quality American jobs. They need them in factories, farms and offices across the United States. The businesses that employ them want to sell their goods and services both here and abroad. To succeed globally, American businesses need U.S.-based financial institutions to support them around the world with competitively priced risk management services.

Unfortunately, this complicated rule will make it harder for U.S. financial institutions to compete globally and serve American businesses. When businesses are placed at a competitive disadvantage, they hire fewer workers. With over 94 million Americans now out of the workforce,[9] that is unacceptable. Therefore, I oppose this rule—it's that simple.

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[6] Such a result would be antithetical to element seven of the BCBS–IOSCO framework, which requires that there be no application of duplicative or conflicting margin requirements to the same transaction or activity. The framework advises that ''[w]hen a transaction is subject to two sets of rules (duplicative requirements), the home and the host regulators should endeavor to (1) harmonize the rules to the extent possible or (2) apply only one set of rules, by recognizing the equivalence and comparability of their respective rules.'' BCBS–IOSCO framework at 23.

[7] In footnote 232 of the preamble the Commission cites, for example, the definition of ''derivative,'' the list of assets eligible to post as collateral, the degree to which margin would be protected under the local bankruptcy regime, and how transactions with affiliates are treated.

[8] I am also concerned about the Commission's unwillingness to delay the cross-border application of its margin rules until after it has made comparability determinations. This will bring into the CFTC's regulatory ambit many cross-border transactions over which U.S. jurisdiction is inappropriate and an undue drain on precious regulatory resources.

[9] Bureau of Labor Statistics, *The Employment Situation—April 2016,* U.S. DEPARTMENT OF LABOR, May 6, 2016, *http://www.bls.gov/news.release/empsit.nr0.htm.*