DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 45

Docket No. OCC-2011-0008

RIN: 1557-AD43s

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

12 CFR Part 237

Docket No. R-1415

RIN: 7100 AD74

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 349

RIN: 3064-AE21

FARM CREDIT ADMINISTRATION

12 CFR Part 624

RIN: 3052-AC69

FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1221

RIN: 2590-AA45

MARGIN AND CAPITAL REQUIREMENTS FOR COVERED SWAP ENTITIES

AGENCIES: Office of the Comptroller of the Currency, Treasury ("OCC"); Board of Governors of the Federal Reserve System ("Board"); Federal Deposit Insurance Corporation ("FDIC"); Farm Credit Administration ("FCA"); and the Federal Housing Finance Agency ("FHFA").

ACTION: Final Rule.

SUMMARY: The OCC, Board, FDIC, FCA, and FHFA (each an "Agency" and, collectively, the "Agencies") are adopting a joint rule to establish minimum margin and capital requirements for registered swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants for which one of the Agencies is the prudential regulator. This final rule implements sections 731 and 764 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, as amended by the Terrorism Risk Insurance Program Reauthorization Act of 2015 ("TRIPRA"). Sections 731 and 764 require the Agencies to adopt rules jointly to establish capital requirements and initial and variation margin requirements for such entities on all non-cleared swaps and non-cleared security-based swaps in order to offset the greater risk to such entities and the financial system arising from the use of swaps and security-based swaps that are not cleared.

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

FOR FURTHER INFORMATION CONTACT:

OCC: Kurt Wilhelm, Director, Financial Markets Group, (202) 649-6437, or Carl Kaminski, Special Counsel, Legislative and Regulatory Activities Division, (202) 649-5490, for persons who are deaf or hard of hearing, TTY (202) 649-5597, Office of the Comptroller of the Currency, 400 7th Street, SW, Washington, DC 20219.

Board: Sean D. Campbell, Associate Director, (202) 452-3760, or Elizabeth MacDonald, Manager, Division of Banking Supervision and Regulation, (202) 475-6316; Anna M. Harrington, Counsel, Legal Division, (202) 452-6406, or Victoria M. Szybillo, Counsel, Legal

Division, (202) 475-6325, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, D.C. 20551.

FDIC: Bobby R. Bean, Associate Director, Capital Markets Branch, bbean@fdic.gov, Jacob Doyle, Capital Markets Policy Analyst, jdoyle@fdic.gov, Division of Risk Management Supervision, (202) 898-6888; Thomas F. Hearn, Counsel, thohearn@fdic.gov, or Catherine Topping, Counsel, ctopping@fdic.gov, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

FCA: J.C. Floyd, Associate Director, Finance & Capital Markets Team, Timothy T. Nerdahl, Senior Policy Analyst – Capital Markets, Jeremy R. Edelstein, Senior Policy Analyst, Office of Regulatory Policy, (703) 883-4414, TTY (703) 883-4056, or Richard A. Katz, Senior Counsel, Office of General Counsel, (703) 883-4020, TTY (703) 883-4056, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102-5090.

FHFA: Robert Collender, Principal Policy Analyst, Office of Policy Analysis and Research, (202) 649-3196, Robert.Collender@fhfa.gov, or Peggy K. Balsawer, Associate General Counsel, Office of General Counsel, (202) 649-3060, Peggy.Balsawer@fhfa.gov, Federal Housing Finance Agency, Constitution Center, 400 7th St., SW, Washington, DC 20024. The telephone number for the Telecommunications Device for the Hearing Impaired is (800) 877-8339.

SUPPLEMENTARY INFORMATION:

I. Background.

A. The Dodd-Frank Act.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act" or "Dodd-Frank Act") was enacted on July 21, 2010.[1] Title VII of the Dodd-Frank Act established a comprehensive new regulatory framework for derivatives, which the Act generally characterizes as "swaps" (which are defined in section 721 of the Dodd-Frank Act to include interest rate swaps, commodity swaps, equity swaps, and credit default swaps) and "security-based swaps" (which are defined in section 761 of the Dodd-Frank Act to include a swap based on a single security or loan or on a narrow-based security index).[2] For the remainder of this preamble, the term "swaps" refers to swaps and security-based swaps unless the context requires otherwise.

As part of this new regulatory framework, sections 731 and 764 of the Dodd-Frank Act add a new section, section 4s, to the Commodity Exchange Act of 1936, as amended ("Commodity Exchange Act") and a new section, section 15F, to the Securities Exchange Act of 1934, as amended ("Securities Exchange Act"), respectively, which require registration with the U.S. Commodity Futures Trading Commission (the "CFTC") of swap dealers and major swap participants and the U.S. Securities and Exchange Commission (the "SEC") of security-based swap dealers and major security-based swap participants (each a "swap entity" and, collectively, "swap entities").[3] For swap entities that are prudentially regulated by one of the Agencies,[4]

---

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

[2] *See* 7 U.S.C. 1a(47); 15 U.S.C. 78c(a)(68).

[3] *See* 7 U.S.C. 6s; 15 U.S.C. 78o-10. Section 731 of the Dodd-Frank Act requires swap dealers and major swap participants to register with the CFTC, which is vested with primary responsibility for the oversight of the swaps market under Title VII of the Dodd-Frank Act.

sections 731 and 764 of the Dodd-Frank Act require the Agencies to adopt rules jointly for swap entities under their respective jurisdictions imposing (i) capital requirements and (ii) initial and variation margin requirements on all swaps not cleared by a registered derivatives clearing

---

Section 764 of the Dodd-Frank Act requires security-based swap dealers and major security-based swap participants to register with the SEC, which is vested with primary responsibility for the oversight of the security-based swaps market under Title VII of the Dodd-Frank Act. Section 712(d)(1) of the Dodd-Frank Act requires the CFTC and SEC to issue joint rules further defining the terms swap, security-based swap, swap dealer, major swap participant, security-based swap dealer, and major security-based swap participant. The CFTC and SEC issued final joint rulemakings with respect to these definitions in May 2012 and August 2012, respectively. *See* 77 FR 30596 (May 23, 2012); 77 FR 39626 (July 5, 2012) (correction of footnote in the Supplementary Information accompanying the rule); and 77 FR 48207 (August 13, 2012). 17 CFR part 1; 17 CFR parts 230, 240 and 241.

[4] Section 1a(39) of the Commodity Exchange Act defines the term "prudential regulator" for purposes of the capital and margin requirements applicable to swap dealers, major swap participants, security-based swap dealers and major security-based swap participants. The Board is the prudential regulator for any swap entity that is (i) a State-chartered bank that is a member of the Federal Reserve System, (ii) a State-chartered branch or agency of a foreign bank, (iii) a foreign bank which does not operate an insured branch, (iv) an organization operating under section 25A of the Federal Reserve Act (an Edge corporation) or having an agreement with the Board under section 25 of the Federal Reserve Act (an Agreement corporation), and (v) a bank holding company, a foreign bank that is treated as a bank holding company under section 8(a) of the International Banking Act of 1978, as amended, or a savings and loan holding company (on or after the transfer date established under section 311 of the Dodd-Frank Act), or a subsidiary of such a company or foreign bank (other than a subsidiary for which the OCC or FDIC is the prudential regulator or that is required to be registered with the CFTC or SEC as a swap dealer or major swap participant or a security-based swap dealer or major security-based swap participant, respectively). The OCC is the prudential regulator for any swap entity that is (i) a national bank, (ii) a federally chartered branch or agency of a foreign bank, or (iii) a Federal savings association. The FDIC is the prudential regulator for any swap entity that is (i) a State-chartered bank that is not a member of the Federal Reserve System or (ii) a State savings association. The FCA is the prudential regulator for any swap entity that is an institution chartered under the Farm Credit Act of 1971, as amended (the "Farm Credit Act"). The FHFA is the prudential regulator for any swap entity that is a "regulated entity" under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended (the "Federal Housing Enterprises Financial Safety and Soundness Act") (i.e., the Federal National Mortgage Association ("Fannie Mae") and its affiliates, the Federal Home Loan Mortgage Corporation ("Freddie Mac") and its affiliates, and the Federal Home Loan Banks). *See* 7 U.S.C. 1a(39).

organization or a registered clearing agency.[5] Swap entities that are prudentially regulated by one of the Agencies and therefore subject to this final rule are referred to herein as "covered swap entities."

Sections 731 and 764 of the Dodd-Frank Act also require the CFTC and SEC separately to adopt rules imposing capital and margin requirements to their applicable swap entities for which there is no prudential regulator.[6] The Dodd-Frank Act requires the CFTC, SEC, and the Agencies to establish and maintain, to the maximum extent practicable, capital and margin

[5] *See* 7 U.S.C. 6s(e)(2)(A); 15 U.S.C. 78o-10(e)(2)(A). Section 6s(e)(1)(A) of the Commodity Exchange Act directs registered swap dealers and major swap participants for which there is a prudential regulator to comply with margin and capital rules issued by the prudential regulators, while section 6s(e)(1)(B) directs registered swap dealers and major swap participants for which there is not a prudential regulator to comply with margin and capital rules issued by the CFTC and SEC. Section 78o-10(e)(1) generally parallels section 6s(e)(1), except that section 78o-10(e)(1)(A) refers to registered security-based swap dealers and major security-based swap participants for which "there is not a prudential regulator." The Agencies construe the "not" in section 78o-10(e)(1)(A) to have been included by mistake, in conflict with section 78o-10(e)(2)(A), and of no substantive meaning. Otherwise, registered security-based swap dealers and major security-based swap participants for which there is not a prudential regulator could be subject to multiple capital and margin rules, and institutions regulated by the prudential regulators and registered as security-based swap dealers and major security-based swap participants might not be subject to any capital and margin requirements under section 78o-10(e).

[6] *See* 7 U.S.C. 6s(e)(2)(B); 15 U.S.C. 78o-10(e)(2)(B). The CFTC issued a proposed rule imposing capital and margin requirements for swap dealers and major swap participants for which there is no prudential regulator on October 3, 2014. *See* 79 FR 59898 (October 3, 2014). The CFTC proposal was substantially similar to the Agencies' proposal. More recently, the CFTC issued a cross-border proposed rule on margin that is also substantially similar to § __.9 of the Agencies' final rule. *See* 80 FR 41376 (July 14, 2015); 17 CFR Part 23. To date, the SEC has yet to finalize similar rules imposing capital and margin requirements for security-based swap dealers and major security-based swap participants. The SEC proposed margin rules in October 2012. *See* 77 FR 70214 (Nov. 23, 2012).

requirements that are comparable, and to consult with each other periodically (but no less than annually) regarding these requirements.[7]

The capital and margin standards for swap entities imposed under sections 731 and 764 of the Dodd-Frank Act are intended to offset the greater risk to the swap entity and the financial system arising from non-cleared swaps.[8] Sections 731 and 764 of the Dodd-Frank Act require that the capital and margin requirements imposed on swap entities must, to offset such risk, (1) help ensure the safety and soundness of the swap entity and (2) be appropriate for the greater risk associated with non-cleared swaps.[9] In addition, sections 731 and 764 of the Dodd-Frank Act require the Agencies, in establishing capital requirements for entities designated as covered swap entities for a single type or single class or category of swap or activities, to take into account the risks associated with other types, classes, or categories of swaps engaged in, and the other activities conducted by swap entities that are not otherwise subject to regulation.[10]

---

[7] *See* 7 U.S.C. 6s(e)(2)(A); 6s(e)(3)(D); 15 U.S.C. 78o-10(e)(2)(A), 78o-10(e)(3)(D). Staffs of the Agencies have consulted with staff of the CFTC and SEC in developing the final rule.

[8] *See* 7 U.S.C. 6s(e)(3)(A); 15 U.S.C. 78o-10(e)(3)(A).

[9] *See* 7 U.S.C. 6s(e)(3)(A); 15 U.S.C. 78o-10(e)(3)(A). In addition, section 1313 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires the Director of FHFA, when promulgating regulations relating to the Federal Home Loan Banks, to consider the following differences between the Federal Home Loan Banks and Fannie Mae and Freddie Mac: cooperative ownership structure; mission of providing liquidity to members; affordable housing and community development mission; capital structure; and joint and several liability. *See* 12 U.S.C. 4513. The Director of FHFA also may consider any other differences that are deemed appropriate. For purposes of this final rule, FHFA considered the differences as they relate to the above factors.

[10] *See* 7 U.S.C. 6s(e)(2)(C); 15 U.S.C. 78o-10(e)(2)(C). In addition, the margin requirements imposed by the Agencies must permit the use of noncash collateral, as the Agencies determine to be consistent with (i) preserving the financial integrity of the markets trading swaps and (ii) preserving the stability of the U.S. financial system. *See* 7 U.S.C. 6s(e)(3)(C); 15 U.S.C. 78o-10(e)(3)(C).

In addition to the Dodd-Frank Act authorities mentioned above, the Agencies also have safety and soundness authority over the entities they supervise.[11] The Dodd-Frank Act specified that the provisions of its Title VII shall not be construed as divesting any Agency of its authority to establish or enforce prudential or other standards under other law.[12]

The capital and margin requirements for non-cleared swaps under sections 731 and 764 of the Dodd-Frank Act complement other Dodd-Frank Act provisions that require all sufficiently standardized swaps to be cleared through a registered derivatives clearing organization or clearing agency.[13] This requirement is consistent with the consensus of the G-20 leaders to clear derivatives through central counterparties ("CCPs") where appropriate.[14]

In the derivatives clearing process, CCPs manage credit risk through a range of controls and methods, including a margining regime that imposes both initial margin and variation margin requirements on parties to cleared transactions.[15] Thus, the mandatory clearing requirement

[11] 12 U.S.C. 1 et. seq., 12 U.S.C. 93a, 12 U.S.C. 1463, 12 U.S.C. 1464, 12 U.S.C. 1818, 12 U.S.C. 1828, 12 U.S.C. 1831p-1, 12 U.S.C. 3102(b) (OCC); 12 U.S.C. 221 *et seq.*, 12 U.S.C. 1818, 12 U.S.C. 1841 *et seq.*, 12 U.S.C. 3101 *et seq.* and 12 U.S.C. 1461 *et seq.* (Board); 12 U.S.C. 1811 et seq., 12 U.S.C. 1818 (FDIC); 12 U.S.C. 2001 *et seq.;* 12 U.S.C. 2241 through 2274; 12 U.S.C. 2279aa-11; 12 U.S.C. 2279bb through bb-7 (FCA); 12 U.S.C. 4513 (FHFA).

[12] *See* Dodd-Frank Act sections 741(c) and 764(b).

[13] *See* 7 U.S.C. 2(h); 15 U.S.C. 78c-3. Certain types of counterparties (e.g., counterparties that are not financial entities and are using swaps to hedge or mitigate commercial risks) are exempt from this mandatory clearing requirement and may elect not to clear a swap that would otherwise be subject to the clearing requirement.

[14] G-20 Leaders, June 2010 Toronto Summit Declaration, Annex II, ¶ 25. The dealer community has also recognized the importance of clearing beginning in 2009. In an effort led by the Federal Reserve Bank of New York, the dealer community agreed to increase central clearing for certain credit derivatives and interest rate derivatives. *See* Press Release, Federal Reserve Bank of New York, New York Fed Welcomes Further Industry Commitments on Over-the-Counter Derivatives (June 2, 2009), *available at* www.newyorkfed.org/newsevents/news/markets/2009/ma090602.html.

[15] CCPs interpose themselves between counterparties to a swap transaction, becoming the buyer to the seller and the seller to the buyer and, in the process, taking on the

established by the Dodd-Frank Act for swaps effectively will require any party to any transaction subject to the clearing mandate to post initial and variation margin in connection with that transaction.

However, a particular swap may not be cleared either because it is not subject to the mandatory clearing requirement, or because one of the parties to a particular swap is eligible for, and uses, an exception or exemption from the mandatory clearing requirement. Such a swap is a "non-cleared" swap that may be subject to the capital and margin requirements for such transactions established under sections 731 and 764 of the Dodd-Frank Act.

The swaps-related provisions of Title VII of the Dodd-Frank Act, including sections 731 and 764, are intended in general to reduce risk, increase transparency, promote market integrity within the financial system, and, in particular, address a number of weaknesses in the regulation and structure of the swaps markets that were revealed during the financial crisis of 2008 and 2009. During the financial crisis, the opacity of swap transactions among dealers and between dealers and their counterparties created uncertainty about whether market participants were significantly exposed to the risk of a default by a swap counterparty. By imposing a regulatory margin requirement on non-cleared swaps, the Dodd-Frank Act reduces the uncertainty around the possible exposures arising from non-cleared swaps.

Further, the financial crisis revealed that a number of significant participants in the swaps markets had taken on excessive risk through the use of swaps without sufficient financial

---

credit risk that each party poses to the other. For example, when a swaps contract between two parties that are members of a CCP is executed and submitted for clearing, it is typically replaced by two new contracts—separate contracts between the CCP and each of the two original counterparties. At that point, the original counterparties are no longer counterparties to each other; instead, each faces the CCP as its counterparty, and the CCP assumes the counterparty credit risk of each of the original counterparties.

resources to make good on their contracts. By imposing an initial and variation margin requirement on non-cleared swaps, sections 731 and 764 of the Dodd-Frank Act will reduce the ability of firms to take on excessive risks through swaps without sufficient financial resources. Additionally, the minimum margin requirement will reduce the amount by which firms can leverage the underlying risk associated with the swap contract.

The Agencies originally published proposed rules to implement sections 731 and 764 of the Act in May 2011 (the "2011 proposal").[16] Over 100 comments were received in response to the 2011 proposal from a variety of commenters, including banks, asset managers, commercial end users, and various trade associations. Following the release of the Agencies' 2011 proposal, the Basel Committee on Banking Supervision ("BCBS") and the Board of the International Organization of Securities Commissions ("IOSCO") proposed an international framework for margin requirements on non-cleared derivatives with the goal of creating an international standard for non-cleared derivatives.[17] Following the issuance of the international framework proposal, the Agencies re-opened the comment period on the Agencies' 2011 proposal to allow for additional comments in relation to the proposed international framework.[18] The proposed international framework was also subject to extensive public comment before being finalized in September 2013 (the "2013 international framework").[19] Following the publication of the 2013 international framework the Agencies published a re-proposal of the Agencies' rule in September

[16] 76 FR 27564 (May 11, 2011).

[17] *See* BCBS and IOSCO "Consultative Document - Margin requirements for non-centrally cleared derivatives" (July 2012), *available at* http://www.bis.org/publ/bcbs226.pdf and "Second consultative document - Margin requirements for non-centrally cleared derivatives" (February 2013), *available at* http://www.bis.org/publ/bcbs242.pdf.

[18] 77 FR 60057 (October 2, 2012).

[19] *See* BCBS and IOSCO "Margin requirements for non-centrally cleared derivatives," (September 2013), *available at* https://www.bis.org/publ/bcbs261.pdf.

2014 (the "proposal," "2014 proposal" or "proposed rule").[20] The Agencies received over 55 comments in response to the proposal. The Agencies subsequently met with several commenters at their request to discuss their concerns with the proposal and summaries of these meetings may be found on each Agency's respective public Website.

B. Other Dodd-Frank Act Provisions Affecting the Margin and Capital Rule.

The applicability of the Agencies' margin requirements rely in part on regulatory action taken by the CFTC, the SEC, and the Secretary of the Treasury. The margin requirements will apply to any prudentially-regulated entity that: (1) is registered as a swap dealer or major swap participant with the CFTC, or as a security-based swap dealer, major security-based swap participant with the SEC; and (2) enters into a non-cleared swap. In addition, as a means of ensuring the safety and soundness of the covered swap entity's non-cleared swap activities under the final rule, the requirements would apply to all of a covered swap entity's swap and security-based swap activities without regard to whether the entity has registered as both a swap entity and a security-based swap entity. Thus, for example, for an entity that is a swap dealer but not a security-based swap dealer or major security-based swap participant, the final rule's

[20] 79 FR 57348 (Sept. 24, 2014). Comments on the 2011 proposal were discussed in detail in the 2014 proposal. In April 2014, the European Supervisory Authorities published a consultation paper with draft regulatory technical standards on risk-mitigation techniques for over-the-counter ("OTC") derivative contracts not cleared by a CCP under Article 11(15) of the European Market Infrastructure Regulation ("EMIR"), *available at*: https://www.eba.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf. On June 10, 2015, these European authorities released a reproposal *available at*: https://eiopa.europa.eu/Publications/Consultations/JC-CP-2015-002%20JC%20CP%20on%20Risk%20Management%20Techniques%20for%20OTC%20derivatives.pdf. On July 3, 2014, the Financial Services Agency of Japan also published a proposal for OTC Derivatives regulation available at http://www.fsa.go.jp/news/26/syouken/20140703-3.html.

requirements would apply to all of that swap dealer's non-cleared swaps and non-cleared security-based swaps.

On May 23, 2012, the CFTC and SEC adopted a final joint rule defining "swap dealer," "major swap participant," "security-based swap dealer," and "major security-based swap dealer." These definitions include quantitative thresholds in the relevant activity that affect whether an entity subject to the "prudential regulator" definition also will be subject to the margin regulations.[21]

On August 13, 2012, the CFTC and SEC adopted a final joint rule defining "swap" and "security-based swap."[22] On November 16, 2012, the Secretary of the Treasury made a determination pursuant to sections 1a(47)(E) and 1(b) of the Commodity Exchange Act to exempt foreign exchange swaps and foreign exchange forwards from certain swap requirements, including the Title VII margin requirements.[23]

The CFTC has adopted a final rule requiring registration by entities meeting the substantive definition of swap dealer or major swap participant and engaging in relevant activities above the applicable quantitative thresholds.[24] As of September 24, 2015, 104 entities have registered as swap dealers,[25] and two entities have registered as major swap participants. The SEC has also adopted rules for registering entities that meet the definition of "security-based

---

[21] *See* 77 FR 30596 (May 23, 2012), 77 FR 39626 (July 5, 2012) (correction of footnote in Supplementary Information accompanying the rule) and 77 FR 48207 (August 13, 2012); 17 CFR part 1; 17 CFR parts 230, 240, and 241.

[22] *See* 77 FR 48207 (August 13, 2012); 17 CFR part 1; 17 CFR parts 230, 240, and 241.

[23] 77 FR 69694 (November 20, 2013).

[24] 77 FR 2613 (January 1, 2012); 17 CFR 23.21.

[25] Currently, all swap dealers are provisionally registered with the CFTC.

swap dealer," or "major security-based swap participant," however, the compliance dates for registration have yet to occur.[26] The CFTC has adopted guidance addressing how the Commodity Exchange Act's swap requirements, will apply to "cross-border swaps."[27] Similarly, the SEC published a final rule and interpretative guidance that addresses the application of the definitions of "security-based swap dealer'' and ''major security-based swap participant'' in the cross-border context.[28] The SEC also recently proposed amendments and a re-proposed rule to address the application of certain provisions of the Securities Exchange Act to cross-border security-based swap activities.[29]

On January 12, 2015, the President signed into law TRIPRA. Title III of TRIPRA amends sections 731 and 764 of the Dodd-Frank Act to exempt certain transactions of certain

[26] *See* 80 FR 48963 (August 14, 2015); 17 CFR parts 240, 249; 17 CFR § 240.15Fb1-1 et seq. (effective October 15, 2015). The compliance date for the SEC registration requirements for security-based swap dealers and major security-based swap participants is the later of: (1) six months after the date of publication in the Federal Register of a final rule establishing capital, margin, and segregation requirements for security-based swap dealers and major security-based swap participants; (2) the compliance date of final rules establishing recordkeeping and reporting requirements for security-based swap dealers and major security-based swap participants; (3) the compliance date of final rules establishing business conduct requirements under Securities Exchange Act sections 15F(h) and 15F(k); and (4) the compliance date for final rules establishing a process for registered security-based swap dealers and major security-based swap participants to make an application to the SEC to allow an associated person who is subject to a disqualification to effect or be involved in effecting security-based swaps on the security-based swap dealer's and major security-based swap participant's behalf.

[27] In 2013, the CFTC issued guidance addressing the cross-border applicability of certain swap provisions. *See* 78 FR 45292 (July 26, 2013); 17 CFR part 1. More recently, the CFTC issued a cross-border proposed rule for swap margin requirements. *See* 80 FR 41376 (July 14, 2015); 17 CFR Part 23.

[28] *See* 79 FR 47278 (August 12, 2014); 17 CFR parts 240, 241, and 250.

[29] *See* 80 FR 27444 (May 13, 2015); 17 CFR parts 240 and 242. The SEC published for comment proposed amendments and a re-proposed rule to address the application of certain provisions of the Securities Exchange Act that were added by Subtitle B of Title VII of the Dodd-Frank Act to cross-border security-based swap activities.

counterparties from the Agencies' margin requirements as set out in this final rule.[30] Specifically, section 302 of Title III amends sections 731 and 764 of the Dodd-Frank Act to provide that the Agencies' rules on margin requirements under those sections shall not apply to a swap in which a counterparty: (1) qualifies for an exception under section 2(h)(7)(A) of the Commodity Exchange Act, (2) qualifies for an exemption issued under section 4(c)(1) of the Commodity Exchange Act for cooperative entities as defined in such exemption, or (3) satisfies the criteria in section 2(h)(7)(D) of the Commodity Exchange Act, or a security-based swap in which a counterparty (1) qualifies for an exception under section 3C(g)(1) of the Securities Exchange Act or (2) satisfies the criteria in section 3C(g)(4) of the Securities Exchange Act.

Section 303 of TRIPRA requires that the Agencies implement the provisions of Title III by seeking comment on an interim final rule. The Agencies are adopting and, in a separate *Federal Register* notice are inviting comment on, an interim final rule ("IFR") that will implement these statutory exemptions in § __.1(d) of the final rule.

II. Overview of Final Rule.

A. Margin Requirements.

In the final rule, the Agencies are adopting a risk-based approach for initial and variation margin requirements for covered swap entities. Consistent with the statutory requirement, the final rule would help ensure the safety and soundness of the covered swap entity and would be appropriate for the risk to the financial system associated with non-cleared swaps held by covered swap entities. The final rule takes into account the risk posed by a covered swap entity's counterparties by establishing the minimum amount of initial and variation margin that the covered swap entity must exchange with its counterparties.

[30] Pub. L. 114-1, 129 Stat. 3.

In implementing this risk-based approach, the final rule distinguishes among four separate types of swap counterparties: (i) counterparties that are themselves swap entities; (ii) counterparties that are financial end users with a material swaps exposure; (iii) counterparties that are financial end users without a material swaps exposure, and (iv) other counterparties, including nonfinancial end users, sovereigns, and multilateral development banks.[31] The final rule also includes special provisions for inter-affiliate swaps between a covered swap entity and its affiliates. The requirements of this final rule will apply to non-cleared swaps with those counterparties to the extent they are not exempt pursuant to TRIPRA. Each of these four types of counterparties pose different levels of risk to the financial system, and the final rule adopts a risk-based approach to the margin requirements for the different types of counterparties, which reflect both the Agencies' safety and soundness concerns and the provisions of the Dodd-Frank Act.

Post and collect. The initial and variation margin requirements generally apply to the posting and the collecting of minimum initial and variation margin amounts between a covered swap entity and its counterparties. While the Agencies believe that imposing requirements with respect to collecting the minimum amount of initial and variation margin is a critical aspect of offsetting the greater risk to the covered swap entity and the financial system arising from the covered swap entity's non-cleared swap exposure, the Agencies also believe that requiring a covered swap entity to post margin to other financial entities could forestall a build-up of potentially destabilizing exposures in the financial system. The final rule's approach therefore is designed to ensure that covered swap entities transacting with other swap entities and with

[31] *See* § __.2 of the final rule for the various definitions that identify these four types of swap counterparties.

financial end users in non-cleared swaps, with certain exceptions, will be collecting and posting appropriate minimum margin amounts with respect to those transactions.

The final rule's margin provisions establish only minimum requirements with respect to initial and variation margin. Nothing in the final rule is intended to prevent or discourage a covered swap entity from collecting or posting margin in amounts greater than is required under the final rule.

Initial margin. For initial margin, the final rule would require a covered swap entity to calculate its minimum initial margin requirement in one of two ways. The covered swap entity may use a standardized margin schedule, which is set out in Appendix A of the final rule. The standardized margin schedule allows for certain types of netting and offsetting of exposures. In the alternative, a covered swap entity may use an internal margin model that satisfies the criteria outlined in §__.8 of the final rule and that has been approved by the relevant prudential regulator.[32]

When a covered swap entity transacts with another swap entity (regardless of whether the other swap entity meets the definition of a "covered swap entity" under the final rule), the covered swap entity must collect at least the amount of initial margin required under the final rule. Likewise, the swap entity counterparty also will be required, under margin rules that are applicable to that swap entity, to collect a minimum amount of initial margin from the covered swap entity. Accordingly, covered swap entities will both collect and post a minimum amount of

[32] *See* § __.8 and Appendix A of the final rule for a complete description of the requirements for initial margin models and standardized minimum initial margin requirements.

initial margin when transacting with another swap entity.[33] A covered swap entity transacting with a financial end user with a material swaps exposure must collect at least the amount of initial margin required by the final rule and must post at least the amount of initial margin that the covered swap entity would be required by the final rule to collect if the covered swap entity were in the place of the counterparty. In addition, a covered swap entity must post or collect initial margin on at least a daily basis if changes in portfolio composition or any other factors result in a change in the required initial margin amounts.[34]

The final rule permits a covered swap entity to adopt a maximum initial margin threshold amount of $50 million, below which it need not collect or post initial margin from or to swap entities and financial end users with material swaps exposures. The threshold amount applies on a consolidated basis, and applies both to the consolidated covered swap entity as well as to the consolidated counterparty.[35]

Variation margin. With respect to variation margin, the final rule generally requires a covered swap entity to collect or post variation margin for swaps with a swap entity or a financial end user (regardless of whether the financial end user has a material swaps exposure) in

---

[33] All swap entities will be subject to a rule on minimum margin for non-cleared swaps promulgated by one of the Agencies, the SEC or the CFTC. The counterparty may be a covered swap entity subject to this final rule or a swap entity that is subject to the margin rules of the CFTC or SEC. If the counterparty is a covered swap entity, it must collect at least the amount of margin required under this final rule. If the counterparty is a swap entity subject to the margin rules of the CFTC or SEC, it must collect the amount of margin required under the CFTC or SEC margin rules.

[34] Under the final rule, when entering into a swap transaction, the first collection and posting of initial margin must occur on or before the business day following the day of execution. Thereafter, posting and collecting initial margin must be made on at least a daily basis, in response to changes in portfolio composition or any other factors that would change the required initial margin amounts, until the date the non-cleared swap terminates or expires.

[35] *See* §§ __.3 and __.8 of the final rule for a complete description of the initial margin requirements.

an amount that is at least equal to the increase or decrease in the value of the swap since the counterparties' previous exchange of variation margin. The final rule would not permit a covered swap entity to adopt a threshold amount below which it need not collect or post variation margin on swaps with swap entity and financial end user counterparties.[36] In addition, a covered swap entity must collect or post variation margin with swap entities and financial end user counterparties under the final rule on at least a daily basis.[37]

Exempt transactions and "other counterparties." Under the final rule, certain transactions with certain nonfinancial end users and other financial counterparties are exempt from the Agencies' margin requirements. Specifically, under §__.1(d) of the final rule, the Agencies' margin requirements do not apply to a swap or security-based swap with a counterparty that: (1) qualifies for an exception from clearing under section 2(h)(7)(A) of the Commodity Exchange Act or section 3C(g)(1) of the Securities Exchange Act (i.e., a nonfinancial entity using the swap or security-based swap to hedge or mitigate commercial risk, certain small financial institutions, and captive finance companies);[38] (2) qualifies for an exemption from clearing under section 4(c)(1) of the Commodity Exchange Act for cooperative entities that would otherwise be subject to the requirement to clear; [39] or (3) satisfies the criteria for the affiliate exception from clearing pursuant to section 2(h)(7)(D) of the Commodity Exchange Act or section 3C(g)(4) of the

---

[36] Covered swap entities, however, are not required to collect or post margin from or to any individual counterparty unless and until the combined amount of initial and variation margin that must be collected or posted under the final rule , but has not yet been exchanged with the counterparty, is greater than $500,000. *See* § __.5 of the final rule.

[37] *See* § __.4 of the final rule for a complete description of the variation margin requirements.

[38] *See* 7 U.S.C. 2(h)(7)(A); 15 U.S.C. 78c-3(g).

[39] *See* 7 U.S.C. 6(c)(1). The CFTC, pursuant to its authority under section 4(c)(1) of the Commodity Exchange Act, adopted 17 CFR 50.51 which exempts from required clearing certain swaps entered into by certain cooperatives.

Securities Exchange Act for treasury affiliates that act as agent.[40] Section 1(d) of the final rule implements the exemptions enacted in Title III of TRIPRA, which excludes these swaps from the statutory directive issued to the Agencies by section 4s of the Commodity Exchange Act and section 15F of the Securities Exchange Act to impose margin requirements for all non-cleared swaps.

Separate from the transactions exempt from the final rule in accordance with TRIPRA, there are also swap transactions with "other counterparties" that are subject to this final rule, but that are not subject to specific, numerical minimum initial or variation margin requirements. As discussed below, these swaps include swaps with counterparties such as foreign sovereigns, as well as swaps with financial end users that do not have a material swaps exposure (with respect to the initial margin requirement). The final rule makes a covered swap entity's collection of margin from these "other counterparties" subject to the judgment of the covered swap entity. That is, under the final rule, a covered swap entity will not be required to collect initial and variation margin from these "other counterparties" as a matter of course.[41] Instead, a covered swap entity should continue with the current practice of collecting initial or variation margin at such times and in such forms and amounts (if any) as the covered swap entity determines appropriate in its overall credit risk management of the swap entity's exposure to the customer.

---

[40] *See* 7 U.S.C. 2(h)(7)(D); 15 U.S.C. 78c-3(g)(4).

[41] Covered swap entities would be required to collect variation margin from all financial end user counterparties under the final rule. However, no specific minimum initial margin requirement would apply to transactions with those financial end users that do not have a material swaps exposure. Thus, for the purpose of the initial margin requirements, financial end users that do not have material swaps exposure would be treated in the same manner as entities characterized as "other counterparties."

The Agencies recognize that a covered swap entity may find it prudent from a risk management perspective to collect margin from one or more of these "other counterparties."[42]

Eligible collateral. The final rule limits the types of collateral that are eligible to be used to satisfy both the initial and variation margin requirements. Eligible collateral is generally limited to high-quality, liquid assets that are expected to remain liquid and retain their value, after accounting for an appropriate risk-based "haircut" or "discount," during a severe economic downturn.

Eligible collateral for initial margin includes cash, debt securities that are issued or guaranteed by the U.S. Department of Treasury or by another U.S. government agency, the Bank for International Settlements, the International Monetary Fund, the European Central Bank, multilateral development banks, certain U.S. Government-sponsored enterprises' ("GSEs") debt securities,[43] certain foreign government debt securities, certain corporate debt securities, certain listed equities, shares in certain pooled investment vehicles, and gold.

Eligible collateral for variation margin depends on the type of counterparty the covered swap entity is facing in its swap transaction. For swaps between a covered swap entity and another swap entity, eligible collateral for variation margin is limited to only immediately available cash funds denominated in U.S. dollars, another major currency, or the currency of settlement for the swap. When a covered swap entity faces financial end user counterparties, on

[42] *See* §§ __.3 and __.4 of the final rule for a complete description of the initial and variation margin requirements that apply to "other counterparties."

[43] An asset-backed security guaranteed by a U.S. GSE is eligible collateral for purposes of initial margin (and variation margin for transactions with financial end users) only if the GSE is operating with capital support or another form of direct financial assistance from the U.S. government.

the other hand, a covered swap entity may exchange variation margin in any of the same forms of collateral as the final rule permits for initial margin collateral.

When determining collateral value for purposes of satisfying the final rule's margin requirements, non-cash collateral is subject to an additional "haircut" or "discount" as determined using Appendix B of the final rule.[44] The limits on eligible collateral and the haircuts under Appendix B would not apply to margin collected or posted in excess of what is required by the rule. The Agencies believe that the eligibility of certain non-cash collateral, subject to the conditions and restrictions contained in the final rule, is consistent with the Dodd-Frank Act, because the use of such non-cash collateral is consistent with preserving the financial integrity of markets by trading swaps and preserving the stability of the U.S. financial system. The use of different types of eligible collateral pursuant to the requirements of the final rule should also incrementally increase liquidity in the financial system.

<u>Collateral segregation.</u> Under the final rule, a covered swap entity must require that any collateral other than variation margin that it posts to its counterparty (even collateral in excess of any required by the final rule) be segregated at one or more custodians that are not the covered swap entity or the counterparty nor affiliates of the covered swap entity or the counterparty ("third-party custodian"). The final rule would also require a covered swap entity to place the initial margin it collects (up to the amount required by the final rule) from a swap entity or a financial end user with material swaps exposure at a third-party custodian.[45] In both of the

---

[44] *See* § __.6 and Appendix B of the final rule for a complete description of the eligible collateral requirements, including an additive 8 percent cross-currency haircut. The terms "haircut" and "discount" are used interchangeably.

[45] The segregation requirement therefore applies only to the minimum amount of initial margin that a covered swap entity is required to collect by the rule from a swap entity

foregoing cases, the final rule would require that a custodial agreement prohibit certain actions with respect to any of the funds or other property that the custodian holds as initial margin. First, the custodial agreement must prohibit the custodian from rehypothecating, repledging, reusing, or otherwise transferring (through securities lending, securities borrowing, repurchase agreement, reverse repurchase agreement or other means) the funds or other property held by the custodian, except that cash collateral may be held in a general deposit account with the custodian if the funds in the account are used to purchase an asset described in § __.6(a)(2) or §__.6(b), such assets are segregated pursuant to § __.7(a)-(b), and such purchase takes place within a time period reasonably necessary to consummate such purchase after the cash collateral is posted as initial margin. Second, with respect to initial margin required to be posted or collected, the custodial agreement must prohibit the substituting or reinvesting of any funds or other property in any asset that would not qualify as eligible collateral under the final rule. Third, the custodial agreement must require that after such substitution or reinvestment, the amount net of applicable discounts described in Appendix B continue to be sufficient to meet the requirements for initial margin under the final rule.[46] With the exception of collateral posted by a covered swap entity, funds or other property held by a third-party custodian in excess of the amounts required to be posted or collected under the rule are not subject to any of these restrictions on collateral substitution or reinvestment.

Cross-border transactions. Given the global nature of swaps markets and swap transactions, margin requirements will be applied to transactions across different jurisdictions.

---

or financial end user with a material swaps exposure, but applies to all collateral (other than variation margin) that the covered swap entity posts to any counterparty.

[46] *See* § __.7 of the final rule for a complete description of the segregation requirements.

As required by the Dodd-Frank Act, the Agencies are adopting a specific approach to address cross-border non-cleared swap transactions. Under the final rule, foreign swaps of foreign covered swap entities would not be subject to the margin requirements of the final rule.[47] In addition, certain covered swap entities that are operating in a foreign jurisdiction and covered swap entities that are organized as U.S. branches or agencies of foreign banks may choose to abide by the swap margin requirements of the foreign jurisdiction if the Agencies determine that the foreign regulator's swap margin requirements are comparable to those of the final rule.[48] This section would also allow any covered swap entity to post initial margin to its counterparty pursuant to a foreign regulator's swap margin requirements that are comparable to those of the final rule in certain circumstances. In addition, this section also addresses certain jurisdictions where inherent limitations in the legal or operational infrastructure make it impracticable for the covered swap entity and counterparty to post initial margin as required in §__.3(b) in compliance with the segregation requirements of §__.7 of this rule; in these circumstances, the final rule provides that a covered swap entity should collect initial margin in cash and post and collect variation margin in cash in such jurisdictions but would not require the covered swap entity to post initial margin to its counterparty.

Affiliate transactions. The final rule contains a special section for swaps with affiliates. This section provides that the requirements of the rule generally apply to a non-cleared swap with an affiliate unless the swap is excluded from coverage under §__.1(d) or a special rule applies. For instance, collection of initial margin is not addressed in this special section. As a result, a covered swap entity is required to collect initial margin from its affiliate pursuant to

[47] *See* § __.9 of the final rule.

[48] *See* § __.9 of the final rule for a complete description of the treatment of cross-border swap transactions.

§__.3(a) under the final rule. Where a covered swap entity transacts with another covered swap entity that is an affiliate, this will result in a collect and post regime for initial margin among affiliates.

The special rules for affiliates provide that a covered swap entity is not required to post initial margin to an affiliate that is not also a covered swap entity but must calculate the amount of initial margin that would be required to be posted to such an affiliate and provide documentation to each affiliate on a daily basis. In addition, each affiliate may be granted an initial margin threshold of $20 million. A covered swap entity that collects non-cash collateral from an affiliate may serve as the custodian for the collateral or have an affiliate serve as the custodian. In addition, a covered swap entity may use a holding period in its margin model equal to the shorter of five business days or the maturity of the portfolio for any swaps with an affiliate that are subject to an exemption from mandatory clearing, provided that the initial margin amount for these swaps are calculated separately from other swaps. In addition, a covered swap entity must collect and post variation margin with any affiliate counterparty as provided in §__.4 of the final rule.[49]

B. Capital Requirements.

Sections 731 and 764 of the Dodd-Frank Act also require each Agency to issue, in addition to margin rules, joint rules on capital for covered swap entities for which it is the

[49] The Agencies note the approach of the final rule is consistent with the approach of other applicable laws, which require transactions between banks and their affiliates to be on an arm's length basis. In particular, section 23B of the Federal Reserve Act provides that many transactions between a bank and its affiliates must be on terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to the bank as those prevailing at the time for comparable transactions with or involving nonaffiliated companies. 12 U.S.C. 371c-1(a).

prudential regulator.[50] The Board, FDIC, and OCC (each a "banking agency" and, collectively, the "banking agencies") have had risk-based capital rules in place for banks to address over-the-counter ("OTC") swaps since 1989 when the banking agencies implemented their risk-based capital adequacy standards (general banking risk-based capital rules)[51] based on the first Basel Accord.[52] The general banking risk-based capital rules have been amended and supplemented over time to take into account developments in the swaps market. These supplements include the addition of the market risk rule which requires banking organizations[53] meeting certain thresholds to calculate their capital requirements for trading positions through models approved by their primary Federal supervisor.[54] In addition, certain large, complex banking organizations

[50] 7 U.S.C. 6s(e)(2); 15 U.S.C. 78o-10(e)(2).

[51] *See* 54 FR 4186 (January 27, 1989). The general banking risk-based capital rules were at 12 CFR part 3, Appendices A, B, and C (national banks); 12 CFR part 167 (federal savings banks); 12 CFR part 208, Appendices A, B, and E (state member banks); 12 CFR part 225, Appendices A, D, and E (bank holding companies); 12 CFR part 325, Appendices A, B, C, and D (state nonmember banks); 12 CFR part 390, subpart Z (state savings associations).

[52] The BCBS developed the first international banking capital framework in 1988, entitled *International Convergence of Capital Measurement and Capital Standards.*

[53] Banking organizations include national banks, state member banks, state non-member banks, Federal savings associations, state savings associations, top-tier bank holding companies domiciled in the United States not subject to the Board's Small Bank Holding Company Policy Statement (12 CFR part 225, appendix C)), as well as top-tier savings and loan holding companies domiciled in the United States, other than (i) savings and loan holding companies subject to the Board's Small Bank Holding Company Policy Statement and (ii) certain savings and loan holding companies that are substantially engaged in insurance underwriting or commercial activities.

[54] The banking agencies' market risk capital rules are at 12 CFR part 3, subpart F (national banks and federal savings associations), 12 CFR part 217, subpart F (state member banks, bank holding companies, and savings and loan holding companies), and 12 CFR part 324, subpart F (state nonmember banks and state savings associations). The rules apply to banking organizations with trading activity (on a worldwide consolidated basis) that equals 10 percent or more of the institution's total assets, or $1 billion or more.

are subject to the banking agencies' advanced approaches risk-based capital rule (advanced approaches rules), based on the advanced approaches of the Basel II Accord.[55]

In July 2013 the Board and the OCC issued a final rule (revised capital framework) implementing regulatory capital reforms reflecting agreements reached by the BCBS in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" (Basel III framework).[56] The revised capital framework includes the capital requirements for OTC derivatives contracts, which are defined to include transactions that would also meet the definition of swaps described above, as well as a minimum supplementary leverage ratio for advanced approaches banking organizations that is reflective of their on- and –off-balance sheet activities, including derivatives activities. The FDIC adopted an interim final rule that was substantively identical to the revised capital framework in July 2013 and later issued a final rule in April 2014 identical to the Board's and the OCC's final rule.[57]

---

[55] *See* BCBS, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (2006). The banking agencies implemented the advanced approaches of the Basel II Accord in 2007. *See* 72 FR 69288 (December 7, 2010). The advanced approaches rules are codified at 12 CFR part 3, subpart E (national banks and federal savings associations), 12 CFR part 217, subpart E (state member banks, bank holding companies, and savings and loan holding companies), and 12 CFR part 324, subpart E (state nonmember banks and state savings associations). The advanced approaches rules apply to banking organizations with consolidated total assets equal to $250 billion or more or consolidated total on-balance sheet foreign exposures equal to $10 billion or more (advanced approaches banking organizations).

[56] *See* BCBS, *Basel III: A Global Regulatory Framework For More Resilient Banks and Banking Systems* (2010), *available at* www.bis.org/publ.bcbs189.htm.

[57] 78 FR 62018 (October 11, 2013) (Board and OCC); 78 FR 20754 (April 14, 2014) (FDIC). These rules are codified at 12 CFR part 3 (national banks and federal savings associations), 12 CFR part 217 (state member banks, bank holding companies, and savings and loan holding companies), and 12 CFR part 324 (state nonmember banks and state savings associations).

FHFA's predecessor agencies used a methodology similar to that endorsed by the BCBS prior to the development of the Basel III framework to develop the risk-based capital rules applicable to those entities now regulated by FHFA. Those rules still apply to all FHFA-regulated entities.[58] FHFA is in the process of revising and updating these regulations for the Federal Home Loan Banks.

The FCA's risk-based capital regulations for Farm Credit System ("FCS") institutions, except for the Federal Agricultural Mortgage Corporation ("Farmer Mac"), have been in place since 1988 and were last updated in 2005.[59] The FCA's risk-based capital regulations for Farmer Mac have been in place since 2001 and were updated in 2011.[60] The FCA proposed revisions to its capital rules for all FCS institutions, except Farmer Mac, that are comparable to the Basel III framework.[61]

As described below, the final rule requires a covered swap entity to comply with regulatory capital rules already made applicable to that covered swap entity as part of its prudential regulatory regime. Given that these existing regulatory capital rules specifically take into account and address the unique risks arising from swap transactions and activities, the

---

[58] For the duration of the conservatorships of Fannie Mae and Freddie Mac (together, the "Enterprises"), FHFA has directed that its existing regulatory capital requirements would not be binding. However, FHFA continues to closely monitor the Enterprises' activities. Such monitoring, coupled with the unique financial support available to the Enterprises from the U.S. Department of the Treasury and the likelihood that FHFA will promulgate new risk-based capital rules in due course to apply to the Enterprises (or their successors) once the conservatorships have ended, lead to FHFA's view that the reference to existing capital rules is sufficient to address the risks arising from swap transactions and activities of the Enterprises.

[59] *See* 53 FR 40033 (October 13, 1988); 70 FR 35336 (June 17, 2005); 12 CFR part 615, subpart H.

[60] *See* 66 FR 19048 (April 12, 2001); 76 FR 23459 (April 27, 2011); 12 CFR part 652.

[61] *See* 79 FR 52814 (Sept. 4, 2014).

Agencies will rely on these existing rules as appropriate and sufficient to offset the greater risk to the covered swap entity and the financial system arising from the use of swaps that are not cleared and to protect the safety and soundness of the covered swap entity.

C. The Final Rule and Community Banks.

The Agencies expect that the final rule likely will have minimal impact on community banks. The Agencies anticipate that community banks will not engage in swap activity to the level that would require them to register as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant; and therefore, are unlikely to fall within the definition of a covered swap entity.[62] Because the final rule imposes requirements on covered swap entities, no community bank will likely be directly subject to the rule. Thus, a community bank that enters into non-cleared interest rate swaps with its commercial customers will not be required to apply to those swaps the final rule's requirements for initial margin or variation margin.

The TRIPRA also excluded certain swaps with community banks from the margin requirements of this rule. In particular, section 2(h)(7)(A) of the Commodity Exchange Act excepts from clearing any swap where one of the counterparties is not a financial entity, is using the swap to hedge or mitigate commercial risk, and notifies the CFTC how it generally meets its financial obligations associated with entering into non-cleared swaps.[63] As authorized by the

[62] At the time the Agencies adopted this final rule, no community banks had registered in any of these capacities.

[63] A "financial entity" is defined to mean (i) a swap dealer; (ii) a security-based swap dealer; (iii) a major swap participant; (iv) a major security-based swap participant; (v) a commodity pool; (vi) a private fund as defined in section 202(a) of the Investment Advisers Act of 1940; (vii) an employee benefit plan as defined in sections 3(3) and 3(32) of the Employment Retirement Income Security Act of 1974; (viii) a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in

Dodd-Frank Act, the CFTC has excluded depository institutions, FCS institutions, and credit unions with total assets of $10 billion or less, from the definition of "financial entity," thereby permitting those institutions to avail themselves of the clearing exception for end users.[64] Non-cleared swaps with those entities would be eligible for the TRIPRA exemption in the Agencies' margin rules, provided they met the other requirements for the clearing exception. As a consequence of TRIPRA, if a community bank with total assets of $10 billion or less enters into a swap with a covered swap entity that meets the requirements of the exception from clearing, that swap will not be subject to the margin requirements of this rule. As of June 30, 2015, of the 6,348 insured depository institutions, all but 111 institutions had total assets of $10 billion or less.[65]

When a community bank with total assets greater than $10 billion enters into a swap with a covered swap entity, the covered swap entity will be required to post and collect initial margin pursuant to the rule only if the community bank had a material swaps exposure and is not otherwise exempt pursuant to TRIPRA.[66] Further, if a community bank with total assets above $10 billion does not engage in swaps activities that would exceed its initial margin threshold

---

nature, as defined in section 4(k) of the Bank Holding Company Act of 1956. *See* 7 U.S.C. 2(h)(7)(C)(i).

[64] *See* 7 U.S.C. 2(h)(7)(C)(ii) and 77 FR 42560 (July 19, 2012); 77 FR 20536 (April 5, 2012).

[65] FDIC Quarterly Banking Profile, Second Quarter 2015, p. 7. https://www5.fdic.gov/qbp/2015jun/qbp.pdf. Of the 6,237 insured depository institutions with total assets of $10 billion or less as of June 30, 2015, 5,646 institutions had total assets of $1 billion or less and 591 institutions had total assets between $1 billion and $10 billion.

[66] The final rule defines material swaps exposure as an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps with all counterparties for June, July, and August of the previous calendar year that exceeds $8 billion, where such amount is calculated only for business days.

amount, the final rule will only require a covered swap entity to collect initial margin that it determines is appropriate to address the credit risk posed by such a community bank. The Agencies believe covered swap entities currently apply this approach as part of their credit risk management practices.

The final rule requires a covered swap entity to exchange daily variation margin with a community bank with total assets below $10 billion, regardless of whether the community bank has material swaps exposure, provided the swap is not otherwise exempt pursuant to TRIPRA. In addition, the final rule requires a covered swap entity to exchange daily variation margin with a community bank with total assets above $10 billion, regardless of whether the community bank has material swaps exposure. However, the covered swap entity will only be required to collect variation margin from a community bank when the amount of both initial margin and variation margin required to be collected exceeds the minimum transfer amount of $500,000, as provided for in § __.5(b) of the final rule.

D. The Final Rule and Farm Credit System Institutions.

The final rule should have a minimal impact on the FCS. Currently, no FCS institution, including Farmer Mac, engages in swap activity at the level that would require them to register as a swap dealer, major swap participant, security-based swap dealer, or a major security-based swap participant. For this reason, no FCS institution, including Farmer Mac, would fall within the definition of a covered swap entity and, therefore, become directly subject to this rule. Further, almost all swaps of FCS institutions are exempt from clearing and the margin requirements of this final rule as a result of TRIPRA. Most FCS institutions have total assets of less than $10 billion and, therefore, they are exempt from clearing under a CFTC regulation, 17

CFR § 50.50(d), which implements section 2(h)(7)(C)(ii) of the Commodity Exchange Act.[67] Separately, FCS banks and associations, regardless of size, may elect not to clear swaps that (1) they enter into in connection with loans to their members; or (2) hedge or mitigate risks related to loans with their members, pursuant to 17 CFR § 50.51.[68] Furthermore, TRIPRA exempts financial cooperatives from exchanging initial and variation margin on all their swaps that are subject to the exemption from clearing provided by the CFTC. Farmer Mac is the only FCS institution that does not have an exemption from mandatory clearing because it has total assets that exceed $10 billion, and it is not a cooperative. For this reason, Farmer Mac is a financial end user and is subject to the initial margin requirements of this final rule to the extent its non-cleared swap transactions exceed the material swaps exposure or initial margin thresholds. Farmer Mac would also be subject to the variation margin requirements of this final rule.

III. Section by Section Summary of Final Rule.

A. Section __.1: Authority, Purpose, Scope, Exemptions and Compliance Dates.

As in the proposal, §§ __.1(a)-(c) of the final rule are Agency-specific. Section __.1(a) of the final rule sets out each Agency's specific authority, and § __.1(b) describes the purpose of the rule, including the specific entities covered by each Agency's rule. Section __.1(c) of the final rule specifies the scope of the transactions to which the margin requirements apply. Under § __.1(c), the margin requirements apply to <u>all</u> non-cleared swaps into which a covered swap entity enters. Each Agency has set forth text for its Agency-specific version of § __.1(c) that specifies the entities to which that Agency's rule applies. Section __.1(c) further states that the

---

[67] The SEC has not yet enacted a comparable rule granting small deposit institutions, FCS institutions, and credit unions, an exemption from clearing.

[68] The CFTC enacted 17 CFR § 50.51 pursuant to its authority under section 4(c)(1) of the Commodity Exchange Act.

margin requirements apply only to non-cleared swaps and non-cleared security-based swaps that are entered into on or after the relevant compliance dates set forth in §__.1(e). Section ___.1(c) also provides that nothing in this final rule is intended to prevent, nor is it intended to require, a covered swap entity from independently collecting margin in amounts greater than the amounts required under this final rule. Section __.1(d) provides for exemptions from the rule for certain swaps and security-based swaps with certain commercial end users and others as described above and in the companion interim final rule. Section __.1(e) sets forth compliance dates. Section 1(f) provides that once a covered swap entity and its counterparty become subject to the margin requirements based on the compliance dates set forth in §__.1(e), the covered swap entity and its counterparty shall remain subject to the final rule. Section __.1(g) of the final rule specifies how the margin requirements apply in the event a covered swap entity's counterparty changes its status (for example, if the counterparty is a financial end user without material swaps exposure and thereafter becomes a financial end user with material swaps exposure).

1. Treatment of Swaps with Commercial End Users and Other "Low-Risk" Counterparties.

Section ___.1(d) of the final rule, which is the same for all the Agencies, implements the provisions of TRIPRA and provides for exemptions from the rule for certain swaps with certain commercial end users and certain other counterparties. These exemptions are discussed further in the Agencies' interim final rule and request for comment, published elsewhere in the *Federal Register*.

The proposal applied to all swaps and security-based swaps, consistent with the original provisions of sections 731 and 764 of the Dodd-Frank Act. For certain swaps, however, such as those between a covered swap entity and a "commercial end user" (*i.e.*, a nonfinancial counterparty that is neither a swap entity nor a financial end user and engages in swaps to hedge commercial risk),[69] the Agencies proposed a reduced, risk-based, approach to margin. For those counterparties, which the proposal treated as "other counterparties," the proposal would have required only that a covered swap entity collect margin in such forms and amounts (if any) that the covered swap entity determined appropriately addressed the credit risk posed by the counterparty and the risks of the swap.[70]

As discussed earlier, TRIPRA, which was enacted on January 12, 2015, amends sections 731 and 764 of the Dodd-Frank Act to exempt certain transactions of certain financial and nonfinancial end users from the Agencies' margin requirements set out in this final rule.[71] Specifically, section 302 of TRIPRA amends sections 731 and 764 so that initial and variation margin requirements will not apply to a swap or security-based swap of a counterparty (to a covered swap entity) in which a counterparty is:

> (1) A nonfinancial entity, including a captive finance company, that qualifies for the clearing exception under section 2(h)(7)(A) of the Commodity Exchange Act or section 3C(g)(1) of the Securities Exchange Act;[72]

---

[69] Although the term "commercial end user" is not defined in the Dodd-Frank Act, it is used in this preamble to mean a company that is eligible for the exception to the mandatory clearing requirement for swaps under section 2(h)(7)(A) of the Commodity Exchange Act and section 3C(g)(1) of the Securities Exchange Act, respectively. This exception is generally available to a person that (1) is not a financial entity, (2) is using the swap to hedge or mitigate commercial risk, and (3) has notified the CFTC or SEC how it generally meets its financial obligations with respect to non-cleared swaps or security-based swaps, respectively. *See* 7 U.S.C. 2(h)(7)(A) and 15 U.S.C. 78c-3(g)(1).

[70] *See* discussion below of §§ __.3(d) and __.4(c) of the proposed rule.

[71] Pub. L. 114-1, 129 Stat. 3.

[72] *See* 7 U.S.C. 2(h)(7)(A); 15 U.S.C. 78c-3(g)(1). A "captive finance company" is an entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company. *See* 7 U.S.C. 2(h)(7)(C)(iii). Section 2(h)(7)(C)(ii) of the Commodity Exchange Act and section 3C(g)(3)(B) of the Securities Exchange Act authorize the CFTC and the SEC, respectively, to exempt small depository

(2) A cooperative entity that qualifies for an exemption from the clearing requirements issued under section 4(c)(1) of the Commodity Exchange Act;[73] or

(3) An affiliate that satisfies the criteria for an exception from clearing in section 2(h)(7)(D) of the Commodity Exchange Act or section 3C(g)(4) of the Securities Exchange Act.[74]

The Agencies have implemented the TRIPRA exemptions in § __.1(d) of the final rule. These exemptions are transaction-based, as opposed to counterparty-based. For example, if a commercial end user enters into a non-cleared swap with a covered swap entity and the transaction is not for hedging purposes, then the covered swap entity would treat the swap in

---

institutions, small FCS institutions, and small credit unions with total assets of $10 billion or less from the mandatory clearing requirements for swaps and security-based swaps. *See* 7 U.S.C. 2(h)(7)(C)(ii) and 15 U.S.C. 78c–3(g)(3)(B). The CFTC has exempted these small institutions by rule, and therefore swaps entered into to hedge or mitigate commercial risk by those institutions are also exempt from this final rule by operation of TRIPRA. *See* 77 FR 42560 (July 19, 2012); 77 FR 20536 (April 5, 2012). On December 21, 2010, the SEC proposed to exempt security-based swaps used by small depository institutions, small FCS institutions, and small credit unions with total assets of $10 billion or less from clearing. 75 FR 79992 (December 21, 2010).

[73] *See* 7 U.S.C. 6(c)(1). The CFTC, pursuant to its authority under section 4(c)(1) of the Commodity Exchange Act, adopted 17 CFR 50.51, which allows certain cooperative financial entities, including those with total assets in excess of $10 billion, to elect an exemption from mandatory clearing of swaps that: (1) they enter into in connection with originating loans for their members; or (2) hedge or mitigate commercial risk related to loans or swaps with their members or arising from certain swaps with members.

[74] *See* 7 U.S.C. 2(h)(7)(D) and 15 U.S.C. 78c-3(g)(4). This exception applies to an affiliate of a person that qualifies for an exception from clearing (including affiliate entities predominantly engaged in providing financing for the purchase of the merchandise or manufactured goods of the person), only if the affiliate, acting on behalf of the person and as an agent, uses the swap to hedge or mitigate the commercial risk of the person or other affiliate of the person that is not a financial entity. This exception does not apply to a person that is a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, an issuer that would be an investment company, as defined in section 3 under the Investment Company Act but for paragraphs (c)(1) or (c)(7), a commodity pool, or a bank holding company with over $50 billion in consolidated assets.

accordance with the "other counterparties" provisions in §§__.3 and ___.4 of this final rule.[75] Finally, the Agencies note that the exception or exemption of a transaction from the margin requirements in no way prohibits a covered swap entity from requiring initial and/or variation margin on such transactions but does not impose initial or variation margin requirements as a regulatory matter.

Section 303 of TRIPRA requires that the Agencies implement the provisions of Title III, "Business Risk Mitigation and Price Stabilization Act of 2015," by promulgating an interim final rule, and seeking public comment on the interim final rule. The Agencies are adopting §__.1(d) as part of a companion interim final rule, and will be requesting comment, as required by TRIPRA, in a separate publication in the *Federal Register*. If necessary, the Agencies will amend §__.1(d) after receiving comments on the interim final rule.

2. Compliance Dates.

Section __.1(e) of the final rule sets forth the compliance dates by which covered swap entities must comply with the minimum margin requirements for non-cleared swaps that are entered into on or after the applicable compliance date. The compliance dates are consistent with the modified compliance dates associated with the 2013 international framework.[76]

Under the 2014 proposal, the implementation of both initial and variation margin requirements would have started on December 1, 2015. With respect to initial margin requirements, the requirements would have been phased-in between December 1, 2015 and December 1, 2019. Variation margin requirements for all covered swap entities with respect to

[75] *See* discussion below of §§ __.3(d) and __.4(c) of the final rule.

[76] *See* BCBS and IOSCO "Margin requirements for non-centrally cleared derivatives," (March 2015), *available at* https://www.bis.org/bcbs/publ/d317.htm., which extends the original compliance dates set out in the 2013 international framework by nine months.

covered swaps with any counterparty would have been effective as of December 1, 2015. This proposed set of compliance dates was consistent with those set forth in the 2013 international framework. On March 18, 2015, the BCBS and IOSCO issued a press release announcing that the implementation of the 2013 international framework would be delayed by nine months.[77] This announcement was in response to the fact that to date in March 2015, no jurisdiction had yet finalized rules for margin requirements for non-centrally cleared derivatives. Accordingly, the final rule has been revised to delay the implementation of both initial and variation margin requirements by nine months from the compliance schedule set forth in the 2014 proposal. This delay results in a uniform approach with respect to compliance dates across the final rule and the international framework.

The changes to the proposed compliance dates in the final rule should help address concerns raised by commenters. For example, the proposal was revised, in part, to respond to commenters who stated that, to the extent practicable, there should be international harmonization of implementation dates for margin and capital requirements. While one commenter supported the proposed compliance date schedules set out in the 2014 proposal, a number of commenters argued that compliance with the final rule should be delayed for 18 months to two years in order to allow for operational changes that will be required for covered swaps entities to comply with the rule. With respect to phasing-in the implementation of the initial margin requirements, a commenter stated that the phase-in provisions should be revised to apply only to non-cleared swaps between covered swap entities. The commenter further stated that non-covered swap entities should not be required to comply with the initial margin requirements until December 2019. The Agencies also received a comment stating that the

[77] http://www.bis.org/bcbs/publ/d317.htm.

implementation of the compliance date schedule should not coincide with code freezes – i.e., periods like year-end when companies typically do not change their information technology systems in anticipation of certain reporting deadlines.

The Agencies agree that the international harmonization of margin and capital requirements is prudent. In light of the concerns raised by the commenters and the delay of the implementation of the 2013 international framework, the Agencies have incorporated into the final rule provisions reflecting the implementation schedule for the 2013 international framework that was recently set out by the BCBS and IOSCO.

a. Compliance Date Schedule for Initial Margin.

For purposes of initial margin, as reflected in the table below, the compliance dates range from September 1, 2016, to September 1, 2020, depending on the average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps ("covered swaps") of the covered swap entity and its counterparty (accounting for their respective affiliates) for each business day in March, April and May of that year.[78]

Compliance Date	Initial Margin Requirements
September 1, 2016	Initial margin where both the covered swap entity combined with all its affiliates and its counterparty combined with all its affiliates have an average daily aggregate notional amount of covered swaps for March, April and May of 2016 that exceeds $3 trillion.
September 1, 2017	Initial margin where both the covered swap

78 "Foreign exchange forward" and "foreign exchange swap" are defined to mean any foreign exchange forward, as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)), and foreign exchange swap, as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25)).

	entity combined with all its affiliates and its counterparty combined with all its affiliates have an average daily aggregate notional amount of covered swaps for March, April and May of 2017 that exceeds $2.25 trillion.
September 1, 2018	Initial margin where both the covered swap entity combined with all its affiliates and its counterparty combined with all its affiliates have an average daily aggregate notional amount of covered swaps for March, April and May of 2018 that exceeds $1.5 trillion.
September 1, 2019	Initial margin where both the covered swap entity combined with all its affiliates and its counterparty combined with all its affiliates have an average daily aggregate notional amount of covered swaps for March, April and May of 2019 that that exceeds $0.75 trillion.
September 1, 2020	Initial margin for any other covered swap entity with respect to covered swaps with any other counterparty.

In calculating the amount of covered swaps as set forth in the table above, the final rule provides that a covered swap entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time, and shall not count a swap or security-based swap that is exempt from the Agencies' margin requirements under § __.1(d).[79] These provisions were not included in the proposed rule. The purpose of the first provision in the final rule is to prevent double counting of covered swaps between affiliates, a concern raised by a number of commenters, which could artificially increase a covered swap entity's average daily aggregate notional amount. The purpose of the second provision is to ensure that swaps

[79] *See* § __.1(e) of the final rule.

that have been exempted from the margin requirements are fully exempted and do not influence other aspects of the rule such as whether an entity maintains a material swaps exposure.

The Agencies expect that covered swap entities likely will need to make a number of operational and legal changes to their current swaps business operations in order to achieve compliance with the provisions of the final rule relating to the initial margin requirements, including potential changes to internal risk management and other systems, trading documentation, collateral arrangements, and operational technology and infrastructure. In addition, the Agencies expect that covered swap entities that wish to calculate initial margin using an initial margin model will need sufficient time to develop such models and obtain regulatory approval for their use. Accordingly, the compliance dates have been structured to ensure that the largest and most sophisticated covered swap entities and counterparties that present the greatest potential risk to the financial system comply with the requirements first. These swap market participants should be able to make the required operational and legal changes more rapidly and easily than smaller entities that engage in swaps less frequently and pose less risk to the financial system.

b. Compliance Date Schedule for Variation Margin.

For purposes of variation margin, the compliance dates are September 1, 2016 and March 1, 2017. As set out in the table below, these compliance dates also depend on the average daily aggregate notional amount of covered swaps of the covered swap entity combined with its affiliates and each of its counterparties (combined with that counterparty's affiliates) for each business day in March, April and May of that year (the "calculation period").[80] Thus, a given covered swap entity may have multiple compliance dates depending on both the combined

[80] *See* § __.1(e) of the final rule.

average daily aggregate notional amount of covered swaps of the covered swap entity and its affiliates during the calculation period as well as the combined average daily notional amount of covered swaps of each of its counterparties and that counterparty's affiliates during the calculation period.

Compliance Date	Variation Margin Requirements
September 1, 2016	Variation margin where both the covered swap entity combined with all its affiliates and its counterparty combined with all its affiliates have an average daily aggregate notional amount of covered swaps for March, April and May of 2016 that exceeds $3 trillion.
March 1, 2017	Variation margin for any other covered swap entity with respect to covered swaps with any other counterparty.

Calculating the amount of covered swaps set forth in the table above for the purposes of determining variation margin is done in the same manner as calculating the amount of covered swaps for purposes of determining initial margin.[81] A covered swap entity shall count the

[81] As a specific example of the calculation, consider a U.S.-based financial end user (together with its affiliates) with a portfolio consisting of two non-cleared swaps (e.g., an equity swap, an interest rate swap) and one non-cleared security-based credit swap. Suppose that the notional value of each swap is exactly $1 trillion on each business day of March, April and May of 2016. Furthermore, suppose that a foreign exchange forward is added to the entity's portfolio at the end of the day on April 29, 2016, and that its notional value is $1 trillion on every business day of May 2016. On each business day of March and April of 2016, the aggregate notional amount of non-cleared swaps, security-based swaps and foreign exchange forwards and swaps is $3 trillion. Beginning on May 1, 2016, the aggregate notional amount of non-cleared swaps, security-based swaps and foreign exchange forwards and swaps is $4 trillion. The daily average aggregate notional value for March, April and May 2016 is then (23x$3 trillion +21x$3 trillion + 21x$4 trillion)/(23+21+21)=$3.3 trillion, in which case this entity would have a gross notional exposure that would result in its compliance date beginning on September 1, 2016.

average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time, and shall not count a swap or security-based swap that is exempt from the Agencies' margin requirements under § __.1(d).

The final rule adopts a phase-in arrangement for variation margin requirements that is different from the 2014 proposal. Several commenters urged that the compliance date for variation margin requirements be phased in, in a manner similar to the compliance dates for the initial margin requirements. These commenters argued, among other things, that the phase-in of the variation margin requirements would allow covered swap entities the time to re-document all necessary swap contracts at one time. One commenter stated that variation margin requirements should be phased in based on decreasing notional amount thresholds over a two-year period commencing upon the latter of the publication of the margin rules for OTC derivatives in the United States, the EU and Japan or the publication of the Agencies' comparability determinations with respect to the EU and Japan. In response to these comments, the Agencies believe that a phase-in of variation margin requirements similar to the phase-in of initial margin requirements is not necessary because the collection of daily variation margin is currently an industry best practice and will not require many changes in current swaps business operations for covered swaps entities. However, the Agencies have revised the 2014 proposal to include the phase-in of compliance dates for variation margin as set forth above to align with the dates suggested by the BCBS and IOSCO on March 18, 2015.

c. The meaning of swaps entered into after the compliance date.

The rule's margin requirements apply to non-cleared swaps entered into on or after the applicable compliance date. Certain commenters also requested that the Agencies consider the following swaps as entered into prior to the compliance date: (1) swaps entered into prior to the applicable compliance date (legacy swaps) that are amended in a non-material manner; (2) novations; and (3) new derivatives that result from portfolio compression of legacy derivatives. These commenters urged that if a general exclusion for novated legacy swaps is not provided, there should be an exclusion for novated swaps between affiliates resulting from organizational restructuring or regulatory requirements such as the swaps push-out rule.

Notwithstanding these comments, the Agencies believe that classifying new swap transactions as "swaps entered into prior to the compliance date" could create significant incentives to engage in amendments and novations for the purpose of evading the margin requirements. Moreover, limiting the extension to "material" amendments or "legitimate" novations is difficult to effect within the final rule as the specific motivation for an amendment or novation is generally not observable. Finally, the Agencies believe that classifying some new swap transactions as transactions entered into prior to the compliance date would make the process of identifying those swaps to which the rule applies overly complex and non-transparent. Accordingly, the Agencies have elected not to extend the meaning of swaps entered into prior to the compliance date as was requested by some commenters.

d. Ongoing Applicability and Implementation of the Margin Requirements.

Section __.1(f) provides that once a covered swap entity and its counterparty must comply with the margin requirements for non-cleared swaps based on the compliance dates set forth in § __.1(e), the covered swap entity and its counterparty shall remain subject to the margin requirements from that point forward. For example, September 1, 2017 is the relevant compliance date where both the covered swap entity combined with all its affiliates and its counterparty combined with all its affiliates have an average aggregate daily notional amount of covered swaps that exceed $2.25 trillion must comply with these margin requirements. If the notional amount of the swap activity for the covered swap entity or the counterparty drops below that threshold amount of covered swaps in subsequent years, their swaps would nonetheless remain subject to the margin requirements. On September 1, 2020, any covered swap entity/counterparty combination that did not have an earlier compliance date will become subject to the initial margin requirements with respect to any non-cleared swaps.

One commenter urged that, during the phase-in period, only entities whose swap volume currently exceeds the applicable threshold should be subject to the margin requirements. The commenter stated that, if the swap activity of either party to a swap declines below the applicable threshold, that party should cease being subject to the initial margin requirements until such time as it exceeds the applicable threshold. The Agencies have declined to make this change to the final rule. The Agencies believe that allowing entities' coverage status to change over time results in additional complexity with little benefit since all entities will in any event be subject to the rule as of September 1, 2020. Accordingly, allowing an entity's coverage status to fluctuate would only be consequential for a limited period of time.

One commenter asked how the margin requirements would apply in the event of a change in status of the counterparty. The Agencies have added § __.1(g) to the final rule to clarify the applicability of the margin requirements in the event a covered swap entity's counterparty changes its status (for example, if the counterparty is a financial end user without material swaps exposure and becomes a financial end user with material swaps exposure).[82] Under §__.1(g)(1), in the event a counterparty changes its status such that a non-cleared swap or non-cleared

[82] This could apply in other circumstances as well – e.g., if an entity that is exempt pursuant to TRIPRA no longer qualifies for an exception or exemption.

security-based swap with that counterparty becomes subject to stricter margin requirements, then the covered swap entity shall comply with the stricter margin requirements for any non-cleared swap or non-cleared security-based swap entered into with that counterparty after the counterparty changes its status. Section __.1(g)(2) states that in the event a counterparty changes its status such that a non-cleared swap or non-cleared security-based swap with that counterparty becomes subject to less strict margin requirements (such as when a counterparty changes status from a financial end user with material swaps exposure to a financial end user without material swaps exposure), then the covered swap entity may comply with the less strict margin requirements for any swap or security-based swap entered into with that counterparty after the counterparty changes its status as well as for any outstanding non-cleared swap or non-cleared security-based swap entered into after the applicable compliance date in §___.1(e) and before the counterparty changed its status. As a specific example, if a covered swap entity's counterparty transitioned from a financial end user with material swaps exposure to a financial end user without material swaps exposure, initial margin that had been previously collected could be returned if agreed to by both parties since the rule would not require an exchange of initial margin on pre-existing or future non-cleared swaps.

e. Treatment of Swaps Executed Prior to the Applicable Compliance Date under a Netting Agreement.

As discussed in further detail below in §___.5, a covered swap entity may enter into swaps on or after the final rule's compliance date pursuant to the same master netting agreement that governs existing swaps entered into with a counterparty prior to the compliance date. The final rule permits a covered swap entity to (1) calculate initial margin requirements for swaps under an eligible master netting agreement ("EMNA") with the counterparty on a portfolio basis in certain circumstances, if it does so using an initial margin model; and (2) calculate variation margin requirements under the final rule on an aggregate, net basis under an EMNA with the counterparty. Applying the final rule in such a way would, in some cases, have the effect of applying it retroactively to swaps entered into prior to the compliance date under the EMNA.

The Agencies received several comments expressing concern that the 2014 proposal might require swaps entered into before the compliance dates to be documented under a different EMNA than swaps entered into after the compliance dates in order for the margin requirements not to apply to the pre-compliance dates swaps. As described further in §___.5, the Agencies have revised the final rule to allow for the establishment of separate netting sets under a single ENMA to avoid this outcome.

3. *Numerical amounts expressed in U.S. dollar terms in the final rule and their relation to numerical amounts expressed in Euros in the 2013 international framework.*

The 2014 proposal contained a number of numerical amounts that are expressed in U.S. dollar terms. The amounts include the effective date phase-in thresholds, the initial margin threshold amount, the material swaps exposure amount, and the minimum transfer amount. These numerical amounts are expressed in the 2013 international framework in terms of Euros. In the 2014 proposal, the Agencies translated the Euro amounts from the 2013 international framework using a Euro-U.S. Dollar exchange rate that was broadly consistent with the exchange rate that prevailed at the time of the proposal's publication.

In the proposal, the Agencies sought comment on how to deal with fluctuations in exchange rates and how such fluctuations may create inconsistencies in the numerical amounts that are established across differing jurisdictions. One commenter suggested using an average exchange rate calculated over a period of time. Another commenter suggested that the Agencies should periodically recalibrate these amounts in response to broad movements in underlying exchange rates.

The Agencies believe that persistent and significant fluctuations in exchange rates could result in significant differences across jurisdictions that would complicate cross-border transactions and create competitive inequities. The Agencies do not agree, however, that the final rule's numerical amounts should be mechanically linked to either prevailing exchange rates or average exchange rates over a period of time as short term fluctuations in exchange rates would result in high frequency changes that would create significant operational and logistical burdens. Rather, and consistent with the view of one commenter, the Agencies expect to consider periodically the numerical amounts expressed in the final rule and their relation to amounts denominated in other currencies in differing jurisdictions. The Agencies will then propose adjustments, as appropriate, to these amounts.

In the final rule, the Agencies are adjusting the numerical amounts described above in light of significant shifts in the Euro-U.S. Dollar exchange rates since the publication of the 2014 proposal. Specifically, the Agencies are reducing the value of each numerical quantity expressed in dollars to be consistent with a one-for-one exchange rate with the Euro. As a specific example, the amount of the initial margin threshold is being changed from $65 million in the 2014 proposal to $50 million in the final rule. This change will align the U.S dollar denominated numerical amounts in the final rule with those in the 2013 international framework, will be consistent with amounts that have been proposed in margin rules by the European and Japanese authorities and will be more consistent with the Euro-U.S. Dollar exchange rate prevailing at the time the final rule is published.

B. *Section __.2: Definitions.*

Section __.2 of the final rule defines its key terms.

1. *Swap Counterparty Definitions.*

Section __.2 defines key terms used in the final rule, including the types of counterparties that form the basis of the rule's risk-based approach to margin requirements and other key terms needed to calculate the required amount of initial margin and variation margin.[83] As noted above, the final rule, like the proposal, distinguishes among four separate types of counterparties:[84] (i) counterparties that are themselves swap entities; (ii) counterparties that are financial end users with a material swaps exposure; (iii) counterparties that are financial end users without a material swaps exposure; and (iv) other counterparties, including nonfinancial end users, sovereigns, and multilateral development banks to the extent their swaps do not

[83] "Initial margin" means the collateral as calculated in accordance with § __.8 that is posted or collected in connection with a non-cleared swap. *See* § __.2 of the final rule; *see also* § __.3 of the final rule (describing initial margin requirements). "Variation margin" means collateral provided by one party to its counterparty to meet the performance of its obligations under one or more non-cleared swaps or non-cleared security-based swaps between the parties as a result of a change in value of such obligations since the last time such collateral was provided. *See* § __.2 of the final rule; *see also* § __.4 of the final rule (describing variation margin requirements). The final rule's definition of "variation margin" and "variation margin amount" are described in §__.4.

[84] "Counterparty" is defined to mean, with respect to any non-cleared swap or non-cleared security-based swap to which a person is a party, each other party to such non-cleared swap or non-cleared security-based swap. This definition is modified slightly from the proposal to make clear that either party to the swap may be referred to as the counterparty.

qualify for an exemption from clearing pursuant to § __.1(d) of the final rule.[85] Below is a general description of the significant terms defined in § __.2 of the final rule.[86]

a. *Swap entity.*

In the final rule, the Agencies have revised the definition of "swap entity" to clarify that the term applies to persons that have registered with the CFTC as a swap dealer or major swap participant or with the SEC as a security-based swap dealer or major security-based swap participant. The term "swap entity" is used in the final rule in the definition of "covered swap entity" to refer to such an entity that is supervised by one of the Agencies. The term "swap entity" is also used in describing requirements that apply when a covered swap entity engages in non-cleared swaps with a counterparty that is registered with the CFTC or SEC as a dealer or major participant in non-cleared swaps or security-based swaps but is not supervised by one of the Agencies.

The registration status with the CFTC or SEC is central to the scope of the rule's applicability to an entity that is supervised by one of the Agencies. The Commodity Exchange Act requires that "each registered swap dealer and major swap participant for which there is a prudential regulator shall meet such minimum capital requirements and minimum initial and variation margin requirements as the prudential regulator shall by rule or regulation prescribe . . .

[85] The treatment of other counterparties in the final rule thus is only relevant with respect to non-cleared swaps and non-cleared security-based swaps that are not exempt under § __.1(d) of the final rule.

[86] The term "nonfinancial end user" is not used in the final rule. Nonfinancial end users would be treated as "other counterparties" to the extent their swaps do not qualify for an exemption. *See* §§§ __.1(d), __.3(d) and __.4(c) of the final rule.

."[87] The Securities Exchange Act imposes a similar requirement for each registered security-based swap dealer and major security-based swap participant.[88]

For a person that meets the qualitative elements of one or more of the dealer or major participant definitions, whether it is required to register with the applicable Commission will require an application of the minimum thresholds that the Commissions established in their joint regulation. For purposes of this margin rule, "swap entity" refers only to those persons that have actually registered with the applicable Commission as a dealer or major participant in non-cleared swaps or security-based swaps.[89]

b. Financial end user.

In order to provide certainty and clarity to counterparties as to whether they would be financial end users for purposes of this final rule, the financial end user definition provides a list of entities that would be financial end users as well as a list of entities excluded from the definition. In the final rule, as under the proposed rule, the Agencies are relying, to the greatest extent possible, on the counterparty's legal status as a regulated financial entity.

---

[87] 7 U.S.C. §6s(e)(1)(A). The Commodity Exchange Act imposes registration requirements on a "person" that acts as a swap dealer or security-based swap dealer, defining "person" to "import[ing] the plural or singular, and includ[ing] individuals, associations, partnerships, corporations, and trusts." 7 U.S.C. §§ 1a(38), 6s(a).

[88] 15 U.S.C. § 78o-10(e)(1)(A). The Securities Exchange Act imposes registration requirements on a "person" that acts as a security-based swap dealer or major security-based swap participant, defining "person" to mean "a natural person, company, government, or political subdivision, agency, or instrumentality or a government." 15 U.S.C. §§ 78c(a)(9), 78o-10(a).

[89] An entity that is supervised by one of the Agencies that fails to register with the applicable Commission as a dealer or major participant in non-cleared swaps or security-based swaps would be subject to enforcement action by the applicable Commission as well as by the Agency that is its prudential regulator.

Under the final rule, financial end user includes a counterparty that is not a swap entity but is:

- A bank holding company or an affiliate thereof; a savings and loan holding company; a U.S. intermediate holding company established or designated for purposes of compliance with 12 CFR 252.153; a nonbank financial institution supervised by the Board of Governors of the Federal Reserve System under Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5323);

- A depository institution; a foreign bank; a Federal credit union, a State credit union as defined in section 2 of the Federal Credit Union Act (12 U.S.C. 1752(1) & (6)); an institution that functions solely in a trust or fiduciary capacity as described in section 2(c)(2)(D) of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)(D)); an industrial loan company, an industrial bank, or other similar institution described in section 2(c)(2)(H) of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)(H));

- An entity that is state-licensed or registered as a credit or lending entity, including a finance company; money lender; installment lender; consumer lender or lending company; mortgage lender, broker, or bank; motor vehicle title pledge lender; payday or deferred deposit lender; premium finance company; commercial finance or lending company; or commercial mortgage company; but excluding entities registered or licensed solely on account of financing the entity's direct sales of goods or services to customers;

- A money services business, including a check casher; money transmitter; currency dealer or exchange; or money order or traveler's check issuer;

- A regulated entity as defined in section 1303(20) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4502(20)) and any entity for which the Federal Housing Finance Agency or its successor is the primary federal regulator;

- Any institution chartered in accordance with the Farm Credit Act of 1971, as amended, 12 U.S.C. § 2001 et seq. that is regulated by the Farm Credit Administration;[90]

- A securities holding company; a broker or dealer; an investment adviser as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)); an investment company registered with the U.S. Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.); or a company that has

[90] As discussed elsewhere in this preamble, FCS institutions are financial end users, although TRIPRA exempts almost all of the non-cleared swaps of all FCS institutions, except Farmer Mac, from the initial and variation requirements of this final rule.

elected to be regulated as a business development company pursuant to section 54(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-53);

- A private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80-b-2(a)); an entity that would be an investment company under section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3) but for section 3(c)(5)(C); or an entity that is deemed not to be an investment company under section 3 of the Investment Company Act of 1940 pursuant to Investment Company Act Rule 3a-7 of the Securities and Exchange Commission (17 CFR 270.3a-7);

- A commodity pool, a commodity pool operator, or a commodity trading advisor as defined in, respectively, sections 1a(10), 1a(11), and 1a(12) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(10), 7 U.S.C. 1a(11), 7 U.S.C 1a(12)); a floor broker, a floor trader, or introducing broker as defined, respectively, in 1a(22), 1a(23) and 1a(31) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(22), 1a(23), and 1a(31)); or a futures commission merchant as defined in 1a(28) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(28));

- An employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002);

- An entity that is organized as an insurance company, primarily engaged in writing insurance or reinsuring risks underwritten by insurance companies, or is subject to supervision as such by a State insurance regulator or foreign insurance regulator;

- An entity, person or arrangement that is, or holds itself out as being, an entity, person or arrangement that raises money from investors, accepts money from clients, or uses its own money primarily for the purpose of investing or trading or facilitating the investing or trading in loans, securities, swaps, funds or other assets for resale or other disposition or otherwise trading in loans, securities, swaps, funds or other assets; or

- An entity that is or would be a financial end user or swap entity, if it were organized under the laws of the United States or any State.

In developing this definition of financial end user, the Agencies sought to provide certainty and clarity to covered swap entities and their counterparties regarding whether particular counterparties would qualify as financial end users and be subject to the margin requirements of the final rule. The Agencies tried to strike a balance between the desire to capture all financial counterparties, without being overly broad and capturing commercial firms and sovereigns. This approach is consistent with the risk-based approach of the final rule, as financial firms present a higher level of risk than other types of counterparties because the profitability and viability of financial firms is more tightly linked to the health of the financial system than is the case for other types of counterparties.[91] Because financial counterparties are more likely to default during a period of financial stress, they pose greater systemic risk and risk to the safety and soundness of the covered swap entity.

In developing the list of financial entities, the Agencies sought to include entities that engage in financial activities that give rise to Federal or State registration or chartering requirements, such as deposit taking and lending, securities and swaps dealing, or investment advisory activities. The list also includes asset management and securitization entities. For example, certain investment funds as well as securitization vehicles are covered, to the extent those entities would qualify as private funds defined in section 202(a) of the Investment Advisers Act of 1940, as amended (the "Advisers Act"). In addition, certain real estate investment companies would be included as financial end users as entities that would be investment companies under section 3 of the Investment Company Act of 1940, as amended (the "Investment Company Act"), but for section 3(c)(5)(C), and certain other securitization vehicles would be included as entities deemed not to be investment companies pursuant to Rule 3a-7 of the Investment Company Act.

Because Federal law largely looks to the States for the regulation of the business of insurance, the definition of financial end user in the final rule broadly includes entities organized as insurance companies or supervised as such by a State insurance regulator. This element of the final rule's definition would extend to reinsurance and monoline insurance firms, as well as insurance firms supervised by a foreign insurance regulator.

[91] As noted above, TRIPRA also exempts certain swaps of nonfinancial end users and certain other counterparties from the requirements of this rule.

The Agencies intend to cover, as financial end users, the broad variety and number of nonbank lending and retail payment firms that operate in the market. To this end, the Agencies have included State-licensed or registered credit or lending entities and money services businesses under the final rule's provision incorporating an inclusive list of the types of firms subject to State law. However, the Agencies recognize that the licensing of nonbank lenders in some states extends to commercial firms that provide credit to the firm's customers in the ordinary course of business. Accordingly, the Agencies are excluding an entity registered or licensed solely on account of financing the entity's direct sales of goods or services to customers.

Under the final rule, those cooperatives that are financial institutions,[92] such as credit unions, FCS banks and associations,[93] and other financial cooperatives[94] are financial end users because their sole business is lending and providing other financial services to their members, including engaging in swaps in connection with such loans.[95] The treatment of non-cleared

[92] The Agencies expect that state-chartered financial cooperatives that provide financial services to their members, such as lending to their members and entering into swaps in connection with those loans, would be treated as financial end users, pursuant to this aspect of the final rule's coverage of credit or lending entities. However, these cooperatives could elect an exemption from clearing under a CFTC regulation, 17 CFR § 50.51, and as a result, their non-cleared swaps would also be exempt from the margin requirements of the final rule pursuant to § __.1(d).

[93] Section IID of the preamble to §__.1 more fully discusses the status of FCS institutions as financial end users and their exemptions from clearing and the margin requirements.

[94] The National Rural Utility Cooperative Finance Cooperation ("CFC") is an example of another financial cooperative. The CFC's comment letter requested that the Agencies exempt swaps entered into by nonprofit cooperatives from the margin requirement to the extent they that are already exempt from clearing requirements. Section __.1(d) responds to the CFC's concerns.

[95] Most cooperatives are producer, consumer, or supply cooperatives and, therefore, they are not financial end users. However, many of these cooperatives have financing subsidiaries and affiliates. These financing subsidiaries and affiliates would not be financial end users under this final rule if they qualify for an exemption under sections 2(h)(7)(C)(iii)

swaps of these financial cooperatives may differ under the final rule due to TRIPRA, which became law after the proposal was issued. More specifically, almost all swaps of the cooperatives that are financial end users qualify for an exemption from clearing if certain conditions are met,[96] and therefore, these non-cleared swaps also would qualify for an exemption from the initial and variation margin requirements under § __.1(d) of the final rule. Non-cleared swaps of such financial cooperatives that do not qualify for an exemption would be treated as non-cleared swaps of financial end users under the final rule.

In order to address concerns, now or in the future, that one or more types of financial entities might escape classification under the specific Federal or State regulatory regimes included in the definition of a "financial end user," the Agencies have inserted language that would cover an entity, person, or arrangement that is, or holds itself out as an entity, person or arrangement that raises money from investors, accepts money from clients, or uses its own money primarily for the purpose of investing or trading or facilitating the investing or trading in loans, securities, swaps, funds or other assets for resale or other disposition, or otherwise trading in loans, securities, swaps, funds or other assets.

---

or 2(h)(7)(D) of the Commodity Exchange Act or section 3C(g)(4) of the Securities Exchange Act. Moreover, certain swaps of these entities may be exempt pursuant to TRIPRA and §__.1(d) .

[96] Section 2(h)(7)(C)(ii) of the Commodity Exchange Act and section 3C(g)(4) of the Securities Exchange Act authorize the CFTC and the SEC, respectively, to exempt small depository institutions, small FCS institutions, and small credit unions with total assets of $10 billion or less from the mandatory clearing requirements for swaps and security-based swaps. *See* 7 U.S.C. 2(h)(7) and 15 U.S.C. 78c-3(g). Additionally, the CFTC, pursuant to its authority under section 4(c)(1) of the Commodity Exchange Act, enacted 17 CFR part 50, subpart C, section 50.51, which allows cooperative financial entities, including those with total assets in excess of $10 billion, to elect an exemption from mandatory clearing of swaps that: (1) they enter into in connection with originating loans for their members; or (2) hedge or mitigate commercial risk related to loans or swaps with their members.

The final rule's definition of "financial end user" is largely similar to the proposed definition, with a few modifications. In the final rule, the Agencies added as a financial end user a U.S. intermediate holding company ("IHC") established or designated for purposes of compliance with the Board's Regulation YY (12 CFR 252.153). Pursuant to Regulation YY, a foreign banking organization with U.S. non-branch assets of $50 billion or more must establish a U.S. IHC and transfer its ownership interest in the majority of its U.S. subsidiaries to the IHC by July 1, 2016. As not all IHCs will be bank holding companies, the Agencies are explicitly identifying IHCs in the list of financial end users to clarify that they are included. To the extent an IHC that is not itself registered as a swap entity enters into non-cleared swaps with a covered swap entity, the IHC would be treated as a financial end user like other types of holding companies that are not swap entities (e.g., bank holding companies and saving and loan holding companies).

In order to address concerns raised by commenters, the final rule removes the provision in the definition of "financial end user" that included any other entity that the relevant Agency has determined should be treated as a financial end user. A few commenters urged the Agencies to remove this provision due to concerns that it created uncertainty. In response to this concern, the Agencies have removed this provision from the final rule's definition of "financial end user." The Agencies will monitor the margin arrangements of swap transactions of covered swap entities to determine if certain types of counterparties, in fact, are financial entities that some reason are not covered by the definition of "financial end user" in the final rule. In the event that the Agencies find that one or more types of financial entities escape classification as financial end users under the final rule, the Agencies may consider another rulemaking that would amend the definition of "financial end user" to cover such entities.

Many of the provisions in the financial end user definitions rely on whether an entity's financial activities trigger Federal or State registration or chartering requirements. The Agencies proposed to include foreign financial entities that are not subject to U.S. law but are engaged in the same types of activities as U.S. financial end users. The proposed definition of "financial end user" included any entity that would be a financial end user if it were organized under the laws of the United States or any State. A few commenters argued that the proposed test is difficult to apply because it would require a covered swap entity to analyze a foreign counterparty's business activities in light of a broad array of U.S. regulatory requirements.

The Agencies have not modified this provision of the final rule in response to these concerns raised by commenters. Although the Agencies acknowledge that the proposed test imposes a greater incremental burden in classifying foreign counterparties than it does in identifying U.S. financial end users, the Agencies have retained it in the final rule. On balance, the Agencies believe the approach in the final rule is the best alternative to capture the kinds of entities whose profitability and viability is most tightly linked to the health of the financial system. In this respect, the Agencies' financial end user definition is broad by design. Exclusion from the financial end user definition for any enterprise engaged extensively in financial and market activities should, as a practical matter, be the exception rather than the rule. The Agencies believe it is appropriate to require a covered swap entity that seeks to exclude a foreign financial enterprise from the rule's margin requirements to ascertain the basis for that exclusion under the same laws that apply to U.S. entities. The Agencies have included in the final rule not only an entity that is or would be a financial end user but also an entity that is or would be a swap entity, if it were organized under the laws of the United States or any State. Since a financial end user is defined as "a counterparty that is not a swap entity," the purpose of this addition is to make clear that an entity that is not a registered swap entity in the United States but acts as a swap entity in a foreign jurisdiction would be treated as a financial end user under the final rule.

As explained above, in an attempt to provide a level of certainty to financial participants and to clarify the definition of a financial end user, the Agencies proposed an enumerated list which included several CFTC-registered entities. In the final rule, the Agencies have added three other CFTC-registered entities to the enumerated list, floor brokers, floor traders, and introducing brokers.

As defined in section 1a(22) of the Commodity Exchange Act, a floor broker generally provides brokering services on an exchange to clients in purchasing or selling any future, security future, swap, or commodity option. As defined in section 1a(23) of the Commodity Exchange Act, a floor trader generally purchases or sells on an exchange solely for that person's account, any future, security future, swap, or commodity option. As defined in section 1a(31) of the Commodity Exchange Act, an introducing broker generally means any person who engages in soliciting or in accepting orders for the purchase and sale of any future, security future, commodity option, or swap. In addition, it also includes anyone that is registered with the CFTC as an introducing broker.

In deciding to add these entities to the definition of financial end-user, the Agencies determined that these entities' services and activities are financial in nature and that these entities provide services, engage in activities, or have sources of income that are similar to financial entities already included in the definition. The Agencies believe that by including these financial entities in the definition of financial end user, the definition provides additional clarity to covered swap entities when engaging in non-cleared swaps with these entities. As noted above, financial entities are considered to pose greater systemic risk than nonfinancial entities and as such, the Agencies believe that these entities, whose activities, services, and sources of income are financial in nature, should be included in the definition of financial end user.

In the proposal, the Agencies included in the definition of a financial end user “an entity that is, or holds itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in loans, securities, swaps, funds or other assets for resale or other disposition or otherwise trading in loans, securities, swaps, funds or other assets.” In addition to asking whether the definition was too broad or narrow, as noted above, the Agencies asked questions as to whether this prong of the definition was broad enough to capture other types of pooled investment vehicles that should be treated as financial end users.

After reviewing all comments, the Agencies are broadening this prong of the definition to include other types of entities and persons that primarily engage in trading, investing, or in facilitating the trading or investing in loans, securities, swaps, funds or other assets. In broadening the definition, the Agencies believe that the enumerated list in the proposal of financial end users was not inclusive enough to cover certain financial entities that were not organized as pooled investment vehicles but that traded or invested their own or client funds (e.g., high frequency trading firms) or that provided other financial services to their clients.

As noted above, the Agencies believe that financial firms present a higher level of risk than other types of counterparties because the profitability and viability of financial firms is more tightly linked to the health of the financial system than other types of counterparties. Accordingly, the Agencies have adopted a definition of financial end user that includes the types of firms that engage in the activities described above.

The final rule, like the proposal, excludes certain types of counterparties from the definition of financial end user. In particular, the final rule states that the term “financial end user” does not generally include any counterparty that is:

- A sovereign entity; [97]
- A multilateral development bank;[98]
- The Bank for International Settlements;
- A captive finance company that qualifies for the exemption from clearing under section 2(h)(7)(C)(iii) of the Commodity Exchange Act of 1936 and implementing regulations; or
- A person that qualifies for the affiliate exemption from clearing pursuant to section 2(h)(7)(D) of the Commodity Exchange Act of 1936 or section 3C(g)(4) of the Securities Exchange Act of 1934 and implementing regulations.

The Agencies believe that this approach is appropriate as these entities generally pose less systemic risk to the financial system in addition to posing less counterparty risk to a covered swap entity. Thus, the Agencies believe that the application of margin requirements to swaps with these counterparties is not necessary to achieve the safety and soundness objectives of this

---

[97] Sovereign entity is defined to mean a central government (including the U.S. government) or an agency, department, or central bank of a central government. *See* § __.2 of the final rule. A sovereign entity would include the European Central Bank for purposes of this exclusion. At least one commenter expressed support for the exclusion of sovereign entity from the financial end user definition.

[98] Multilateral development bank is defined to mean the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and 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 relevant Agency determines poses comparable credit risk. *See* § __.2 of the final rule.

rule.[99] Rather, the Agencies have included provisions in the final rule that would require covered swap entities to subject these "other counterparties" to margin requirements to the extent that their own internal risk management procedures would require that these counterparty relationships be margined.

A few commenters argued that the exclusion from financial end user for a person that qualifies for the affiliate exemption from clearing pursuant to section 2(h)(7)(D) of the Commodity Exchange Act requires an entity to be acting *as agent* for an affiliate and thus would not capture equivalent entities that act *as principal* for an affiliate. These commenters contended that many such entities act as principal for an affiliate and that the CFTC has issued no-action letters, effectively exempting such entities from clearing.[100] As noted above, the Agencies intend to align the exclusions from the definition of financial end user as much as possible with statutory exceptions as well as exclusions implemented by the CFTC by rule. The Agencies note that to the extent the CFTC acts to exempt such entities from clearing by rule, these entities would also be excluded from the definition of financial end user for purposes of this rule.

A few commenters requested that the Agencies exclude from the definition of financial end user those entities guaranteed by a foreign sovereign or multilateral development bank.[101]

[99] As further discussed below, the final rule specifically excludes these entities from the definition of "financial end users." Instead, they are treated as "other counterparties" with respect to the rule's initial and variation margin requirements to the extent the swaps they enter into with covered swap entities are not otherwise exempt from the requirements of this rule. With respect to the initial margin requirements, the "other counterparties" category also includes financial end users that do not have a material swaps exposure.

[100] *See* CFTC No-Action Letter No. 13-22 (June 4, 2013); CFTC No-Action Letter No. 14-144 (November 26, 2014).

[101] Some commenters requested additional clarity that certain entities would be included as multilateral development banks. The definition in the final rule includes 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 relevant Agency

As described above, the final rule excludes from the definition of financial end user a "sovereign entity" defined to mean a central government (including the U.S. government) or an agency, department, or central bank of a central government. An entity guaranteed by a sovereign entity is not explicitly excluded from the definition of financial end user in the final rule, unless that entity qualifies as a central government agency, department, or central bank. The existence of a government guarantee does not in and of itself exclude the entity from the definition of financial end user.

Similarly, the Agencies note that States would not be excluded from the definition of financial end user in the final rule, as the term "sovereign entity" includes only central governments. This does not mean, however, that States are categorically classified as financial end users. Whether a State or particular part of a State (e.g., counties, municipalities, special administrative districts, agencies, instrumentalities, or corporations) would be a financial end user depends on whether that part of the State is otherwise captured by the definition of financial end user. For example, a State entity that is a "governmental plan" under the Employment Retirement Income Security Act of 1974 ("ERISA"), as amended, (29 U.S.C. 1002), would meet the definition of financial end user. Commenters requested that the Agencies exclude a number of other financial entities from the requirements of the final rule including certain small depository institutions that qualify for an exception from clearing, certain financial cooperatives, employee benefit plans (such as pension plans), and covered bond issuers. Depository institutions, financial cooperatives, employee benefit plans, structured finance vehicles, and covered bond issuers are financial end users for purposes of the final rule. However, as

determines poses comparable credit risk. Entities that meet this part of the definition would be treated as multilateral development banks for purposes of the final rule.

discussed earlier, § __.1(d) of the final rule addresses some of the commenters' concerns by exempting the non-cleared swaps of certain small depository institutions and financial cooperatives from the margin requirements of the final rule because these entities already qualify for exemption from clearing. The non-cleared swaps of small depository institutions and financial cooperatives that do not qualify for the exemptive treatment would be treated as swaps of financial end users under the final rule.

With respect to employee benefit plans, commenters generally argued that these plans should not be subject to margin requirements because they are highly regulated, highly creditworthy, have low leveraged and are prudently managed counterparties whose swaps are used primarily for hedging and, as such, pose little risk to their counterparties or the broader financial system. One commenter urged the Agencies to exclude both U.S. and non-U.S. public and private employee benefit plans where swaps are hedging risk. This commenter also contended that there may be ambiguity whether certain pension plans are financial end users if they are not subject to ERISA. Another commenter argued that current market practice is not to require initial margin for pension plans. The Agencies have considered these comments in light of the purpose and intent of the statute and continue to believe that pension plans should be covered as financial end users under the final rule. Congress explicitly listed an employee benefit plan as defined in paragraph (3) and (32) of section 3 of the ERISA in the definition of "financial entity" in the Dodd-Frank Act, meaning that a pension plan would not benefit from an exclusion from clearing even if the pension plan uses swaps to hedge or mitigate commercial risk. The Agencies believe that, similarly, when a pension plan enters into a non-cleared swap with a covered swap entity, the pension plan should be treated as a financial end user and subject to the requirements of the final rule.

The definition of employee benefit plan in the final rule is the same as in the proposal and is defined by reference to paragraphs (3) and (32) of the ERISA. Paragraph (3) provides that the term "employee benefit plan" or "plan" means an employee welfare benefit plan or an employee pension benefit plan or a plan which is both an employee welfare benefit plan and an employee pension benefit plan. Paragraph (32) describes certain governmental plans. In response to concerns raised by commenters, the Agencies believe that these broad definitions would cover all pension plans regardless of whether the pension plan is subject to the ERISA. In addition, non-U.S. employee benefit plans would be included as an entity that would be a financial end user, if it were organized under the laws of the United States or any State thereof.

A number of commenters also requested that the Agencies exclude from financial end user structured finance vehicles including securitization special purpose vehicles ("SPVs") and covered bond issuers. These commenters argued that imposing margin requirements on structured finance vehicles would restrict their ability to hedge interest rate and currency risk and potentially force these vehicles to exit swaps markets since these vehicles generally do not have ready access to liquid collateral. Certain of these commenters also expressed concerns about consistency with the treatment under the EU proposal. One commenter stated that the EU proposal has special criteria for covered bond issuers and that covered bond issuers should be able to use collateral arrangements other than the requirements in the Agencies' proposal. Moreover, commenters argued that covered swap entities that enter into a swap may be protected by other means – e.g., a security interest granted in the assets of a securitization SPV. Commenters also urged that these types of entities make payments on a monthly payment cycle using collections received on the underlying assets during the previous month and would not be able to make daily margin calls. These commenters argued that significant structural changes would be necessary for securitization SPVs to post and collect variation margin. These commenters urged the Agencies to follow the approach of the proposed European rules, under which securitization vehicles would be defined as non-financial entities and would not be required to exchange initial or variation margin. With respect to covered bond issuers, commenters similarly urged the Agencies to follow the EU margin proposal which provided a special set of criteria for covered bond issuers and requested that the Agencies develop rules that would permit covered bond issuers to use other forms of collateral arrangements.

The Agencies have not modified the definition of financial end user to exclude structured finance vehicles or covered bonds issuers. The Agencies believe that all of these entities should be classified as financial end users; their financial and market activities comprise the same range of activities as the other entities encompassed by the final rule's definition of financial end user. The Agencies note that the increased material swaps exposure in the final rule should address some of the concerns raised by these commenters with respect to the applicability of initial margin requirements.

c. Material swaps exposure.

The final rule, like the proposal, distinguishes between swaps with financial end user counterparties depending on whether the counterparty has a "material swaps exposure." In the final rule, "material swaps exposure" for an entity means that an entity and its affiliates have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps with all counterparties for June, July, and August of the previous calendar year that exceeds $8 billion, where such amount is calculated only for business days.[102] The final rule's definition also provides that an entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time and that, for purposes of this calculation, an entity shall not count a swap or security-based swap that is exempt pursuant to § __.1(d).

The final rule increases the level of the aggregate notional amount of transactions that gives rise to material swaps exposure to $8 billion from the proposed level of $3 billion. A number of commenters argued that the Agencies should raise the level of material swaps exposure to the threshold of €8 billion set out in the 2013 international framework to be consistent with the EU and Japanese proposals.[103] In the 2014 proposal, the Agencies had calibrated the proposed $3 billion threshold to the size of a potential swap portfolio between a covered swap entity and a financial end user for which the initial margin amount would often exceed the proposed initial margin threshold amount of $65 million, with an eye towards reducing the burden of calculating initial margin amounts for smaller portfolios. However, some commenters expressed the view that the international implementation of material swaps exposure threshold treats the threshold more as a scope provision, to define the group of financial firms in the swaps market whose activities rise to a level appropriate to the exchange of initial margin as a policy matter.[104] While commenters representing public interest groups and CCPs expressed

[102] The final rule also includes a new definition of "business day" that means any day other than a Saturday, Sunday, or legal holiday. This definition is described further below.

[103] *See supra* note 20.

[104] For example, one commenter acknowledged data described by the Agencies in the proposed rule indicating that bilateral initial margin exposures between one covered swap entity and a financial end user could exceed $50 million for a portfolio with a gross notional value well below the USD-equivalent of the international €8 billion threshold. But the

policy concerns about whether the $3 billion threshold was conservative enough, focusing on the collective systemic risk posed by all smaller counterparties in the aggregate, other commenters representing covered swap entities and financial end users expressed concerns about the additional initial margin they would be required to exchange compared to foreign firms, and the associated competitive impacts.

The material swaps exposure threshold of $8 billion in the final rule is broadly consistent with the €8 billion established by the 2013 international framework and has been calibrated relative to this level in the manner described previously. At this time, the Agencies believe the better course is to calibrate the final rule's material swaps exposure threshold to the higher international amount, in recognition of each financial end user's overall potential future swaps exposure to the market rather than its potential future exposure to one dealer. In this regard, the Agencies note that variation margin will still be exchanged without any threshold, and further that the $8 billion threshold may warrant further discussion among international regulators in future years, if implementation of the threshold proves to create concerns about market coverage for initial margin.

The time period for measuring material swaps exposure is June, July, and August of the previous calendar year under the final rule, the same period as in the proposal.[105] As discussed

---

commenter urged the Agencies to shift their focus from the $65 million amount, as a bilateral constraint, and recognize that a financial end user will often use multiple dealers. Accordingly, the commenter urged the Agencies to treat the material swaps exposure threshold as a focus on a financial end user's multilateral exposures with all its dealers, which provides the rationale for the higher international threshold.

[105] One commenter suggested that the period to determine material swaps exposure should match the compliance date period. The Agencies have decided to use June, July and August of the previous year to determine material swaps exposure as these dates are close to

in the proposed rule, the Agencies believe that using the average daily aggregate notional amount[106] during June, July, and August of the previous year, instead of a single as-of date, is appropriate to gather a more comprehensive assessment of the financial end user's participation in the swaps market, and to address the possibility that a market participant might "window dress" its exposure on an as-of date such as year-end in order to avoid the Agencies' margin requirements. A covered swap entity would calculate material swaps exposure each year on January 1 based on June, July, and August of the previous year. For example, for the period January 1, 2017 through December 31, 2017, an entity would determine whether it had a material swaps exposure with reference to June, July and August of 2016.[107]

The definition of "material swaps exposure" also clarifies questions raised about the treatment of affiliates in the proposed definition. Commenters urged the Agencies to make clear that inter-affiliate swaps would not be included for purposes of determining the material swaps

---

year end but provide swap users with a period of time to gather and verify the required data before performing the required calculation at the end of the year.

[106] A few commenters suggested that a daily aggregate notional measure was burdensome and that the Agencies should use a month-end notional amount like the EU proposal and consistent with the 2013 international framework.

[107] As a specific example of the calculation for material swaps exposure, consider a U.S.-based financial end user (together with its affiliates) with a portfolio consisting of two non-cleared swaps (e.g., an equity swap, an interest rate swap) and one non-cleared security-based credit swap. Suppose that the notional value of each swap is exactly $10 billion on each business day of June, July and August of 2016. Furthermore, suppose that a foreign exchange forward is added to the entity's portfolio at the end of the day on July 31, 2016, and that its notional value is $10 billion on every business day of August 2016. On each business day of June and July 2016, the aggregate notional amount of non-cleared swaps, security-based swaps and foreign exchange forwards and swaps is $30 billion. Beginning on August 1, 2016, the aggregate notional amount of non-cleared swaps, security-based swaps and foreign exchange forwards and swaps is $40 billion. The daily average aggregate notional value for June, July and August 2016 is then (22x$30 billion +20x$30 billion + 23x$40 billion)/(22+20+23)=$33.5 billion, in which case this entity would be considered to have a material swaps exposure for every date in 2017.

exposure. Some of these commenters also expressed concern that the proposal could require an entity to double count inter-affiliate swaps in assessing material swaps exposure. In order to address concerns about double counting affiliate swaps, the final rule provides that an entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time. The purpose of this modification is to clarify that an entity should not double count swaps with an affiliate in calculating material swaps exposure.[108] The Agencies also believe that the revised definition of affiliate in the final rule (described below) should help mitigate some of the concerns raised by commenters about the inclusion of affiliate swaps in determining material swaps exposure.[109]

The final rule's definition of material swaps exposure also states that for purposes of this calculation, an entity shall not count a swap that is exempt pursuant to § __.1(d).[110] This change is consistent with the statutory exemptions provided by Congress in TRIPRA and ensures that exempt swaps do not count toward determining whether an entity has material swaps exposure.

Commenters argued that certain other swaps should not be counted for purposes of the material swaps exposure calculation. A few commenters argued that foreign exchange swaps and foreign exchange forwards that are exempt from the definition of swap by Treasury

[108] The Agencies made a similar change to the definition of "initial margin threshold amount" as described in § __.3.

[109] For example, the revised definition of "affiliate" generally would not treat investment funds that share an investment adviser or investment manager as affiliates unless they otherwise meet the definition of affiliate.

[110] The Agencies made a similar change to the definition of "initial margin threshold amount" as described in § __.3.

determination should not be included for purposes of determining material swaps exposure.[111] Other commenters argued that hedging positions should not be counted toward material swaps exposure. One commenter urged that swaps entered into before the effective dates for mandatory clearing should not be counted for determining material swaps exposure. The Agencies are not incorporating requests by commenters to alter the calculation of the threshold amount in these or other related ways.[112] Although commenters advanced various rationales for each of the requested changes, all the changes had the effect of excluding certain portions of a financial end user's derivatives portfolio from the threshold. The Agencies believe the final rule's approach is appropriate since it strikes a reasonable balance between assessing a swap counterparty's overall size and risk exposure and providing for a simple and transparent measurement of exposure that presents only a modest operational burden. The Agencies believe that the increase in the level of the material swaps exposure to $8 billion in the final rule should address many of the concerns raised by commenters about the inclusion of particular categories of swaps. Moreover, given that the Agencies are viewing the final rule's material swaps

---

[111] Some of these commenters expressed heightened concern about the impact of the Agencies' approach on financial end users that engage in significant foreign exchange transactions that are not subject to margin requirements together with relatively few marginable swaps. The final rule defines "foreign exchange forward and foreign exchange swap" to mean any foreign exchange forward, as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)), and foreign exchange swap, as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25)). *See* §__.2 of the final rule.

[112] For example, one commenter urged the Agencies to conform with the 2013 international framework where material swaps exposure is based on derivatives (not swaps). Another commenter urged the Agencies to exclude registered swap dealers from the material swaps exposure calculation as this could cause affiliates of the swap dealer to exceed the material swaps exposure threshold. The final rule does not exclude registered swap dealers from the material swaps exposure threshold. The Agencies believe that financial affiliates of a registered swap dealer should be treated as having a material swaps exposure based on their level of risk.

exposure as an indicator of a financial end user's overall exposure in the market and revising the threshold upward to $8 billion, the Agencies believe the inclusiveness of the calculation adopted in the final rule is appropriate. A few commenters urged the Agencies to make clear that a covered swap entity may rely on representations of its counterparties in assessing whether it is transacting with a financial end user with material swaps exposure. Although the final rule does not explicitly provide how a covered swap entity should determine if a financial end user counterparty has material swaps exposure, the Agencies believe that it would be reasonable for a covered swap entity to rely in good faith on reasonable representations of its counterparty in making such assessments.

One commenter urged the Agencies to clarify what happens when a financial end user counterparty that had a material swaps exposure falls below the threshold. Because the material swaps exposure determination applies to a financial end user for an entire calendar year, depending on whether the financial end user exceeded the threshold during the third calendar quarter of the previous year, it is possible for a covered swap entity to have a portfolio of swaps with a financial end user whose status under the material swaps exposure test changes from time to time. New §___.1(g) of the final rule addresses this concern and explains what happens upon a change in counterparty status. For example, if a financial end user is moving below the threshold for the upcoming calendar year, the covered swap entity is not obligated under the final rule to exchange initial margin with that end user during that calendar year, either for new swaps entered into that year or existing swaps from a prior year. Financial end users without material swaps exposure are treated as "other counterparties" for purposes of the initial margin requirements in the final rule. Moreover, any margin that had previously collected while the counterparty had a material swaps exposure would not be required under the final rule for as long as the counterparty did not have a material swaps exposure. In addition, a covered swap entity's swaps with a financial end user without material swaps exposure would continue to be subject to the variation margin requirements of the final rule. If a financial end user is moving above the threshold for the upcoming calendar year, the treatment of the existing swaps and the new swaps is the same as described for swaps before and after the rule's compliance implementation date. As described in more detail below under §___.5, the parties have the option to document the old and new swaps as separate portfolios for netting purposes under an EMNA, and exchange initial margin only for the new portfolio of swaps entered into during the new calendar year after the financial end user triggered the material swaps exposure threshold determination.

d. Non-cleared swap and non-cleared security-based swap.

The requirements of this rule are, as a threshold matter, applicable to non-cleared swaps between covered swap entities and their counterparties. The final rule defines "non-cleared swap" to mean a swap that is not cleared by a derivatives clearing organization registered with the Commodity Futures Trading Commission pursuant to section 5b(a) of the Commodity Exchange Act of 1936 (7 U.S.C. 7a-1(a)) or by a clearing organization that the Commodity Futures Trading Commission has exempted from registration by rule or order pursuant to section 5b(h) of the Commodity Exchange Act of 1936 (7 U.S.C. 7a-1(h)). The final rule defines "non-cleared security-based swap" to mean a security-based swap that is not, directly or indirectly, submitted to and cleared by a clearing agency registered with the U.S. Securities and Exchange Commission pursuant to section 17A(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1(b)(1)) or by a clearing agency that the U.S. Securities and Exchange Commission has exempted from registration by rule or order pursuant to section 17A(k) of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1(k)).

In the proposal, the Agencies defined a "non-cleared swap" as a swap that is not a cleared swap as defined in section 1a(7) of the Commodity Exchange Act. Under section 1a(7) of the Commodity Exchange Act, the term "cleared swap" means any swap that is, directly or indirectly, submitted to and cleared by a derivatives clearing organization registered with the CFTC. "Non-cleared security-based swap" was defined in the proposal to mean a security-based swap that is not, directly or indirectly, submitted to and cleared by a clearing agency registered with the SEC.[113]

A few commenters urged the Agencies to define non-cleared swaps and non-cleared security-based swaps to exclude swaps cleared through non-U.S. clearing organizations that are not registered with the CFTC or SEC. The Agencies have modified the definition of these terms in the final rule to address these comments.

Under sections 731 and 764, the Agencies are directed to impose initial and variation margin requirements on all swaps that are not cleared by a registered derivatives clearing organization and on all security-based swaps that are not cleared by a registered clearing agency. The Agencies are interpreting this statutory language to mean all swaps that are not cleared by a registered derivatives clearing organization or registered clearing agency or a derivatives clearing organization or clearing agency that the CFTC or SEC has exempted from registration as provided under the Commodity Exchange Act and Securities Exchange Act, respectively. In particular, the Commodity Exchange Act prohibits persons from engaging in a swap that is required to be cleared unless they submit such swaps for clearing to a derivatives clearing

[113] Clearing agency is defined to have the meaning specified in section 3(a)(2) of the Securities Exchange Act (15 U.S.C. 78c(a)(23)) and derivatives clearing organization is defined to have the meaning specified in section 1a(15) of the Commodity Exchange Act (7 U.S.C. 1a(15)).

organization that is either registered with the CFTC as a derivatives clearing organization or exempt from registration. Section 5b(h) of the Commodity Exchange Act allows the CFTC to exempt, conditionally or unconditionally, a derivatives clearing organization from registration for the clearing of swaps, where the derivatives clearing organization is subject to "comparable, comprehensive supervision and regulation" by the appropriate government authorities in its home country. The Agencies understand that the CFTC has granted, by order, relief from registration to a derivatives clearing organization pursuant to section 5b(h)[114] and would consider granting relief to other derivatives clearing organizations before the implementation date of these rules. The Securities Exchange Act contains similar language that allows the SEC to exempt a clearing agency from registration. Accordingly, the Agencies are excluding from the definition of non-cleared swap those swaps that are cleared by a derivatives clearing organization that is either registered with or has received an exemption by order or rule from registration from the CFTC. The Agencies are similarly excluding from non-cleared swap those swaps that are cleared by a clearing agency that is either registered with or has received an exemption by order or rule from registration from the SEC.

e. Foreign bank.

In the final rule, the Agencies have revised the definition of "foreign bank" to clarify that the term applies only to an organization that is organized under the laws of a foreign country and that engages directly in the business of banking outside of the United States. The proposed definition, which cross-referenced section 1 of the International Banking Act of 1978 (12 U.S.C. 3101), was broader in scope since it included any subsidiary or affiliate of any such organization.

[114] *See* In the Matter of the Petition of ASX Clear (Futures) Pty Limited For Exemption from Registration as a Derivatives Clearing Organization (August 18, 2015).

f. Other definitions.

The final rule also defines a number of other terms, including several that were not defined in the proposal. The Agencies believe that these definitions will help provide additional clarity regarding the application of the margin requirements contained in the final rule.

i. Affiliate and Subsidiary.

The final rule defines a company to be an "affiliate" of another company[115] if:

- Either company consolidates the other on financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles, the International Financial Reporting Standards, or other similar standards;
- Both companies are consolidated with a third company's on a financial statement prepared in accordance with such principles or standards;
- For a company that is not subject to such principles or standards, if consolidation as described in paragraph (1) or (2) would have occurred if such principles or standards had applied; or
- [Agency] has determined that a company is an affiliate of other company, based on [Agency's] conclusion that either company provides significant support to, or is materially subject to the risks of losses of, the other company.

Similarly, the final rule defines a company to be a "subsidiary" of another company if:

- The company's is consolidated by the other company on financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles, the International Financial Reporting Standards, or other similar standards;
- For a company that is not subject to such principles or standards, if consolidation as described in paragraph (1) would have occurred if such principles or standards had applied; or
- [Agency] has determined that the company is a subsidiary of another company, based on [Agency's] conclusion that either company provides significant support to, or is materially subject to the risks of loss of, the other company.

[115] For additional clarity, the final rule also contains a newly defined term "company" that means a corporation, partnership, limited liability company, business trust, special purpose entity, association, or similar organization.

Section __.11 is a special section of the rule that applies to affiliate swaps. In addition, the term "affiliate" is used in a number of other places in the rule, including the definition of initial margin threshold amount. That definition refers to a credit exposure of $50 million that is applicable to non-cleared swaps between a covered swap entity and its affiliates with a counterparty and its affiliates. The inclusion of affiliates in this definition is meant to make clear that the initial margin threshold amount applies to an entity and its affiliates. Similarly, the term "affiliate" is also used in the definition of "material swaps exposure," because material swaps exposure takes into account the exposures of an entity and its affiliates. The term "affiliate" is also used for determining the compliance date for a covered swap entity and its counterparty in § __.1(e) of the final rule. The term "subsidiary" is used throughout the cross-border provisions in §__.9 to describe certain entities that are eligible for an exclusion from the rules as well as substituted compliance.

The proposed rule defined "affiliate" to mean any company that controls, is controlled by, or is under common control with another company, while "subsidiary" meant a company that is controlled by another company.[116] The proposal provided that "control" of another company means: (i) ownership, control, or power to vote 25 percent or more of a class of voting securities of the company, directly or indirectly or acting through one or more other persons; (ii) ownership or control of 25 percent or more of the total equity of the company, directly or indirectly or

[116] The proposal's definitions of "affiliate" and "subsidiary" was similar to the definitions in the Bank Holding Company Act and the Board's Regulation Y. *See* sections 2(d) & 2(k) of the Bank Holding Company Act, 12 U.S.C. 1841(d) & (k); 12 CFR 225.2(o).

acting through one or more other persons; or (iii) control in any manner of the election of a majority of the directors or trustees of the company.[117]

Commenters raised a number of concerns with the proposal's definitions of "affiliate" and "subsidiary," and most of these concerns centered on both definitions' reliance on the definition of "control." The Agencies have responded to the commenters' concerns by omitting the proposed definition of "control" from the final rule. The term "control" is no longer used in the definitions of "affiliate" and "subsidiary."

While one commenter expressed support for the proposal's definition of control, the vast majority of commenters argued for a modified definition of control that did not use the 25 percent threshold. One suggestion was that these terms should be defined by reference to whether an affiliate or subsidiary is consolidated under accounting standards. A number of these commenters urged the Agencies to use a majority ownership test (51 percent or more) for determining control.

Commenters also expressed particular concerns about the application of these definitions to investment funds, including during the seeding period. A number of commenters urged the Agencies to use the same criteria as the 2013 international framework as the basis for determining whether or not an investment fund is an affiliate of a fund sponsor.[118] Commenters

[117] The proposal's definition of control was similar to the definition under the BHC Act. *See*, section 2(a)(2) of the Bank Holding Company Act, 12 U.S.C. 1841(a)(2).

[118] The 2013 international framework states that investment funds that are managed by an investment adviser are considered distinct entities that are treated separately when applying the threshold as long as the funds are distinct legal entities that are not collateralized by or otherwise guaranteed or supported by other investment funds or the investment adviser in the event of fund insolvency or bankruptcy. One commenter suggested an investment fund separateness test to determine whether an investment fund is a separate legal entity. This commenter also urged the agencies to incorporate the concept of "effective control" as

also argued that seed capital contributed by a fund sponsor should not be viewed as control even if the ownership by the fund sponsor exceeds 25 percent. One commenter, for example, suggested that passive investors should not be deemed to control even where they own more than 51 percent of the ownership interests of a fund.

Commenters also expressed particular concerns about how the definitions applied to pension funds. One commenter argued that the sponsor of a pension should not be an affiliate of the pension fund by virtue of appointing trustees or directors of the pension fund. This commenter urged that pension plans should not be deemed to have any affiliates other than those entities to whom a covered swap entity has recourse for swap transactions with the pension fund. Other commenters argued that pension plans should be exempted from the definition of affiliate, expressing concerns that it could conflict with fiduciary obligations under ERISA.

Using financial accounting as the trigger for affiliation, rather than a legal control test, should address many of the concerns raised by commenters. Although consolidation tests under relevant accounting standards must also be applied on a case-by-case basis, like the proposed rule's "control" test, the analysis has already been performed for companies that prepare their financial statements in accordance with relevant accounting standards. For companies that do not prepare these statements, the Agencies believe industry participants are more familiar with the relevant accounting standards and tests, and they will be less burdensome to apply. Additionally, the accounting consolidation analysis typically results in a positive outcome (consolidation) at a higher level of an affiliation relationship than the 25 percent voting interest standard of the legal control test, which is responsive to commenters' concerns that the proposed

---

developed by the Financial Accounting Standards Board ("FASB") to cover variable interest entities and special purpose entities.

definitions were over-inclusive. Because there are circumstances where an entity holds a majority ownership interest and would not consolidate, the Agencies have reserved the right to include any other entity as an affiliate or subsidiary based on an Agency's conclusion that either company provides significant support to, or is materially subject to the risks or losses of, the other company. This provision is meant to leave discretion to the Agencies in order to prevent evasion – for example, where a swap dealer sets up shell joint ventures that are not consolidated in order to execute swap transactions and avoid the requirements of this rule. .

The Agencies believe that the modifications to the definitions of affiliate and subsidiary will address some of the concerns raised by commenters, including with respect to investment and pension funds. Investment funds generally are not consolidated with the asset manager other than during the seeding period or other periods in which the manager holds an outsized portion of the fund's interests though this may depend on the facts and circumstances. The Agencies believe that during these periods, when an entity may own up to 100 percent of the ownership interest of an investment fund, the investment fund should be treated as an affiliate. This approach to investment funds is similar to that in the 2013 international framework. The Agencies acknowledge that some accounting standards, such as GAAP and IFRS variable interest standards, sometimes require consolidation between a sponsor or manager and a special purpose entity created for asset management, securitization, or similar purposes, under circumstances in which the manager does not hold interests comparable to a majority of equity or voting control share. On balance, the Agencies believe it is appropriate to treat these consolidated entities as affiliates of their sponsors or managers; they are structured with legal separation to address the concerns of passive investors, but the manager retains such levels of influence and exposure as to indicate its status is beyond that of another minority or passive investor. In the case of pension funds that are associated with a nonfinancial end user, the Agencies believe that consolidation of the pension fund with its parent would be the exception to the rule under applicable accounting standards. Even if consolidation is applicable for some pension funds, the swaps of the parent would, as a general matter, be exempt from the rule under TRIPRA, and would not be included in threshold amount calculations.

ii. Cross-currency swap.

The final rule defines a cross-currency swap with only minor modifications from the definition in the proposal, as a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs on the date the swap is entered into, with a reversal of the exchange at a later date that is agreed upon when the swap is entered into.[119] As explained in greater detail below, the final rule, like the proposal, provides that the initial margin requirements for cross-currency swaps do not apply to the portion of the swap that is the fixed exchange of principal. This treatment of cross-currency swaps is consistent with the treatment recommended in the 2013 international framework. This treatment of cross-currency swaps also aligns with the determination by the Secretary of the Treasury to exempt foreign exchange swaps from the definition of swap as explained further below. Non-deliverable forwards would not be treated as cross-currency swaps for purposes of the final rule, and thus would be subject to the margin requirements set forth under the rule. No comments were received on this definition.

iii. Major currencies.

[119] The proposal used the term "inception of the swap" in this definition which the final rule replaces with "the date the swap is entered into" for consistency with other provisions in the final rule.

"Major currency" is defined in the proposed and final rules to mean: (i) United States Dollar (USD); (ii) Canadian Dollar (CAD); (iii) Euro (EUR); (iv) United Kingdom Pound (GBP); (v) Japanese Yen (JPY); (vi) Swiss Franc (CHF); (vii) New Zealand Dollar (NZD); (viii) Australian Dollar (AUD); (ix) Swedish Kronor (SEK); (x) Danish Kroner (DKK); (xi) Norwegian Krone (NOK); or (xii) any other currency as determined by the relevant Agency.[120] No comments were received on this definition. Immediately available cash funds that are denominated in a major currency are eligible collateral for initial margin for non-cleared swaps with all counterparties and variation margin for non-cleared swaps with financial end users, as described further in § __.6.

iv. *Prudential regulator.*

Both the proposed and final rules define prudential regulator to have the meaning specified in section 1a(39) of the Commodity Exchange Act.[121] Section 1a(39) of the Commodity Exchange Act defines the term "prudential regulator" for purposes of the capital and margin requirements applicable to swap dealers, major swap participants, security-based swap dealers and major security-based swap participants. No comments were received on this definition. The entities for which each of the Agencies is the prudential regulator is set out in § __.1 of each Agency's rule text.

v. *Eligible master netting agreement.*

[120] *See* the CFTC's regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries for this list of major currencies, 75 FR 55410 at 55412 (September 10, 2010).

[121] *See* 7 U.S.C. 1a(39).

The final rule defines eligible master netting agreement as any written, legally enforceable netting agreement that creates a single legal obligation for all individual transactions covered by the agreement upon an event of default (including conservatorship, receivership, insolvency, liquidation, or similar proceeding) provided that certain conditions are met. These conditions include requirements with respect to the covered swap entity's right to terminate the contract and liquidate collateral and certain standards with respect to legal review of the agreement to ensure it meets the criteria in the definition. The legal review must be sufficient so that the covered swap entity has a well-founded basis to conclude that, among other things, the contract would be found legal, binding, and enforceable under the law of the relevant jurisdiction and that the contract meets the other requirements of the definition.

Since the proposal was issued, the Board and the OCC have issued an interim final rule ("QMNA IFR") that became effective January 1, 2015, that modifies the definition of qualifying master netting agreement ("QMNA") used in their risk-based capital rules.[122] This final rule contains a revised definition of EMNA that aligns with the QMNA definition in the QMNA IFR. The Agencies are aligning the definitions of QMNA and EMNA in order to minimize operational burden for a covered swap entity, which otherwise would have to make a separate determination as to whether its netting agreements meet the requirements of this rule as well as comply with the regulatory capital rules.[123] However, like the proposal, the final rule uses the term "*eligible*

[122] *See* 12 CFR part 3.2, 12 CFR part 217.2, and 12 CFR part 324.2. Regulatory Capital Rules, Liquidity Coverage Ratio: Interim Final Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 79 FR 78287 (Dec. 30, 2014). The FDIC has proposed to make the same modification to its risk-based capital rule. 80 FR 5063 (January 30, 2015).

[123] *See* § __.12 of the final rule.

master netting agreement" to avoid confusion with and distinguish from the term used under the capital rules.

Like the QMNA definition, the EMNA definition, includes a requirement that the agreement not include a walkaway clause, which is defined as a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement.

The proposed EMNA definition included additional language in the definition of walkaway clause that would expressly preclude an EMNA from including a clause that permits a non-defaulting counterparty to "suspend or condition payment" to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is or otherwise would be, a net creditor under the agreement. In the interest of aligning the EMNA definition with the QMNA definition, this additional language is not being included in the final rule's definition of EMNA.[124]

Several commenters argued that the "suspend or condition payment" language should be removed because it would prohibit an existing provision in the ISDA Master Agreement that permits a non-defaulting party to suspend payment to a defaulting counterparty. Because the Agencies have decided to delete the "suspend or condition payment" language in order to align

---

[124] The Agencies had also proposed to add to the walkaway clause in the proposed EMNA definition, "or otherwise would be," which is not included in the final rule, also in the interest of aligning the EMNA and QMNA definitions. Walkaway clauses, including those that permit a party to suspend or condition payment, are not enforceable against the FDIC when acting as receiver or conservator of an insured depository institution or as receiver of a financial company under Title II of the Dodd-Frank Act, or against the FHFA when acting as a receiver or conservator of Fannie Mae, Freddie Mac, or a Federal Home Loan Bank. *See* 12 U.S.C. § 1821(e)(8)(G); 12 U.S.C. § 5390(c)(8)(F); and 12 U.S.C. § 4617(d)(8)(G).

the EMNA and QMNA definitions, these commenters' concerns regarding the impact of the additional proposed language on current provisions in the ISDA Master Agreement are moot.[125]

Commenters generally expressed support for the recognition of foreign stays in the proposal's definition of EMNA.[126] Like the proposal, the final rule's definition of EMNA contains a stay condition regarding certain insolvency regimes where rights can be stayed. In the final rule, the second clause of this condition has been modified to provide that any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than (i) in receivership, conservatorship, or resolution by an Agency exercising its statutory authority, or substantially similar laws in foreign jurisdictions that provide for limited stays to facilitate the orderly resolution of financial institutions, or (ii) in an agreement subject by its terms to any of the foregoing laws.[127]

A few commenters argued that a limited stay under State insolvency and receivership laws applicable to insurance companies also should be recognized under this provision. The

[125] One commenter urged the Agencies not to "outsource" the EMNA definition to ISDA, noting that the vast majority of existing master netting agreements are governed by the ISDA Master Agreement. The commenter argued that the ISDA Master Agreement contains provisions that may be contrary to the interests of counterparties other than ISDA's large swap entity members, such as mandatory arbitration covenants. So long as an agreement meets the requirements of the EMNA definition, however, the Agencies are not endorsing, requiring, or prohibiting use of a particular master netting agreement in the final rule.

[126] However, at least one commenter expressed concern that allowing for foreign jurisdiction and contractual stays could limit important bankruptcy protections for commercial end users and argued that the rule should recognize and clearly state that market participants' rights to avoid stays and other limitations of their close-out rights should be protected. The Agencies note that the stay is very brief, applicable to all counterparties, and its potential value to systemic stability is quite high; therefore, on balance, the Agencies believe the brief stay is warranted.

[127] *See* § __.2 of the final rule. Minor technical modifications have been made to this provision in the final rule to align with the QMNA IFR.

Agencies are not, at this time, modifying the final rule's definition of EMNA to recognize stays under State insolvency and receivership laws for insurance companies. Such a change would be inconsistent with the QMNA definition in the capital rules.

Finally, a number of commenters expressed various concerns with the provision of the EMNA that requires a covered swap entity to conduct sufficient legal review to conclude with a well-founded basis (and to maintain sufficient written documentation of that legal review) that the agreement meets the requirements with respect to the covered swap entity's right to terminate the contract and liquidate collateral and that in the event of a legal challenge (including one resulting from default or from receivership, insolvency, liquidation, or similar proceeding), the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions.[128] These commenters urged that requiring a legal opinion would be expensive and may not be able to be given without qualification, meaning parties can never be certain that a contract is enforceable. The Agencies did not modify the substance of this provision of the EMNA definition in the final rule.[129] These provisions are based on the QMNA definition, which has long been applied by depository institutions and holding companies pursuant to the banking agencies' capital rules.[130] Neither the capital rules nor this final rule require an unqualified legal opinion; the rules set an outcome-based standard for a review that is sufficient so that an institution may conclude with a well-

[128] One commenter, for example, urged "would" should be changed to "should" as "would" is difficult to satisfy in bankruptcy courts making it difficult to state with certainty.

[129] To maintain consistency with the QNMA IFR, the Agencies revised paragraph (4)(i)(A), which identifies the scope of the legal review, to focus on paragraph (2), which specifies the parties' liquidation rights on a net basis.

[130] The QMNA IFR, which was issued after the swap margin proposed rule, contains a provision that requires an institution to comply with the same requirements and no comments were received on this provision in the QMNA IFR.

founded basis that, among other things, the contract would be found legal, binding, and enforceable under the law of the relevant jurisdiction and that the contract meets the other requirements of the definition.

vi. State.

"State" is defined in both the proposal and final rule to mean any State, commonwealth, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, or the United States Virgin Islands. No comments were received on this definition. The purpose of this definition is to make clear these jurisdictions are within the United States for purposes of § __.9, which addresses the cross-border application of margin requirements.

vii. U.S. Government-sponsored enterprises.

Under the final rule, "U.S. Government-sponsored enterprise" means an entity established or chartered by the U.S. government to serve public purposes specified by Federal statute, but whose debt obligations are not explicitly guaranteed by the full faith and credit of the United States. This definition in the final rule is the same as that in the proposal, and no comments were received on this definition. U.S. Government-sponsored enterprises currently include FCS banks, associations, and service corporations, Farmer Mac, the Federal Home Loan Banks, Fannie Mae, Freddie Mac, the Financing Corporation, and the Resolution Funding Corporation. In the future, Congress may create new U.S Government-sponsored enterprises, or terminate the status of existing U.S. Government-sponsored entities. This term is used in the definition of eligible collateral as described further in § __.6.

viii. Entity definitions.

The Agencies are including a number of other definitions including "bank holding company," "broker," "dealer," "depository institution," "futures commission merchant," "savings and loan holding company," and "securities holding company" that are defined by cross-reference to the relevant statute. Many of these terms are also used in the definition of "financial end user" or "market intermediary," which is defined to mean a securities holding company, a broker, a dealer, a futures commission merchant, a swap dealer, or a security-based swap dealer. No comments were received on these definitions, and the Agencies have adopted them as proposed.

ix. Business day and Day of execution.

The terms "business day" and "day of execution" are newly defined terms in the final rule that were not defined in the proposal. "Business day" is defined to mean any day other than a Saturday, Sunday, or legal holiday. "Day of execution" is defined with reference to the time at which the parties enter into a non-cleared swap. Because the location of the covered swap entity may be in a different time zone than the location of the counterparty, the "day of execution" definition provides special accommodations for the difference. The definition of "day of execution" is discussed in greater detail below under §___.3. These terms, which are used in §§ __.3 and __.4, are meant to provide additional clarity regarding the timing of margin requirements and address related concerns raised by commenters, as described in those sections below.

C. Section __.3: Initial Margin.

After reviewing the comments to the 2014 proposal, the Agencies have decided to adopt §__.3 of the rule largely as proposed, albeit with a limited number of changes to address concerns raised by commenters with respect to the calculation, collection, and posting of initial margin.

Consistent with the 2014 proposal, the final rule requires a covered swap entity to collect initial margin when it engages in a non-cleared swap with another covered swap entity. Because all swap entities will be subject to a prudential regulator, CFTC, or SEC margin rule that requires them to collect initial margin, the proposed rule will result in a collect-and-post system for all non-cleared swaps between swap entities.

When a covered swap entity engages in a non-cleared swap with a financial end user with material swaps exposure,[131] the final rule will require the covered swap entity to collect *and* post initial margin with respect to the non-cleared swap. Under the final rule, a covered swap entity transacting with a financial end user with material swaps exposure must (1) calculate its initial margin collection amount using an approved internal model or the standardized look-up table, (2) collect an amount of initial margin that is at least as large as the initial margin collection amount less any permitted initial margin threshold amount (which is discussed in more detail below), and (3) post at least as much initial margin to the financial end user with material swaps exposure as the covered swap entity would be required to collect if it were in the place of the financial end user with material swaps exposure.

The Agencies are not adopting a "collect only" approach for financial end user counterparties recommended by a number of financial industry commenters. The posting requirement under the final rule is one way in which the Agencies seek to reduce overall risk to

[131] The calculation of "material swaps exposure" is addressed in more detail in the discussion of the definitions above under §___.2.

the financial system, by providing initial margin to non-dealer swap market counterparties that are interconnected participants in the financial markets.[132] Commenters representing public interest groups and asset managers supported this aspect of the Agencies' approach, stating that it not only would better protect financial end users from concerns about the failure of a covered swap entity, but also would require covered swap entities to account more fully for the risks of their swaps business.

The final rule permits a covered swap entity to select from two methods (the standardized look-up table or the internal margin model) for calculating its initial margin requirements as described in more detail in §___.8. In all cases, the initial margin amount required under the final rule is a minimum requirement; covered swap entities are not precluded from collecting additional initial margin (whether by contract or subsequent agreement with the counterparty) in such forms and amounts as the covered swap entity believes is appropriate.

1. Initial margin threshold.

The final rule does not require a covered swap entity to collect or post initial margin collateral to the extent that the aggregate un-margined exposure either to or from its counterparty remains below $50 million.[133] In this regard, the final rule is generally consistent with the 2013 international framework and the 2014 proposal. The initial margin threshold amount of $50

[132] Some of these commenters contrasted the Agencies' 2014 proposed approach with those of European and Japanese regulators. In the United States, many financial end users operate outside of the jurisdiction of the prudential regulators to impose margin requirements. Thus, unlike the proposed Japanese and European requirements, which would cover a broader array of financial entities, a collect-only regime in the United States would be applicable only to covered swap entities and thus could leave a large number of financial entities with significant un-margined potential future exposures to their swap dealers.

[133] The final rule defines initial margin threshold amount in §__.2.

million has been adjusted relative to the $65 million threshold in the proposed rule in the manner previously described.

The Agencies believe that allowing covered swap entities to apply initial margin thresholds of up to $50 million is consistent with the rule's risk-based approach, as it will provide relief to smaller and less systemically risky counterparties while ensuring that initial margin is collected from those counterparties that pose greater systemic risk to the financial system. The initial margin threshold also should serve to reduce the aggregate amount of initial margin collateral required by the final rule.

Under the final rule, the initial margin threshold applies on a consolidated entity level. It will be calculated across all non-exempted[134] non-cleared swaps between a covered swap entity and its affiliates and the counterparty and the counterparty's affiliates.[135] The requirement to apply the threshold on a fully consolidated basis applies to both the counterparty to which the threshold is being extended and the counterparty that is extending the threshold.[136] Applying this threshold on a consolidated entity level precludes the possibility that covered swap entities and their counterparties could create legal entities and netting sets that have no economic basis and are constructed solely for the purpose of applying additional thresholds to evade margin

[134] To the extent that a non-cleared swap transaction is exempt from the margin requirements pursuant to § __.1(d), consistent with TRIPRA, the final rule excludes the exempted swap transaction from the calculation of the initial margin threshold amount.

[135] The threshold may be allocated among entities within the consolidated group, at the agreement of the covered swap entity and the counterparties, but the total must remain below $50 million on a combined basis. For an example illustrating allocations, see the 2014 proposal at 79 FR 57348, 57366 (September 24, 2014).

[136] As discussed in connection with §__.11, below, calculation of the initial margin threshold for non-cleared swaps between a covered swap entity and its own affiliate is determined on a per-affiliate basis, with a $20 million per-affiliate threshold.

requirements. Although some commenters suggested the Agencies should not implement the threshold across the covered swap entity and counterparties on a consolidated basis, and instead rely on general anti-evasion authority to address efforts to exploit the threshold, the Agencies have not done so. The revisions to the affiliate and subsidiary definitions in the final rule, described above under §___.2, simplify implementation of the consolidated approach and should help address some of the concerns raised by commenters in this respect.

The Agencies note that the initial margin threshold represents a minimum requirement and should not be viewed as preventing parties from contracting with each other to require the collection of initial margin even when their exposures to one another are less than $50 million. For such transactions, the Agencies expect covered swap entities to make their own internal credit assessments when making determinations as to the credit and other risks presented by their specific counterparties. Therefore, a covered swap entity dealing with a counterparty it judges to be of high credit quality may determine that a counterparty-specific threshold of up to $50 million is appropriate.

In response to commenters, and to clarify the Agencies' intent, the Agencies note that the $50 million threshold is measured as the amount of initial margin for the relevant portfolio of non-cleared swaps and non-cleared security-based swaps, pursuant to either the internal model or standardized initial margin table used by the covered swap entity.[137] The Agencies have not incorporated suggestions by a commenter that the Agencies permit the threshold to be calculated

[137] Although one central clearing commenter urged the Agencies to require covered swap entities to make granular disclosures about the utilization of the initial margin threshold to their investors, credit providers, and the central counterparties of which the covered swap entity is a member, the suggestion is beyond the scope of this margin rulemaking. The Agencies note the final rule does not prohibit a covered swap entity from providing this information, should it wish to negotiate that arrangement with an interested party.

in foreign currencies; conversion to USD can be readily accomplished and provides a measure of relative consistency in application from counterparty to counterparty within and across covered swap entities.

In addition, the Agencies have not incorporated suggestions by commenters for separate treatment of various arrangements under which the assets of a single investment fund vehicle or pension plan are treated as separate portfolios or accounts, each assigned some portion of the fund's or plan's total assets for purposes of managing them pursuant to different investment strategies or by different investment managers as agent for the fund or plan.[138] Commenters said these "separate accounts" are generally managed under documentation that caps the asset manager's ability to incur liabilities on behalf of the fund or plan at the amount of the assets allocated to the account. While the Agencies recognize these types of asset management approaches are well-established industry practice, and that separate managers acting for the same fund or plan do not currently take steps to inform the fund or plan of their non-cleared swap exposures on behalf of their principal on a frequent basis, the Agencies are not persuaded that it would be appropriate to extend each separate account its own initial margin threshold. Based on the comments, it appears the liability cap on each account manager often will be reflected in the fund's or plan's contract with the manager. If one manager breaches its limit, there could be cross-default implications for other managed accounts, and in periods of market stress, the cumulative effect of multiple managers' non-cleared swaps could, in turn, strain the fund's or plan's resources. Because all the swaps are transacted on behalf of a single legal principal, the Agencies do not believe that the subdivision of these separately managed accounts is sufficient to

[138] One industry group commenter also cited as an example a securitization vehicle that creates separate issuances of asset-backed securities through use of a series trust.

merit the extension of separate thresholds.[139] Nevertheless, the Agencies expect that in most cases, two separate investment funds of a single asset manager would not be consolidated under the relevant accounting standards and thus would not be affiliates under this rule.

2. Timing.

The final rule establishes the timing under which a covered swap entity must comply with the initial margin requirements set out in §§ __.3(a) and (b). Under §__.3(c) of the final rule, a covered swap entity, with respect to any non-cleared swap to which it is a party, must, on each business day, comply with the initial margin requirements for a period beginning on or before the business day following the day of execution of the swap and ending on the date the non-cleared swap is terminated or expires. "Business day" is defined in §__.2 to mean any day other than a Saturday, Sunday, or legal holiday.[140]

In practice, each covered swap entity typically will have a portfolio of swaps with a specific counterparty, and the covered swap entity will collect and post initial margin for that portfolio with that counterparty on a rolling basis. The final rule requires the covered swap entity to collect and post initial margin each business day for this portfolio of swaps, based on

[139] Some commenters expressing this concern made the same point with respect to application of the material swaps exposure threshold, which is also calculated on a legal entity basis. The Agencies have the same reservations about subdividing the material swaps exposure test at the managed account level, and these reservations are even somewhat compounded given that the Agencies have revised the threshold to $8 billion in reflection of the financial end user's overall market exposure, instead of a covered-swap-entity-specific exposure.

[140] A "business day" under the final rule is not limited by or tied to typical business hours. A swap dealer seeking to post or collect margin may make the transfer during a "business day" but at a time which is before or after typical business hours. So, for example, a posting that takes place at 10 p.m. local time on a Monday is still recognized as being made on Monday's business day under the final rule.

the initial margin amount calculated for that portfolio by the covered swap entity on the previous business day.[141]

As the covered swap entity and its counterparty enter into new swaps, adding them to the portfolio, these new swaps need to be incorporated into the covered swap entity's calculation of initial margin amounts to be posted and collected on this daily cycle. When a covered swap entity and its counterparty are located in the same or adjacent time zones, this is a straightforward process. However, when the covered swap entity is located in a distant time zone from the counterparty, or the two parties observe different sets of legal holidays, this can be less straightforward.

The Agencies have added new provisions to the final rule to accommodate practical considerations that arise in these circumstances.[142] The final rule requires the covered swap entity to post and collect initial margin on or before the end of the business day after the "day of execution," as defined in §___.2 of the rule. The "day of execution" is determined with reference to the point in time at which the parties enter into the non-cleared swap. When the location of the covered swap entity is in a different time zone than the location of the counterparty, the "day of execution" definition provides three special accommodations for the

[141] Of course, if the initial margin amounts have not changed, or the change to the posting or collecting amount (combined with changes in the variation margin amount, as applicable) is less than the minimum transfer amount specified in §__.5(b), no posting or collection will be required.

[142] The approach is patterned on principles incorporated in the CFTC's rulemaking on clearing execution, with differences the Agencies believe are appropriate in consideration of the bilateral nature of non-cleared swap margin and the non-standardized terms of non-cleared swaps. *See* Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act, 77 FR 74,284 (December 13, 2012), *available at*: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-29211a.pdf

difference. These accommodations are made in recognition of the fact that each of the two parties to the swap will, as a practical necessity, observe its own "business day" in transmitting instructions to the third-party custodian.

First, if at the time the parties enter into the swap, it is a different calendar day at the location of each party, the day of execution is deemed to be the latter of the two calendar days. For example, if a covered swap entity located in New York enters into a swap at 3:30 p.m. on Monday with a counterparty located in Japan, in the Japanese counterparty's location, it is 4:30 a.m. on Tuesday, and the day of execution (for both parties) will be deemed to be Tuesday.

Second, if a non-cleared swap is entered into between 4:00 p.m. and midnight in the location of a party, then such non-cleared swap shall be deemed to have been entered into on the immediately succeeding day that is a business day for both parties, and both parties shall determine the day of execution with reference to that business day. For example, if a covered swap entity located in New York enters into a swap at noon on Friday with a counterparty located in the U.K., in the U.K. counterparty's location, it is 5:00 p.m. on Friday, and the U.K. counterparty will be deemed to enter into the swap the following Monday. Or, if a covered swap entity located in New York enters into a swap at noon on Friday with a counterparty located in Japan, in the Japanese counterparty's location, it is 1:00 a.m. on Saturday, and the Japanese counterparty will be deemed to enter into the swap the following Monday. In both examples, the day of execution (for both parties) will be Monday.

Third, if the day of execution determined under the foregoing rules is not a business day for both parties, the day of execution shall be deemed to be the immediately succeeding day that is a business day for both parties. For example, this addresses the outcome arising from a non-cleared swap entered into by a covered swap entity in New York at noon on Friday with a counterparty in Japan, where it would be 1:00 a.m. on Saturday. Under the first provision, the latter calendar day would be deemed the day of execution, which would be Saturday. Accordingly, this third provision would operate to move the deemed day of execution to the next business day for both parties, i.e., Monday. As a further example under the same circumstances, if the Monday were a legal holiday in New York, the day of execution would then be deemed to be Tuesday for both parties.

When a covered swap entity adds a new non-cleared swap to its portfolio with a specific counterparty, these three provisions may result in different outcomes as to the "day of execution" for that swap pursuant to the definition in §__.2. However, §__.3(c) consistently requires the covered swap entity to begin posting and collecting initial margin reflecting that swap no later than the end of the business day following that day of execution and thereafter collect and post on a daily basis. The Agencies believe the final rule should provide adequate time for the covered swap entity to include the new swap in the regular initial margin cycle, under which the covered swap entity calculates the initial margin posting and collection requirements each business day for a portfolio of swaps covered by an EMNA with a counterparty, and the independent custodian(s) for both parties to hold segregated eligible margin collateral in those amounts by the end of the next business day, pursuant to the respective instructions of the parties. The covered swap entity is required to continue including the swap in its determination of the initial margin posting and collection requirements for that portfolio until the date the swap expires or is terminated.

All commenters that addressed the Agencies' proposed timing requirement for initial margin collection opposed it as unworkable. The basis for these objections included the fact that the settlement and delivery periods for many types of eligible margin securities are longer than the time allowed for margin collection under the proposed rule; the potential inability of financial end users to arrange for collateral transfers under the proposed rule's timeframes; and the difficulties encountered where the parties are in distant time zones. Other concerns included the fact that valuations are typically determined after market close and that the proposed rule did not include time for portfolio reconciliation and dispute resolution. Commenters proposed a number of alternatives, including moving to a T+2 basis; requiring prompt margin calls no later than a T+1 or T+2 basis, with margin transfer occurring one or two days thereafter or according to the standard settlement cycle for the type of collateral; requiring margin collection and settlement weekly; or simply requiring margin collection on a prompt or reasonable basis.

The Agencies have made limited adjustments to the final rule to accommodate operational concerns created by differences in time zones and legal holidays between the counterparties, but otherwise have retained the proposed approach. The Agencies recognize that the final rule requires initial margin to be posted and collected so quickly that covered swap entities and their counterparties may be required to take steps such as pre-positioning eligible margin collateral securities at the custodian and using readily-transferrable forms of eligible collateral, such as cash, to place additional margin quickly with the custodian from time to time, or to initially supply readily-transferrable forms of eligible collateral and subsequently arrange to substitute other eligible margin collateral securities after the initial margin collateral has been delivered to the custodian and the minimum margin requirements have been satisfied. The Agencies also recognize that the final rule will require portfolio reconciliation and dispute resolution to be performed after initial margin has been collected, as adjustments to the original margin call, rather than before. While the Agencies recognize the incremental regulatory burden embedded in the final rule's timing requirement, the Agencies believe the additional delay that would be introduced by the commenters' alternatives would reduce the overall effectiveness of the margin requirements.

3. Transactions with Other Counterparties and Transactions Exempt from the Margin Requirements Pursuant to the Terrorism Risk Insurance Program Reauthorization Act.

The provisions of the final rule requiring a covered swap entity to collect initial margin amounts calculated under the standardized approach or an improved internal model apply only with respect to counterparties that are financial end users with material swaps exposure or swap entities.[143] For other counterparties, §__.3(d) of the final rule directs covered swap entities to collect initial margin at such times and in such forms and amounts (if any) that the covered swap entity determines appropriately address the credit risk posed by the counterparty and the risks of such swaps.

Consistent with the proposed rule, the types of counterparties covered by §__.3(d) are financial end users <u>without</u> a material swaps exposure, as well as financial entities the final rule specifically excludes from the definition of a "financial end user" (e.g., multilateral development banks).[144] In the proposed rule, the Agencies also applied §__.3(d) to all other counterparties. After the proposed rule was issued, Congress enacted TRIPRA which exempts the non-cleared swaps and security-based swaps of specific counterparties (that are not swap entities) from these

[143] The same is true with respect to the final rule's requirements for documentation, eligible collateral, and custody of initial margin collected by a covered swap entity.

[144] These exclusions are contained in paragraph (2) of the definition of "financial end user" in §__.2 of the final rule.

regulatory margin requirements.[145] Accordingly, §__3(d) of the final rule will apply to other nonfinancial counterparties on an even more limited scope than the Agencies proposed, covering nonfinancial counterparties outside the group of entities eligible for the clearing exceptions and exemptions referenced in TRIPRA and §__.1(d), as well as entities that are within that group but that are engaging in specific non-cleared swaps in a manner that does not satisfy the criteria for hedging or mitigating commercial risk within the meaning of those clearing exceptions and exemptions.[146]

Some commenters representing public interest groups raised concerns about the proposed rule's treatment of other counterparties. These concerns ranged from fears that large market

[145] As directed by TRIPRA, the Agencies are issuing §__.1(d) as an interim final rule with request for public comment.

[146] One commenter raised concerns about certain non-cleared matched commodity swaps that economically offset each other and that are used to hedge municipal prepayment transactions for the supply of long-term natural gas or electricity (referred to as "Municipal Prepayment Transactions"). This commenter contended that each side of this matched pair of swaps could be subject to different margin treatment that could make these transactions prohibitively expensive. In particular, according to this commenter, the first or "front-end" swap in this matched pair would be between a nonfinancial end user (typically a government gas supply agency) and a swap entity, while the second swap or "back-end" swap generally would be between a swap entity and a prepaid gas supplier that is a swap entity or other financial entity. The Agencies note that covered swap entities that are parties to these and other types of matched or offsetting swap transactions would need to evaluate each swap to determine whether the requirements of the final rule apply. Under the final rule, it is possible that one swap may be exempt from the requirements of the rule while an offsetting swap is subject to the final rule's requirements as these requirements are set on a risk-basis as required under the statute. This commenter also contended that the rule would cause counterparties to matched commodity swaps to face increased costs to the extent that the rules apply a capital charge to a covered swap entity in connection with these matched swaps. As provided in §__.12, the final rule references existing capital rules including any associated capital charge under existing capital rules.[147] Another public interest group commenter stated that the treatment of other counterparties under the proposed rule should adhere to the CFTC end user exemptions to more clearly protect small commercial end users from procyclical margin requirements. The Agencies note the TRIPRA amendments appear to address this point.

players (such as the type of entities that once included Enron, among others) would be able to participate in the markets on an unmargined basis to disappointment that the Agencies did not at least include a prudential requirement for a specific internal exposure limit for commercial counterparties.[147] Commenters representing commercial end users generally supported the proposed rule's approach and described it as consistent with prudent current market practice. While some commenters also questioned whether the proposed rule's treatment of other counterparties was consistent with the statutory directive to impose margin and capital requirements on all non-cleared swaps, the Agencies believe the approach is consistent with the Dodd-Frank Act's risk-based approach to establishing margin requirements.

E. Section __.4: Variation Margin.

1. Overview of the final rule

After carefully reviewing the comments to the 2014 proposal, the Agencies have decided to adopt § __.4 of the rule largely as proposed, but also make a limited number of changes in the final rule to address concerns raised by commenters with respect to the calculation and exchange of variation margin.

Consistent with the 2014 proposal and the final rule's provisions on initial margin, § ___.4 of the final rule requires a covered swap entity to collect variation margin when it engages in a non-cleared swap transaction with another covered swap entity. Because all swap entities will be subject to a prudential regulator, CFTC, or SEC margin rule that requires them to collect

[147] Another public interest group commenter stated that the treatment of other counterparties under the proposed rule should adhere to the CFTC end user exemptions to more clearly protect small commercial end users from procyclical margin requirements. The Agencies note the TRIPRA amendments appear to address this point.

variation margin, the final rule will result in a collect-and-post system for all non-cleared swaps between swap entities.

When a covered swap entity engages in a non-cleared swap transaction with a financial end user, regardless of whether or not the financial end user has a material swaps exposure, the final rule will require the covered swap entity to collect *and* post variation margin with respect to the non-cleared swap. The final rule requires a covered swap entity to collect or post (as applicable) variation margin on non-cleared swaps in an amount that is at least equal to the increase or decrease (as applicable) in the value of such swaps since the previous exchange of variation margin.

Consistent with the 2014 proposal, a covered swap entity may not establish a threshold amount below which it need not exchange variation margin on swaps with a swap entity or financial end user counterparty (although transfers below the minimum transfer amount would not be required, as discussed in § __.5).

The Agencies believe the bilateral exchange of variation margin will support the safety and soundness of the covered swap entity as well as effectively reduce systemic risk by protecting both the covered swap entity and its counterparty from the effects of a counterparty default.

2. "Collecting" and "Posting" Variation Margin

Unlike the 2014 proposal, which used the terms "pay" and "paid" to refer to the transfer of variation margin, the final rule refers to variation margin in terms of "post" and "collect." After carefully reviewing the comments on the 2014 proposal that addressed the appropriate characterization of the transfer of variation margin, the Agencies have determined that it is more appropriate to refer to variation margin collateral as having been “posted,” rather than “paid,” consistent with the treatment of initial margin.

Among the reasons underlying the Agencies’ proposal to refer to variation margin in terms of payment was the existing market practice of swap dealers to exchange variation margin with other swap dealers in the form of cash. As is discussed below in the final rule’s provisions on eligible collateral, the Agencies have concluded that it is appropriate to permit financial end users to use other, non-cash forms of collateral for variation margin. This revision to the nomenclature of the final rule is consistent with the Agencies’ inclusion of eligible non-cash collateral for variation margin.

In the context of cash variation margin, commenters also expressed concerns that the Agencies’ choice of the “pay” nomenclature reflected an underlying premise of current settlement that may be inconsistent with various operational, accounting, tax, legal, and market practices. The Agencies use of the “post” and “collect” nomenclature for the final rule is not intended to reflect upon or alter the characterization of variation margin exchanges – either as a transfer and settlement or a provisional form of collateral – for other purposes in the market.

3. Variation Margin Definitions and Calculation of Market Value

Under the final rule, “variation margin” means the collateral provided by one party to its counterparty to meet the performance of its obligations under one or more non-cleared swaps or non-cleared security-based swaps between the parties as a result of a change in value of such obligations since the last time such collateral was provided.[148] The amount of variation margin to be collected or posted (as appropriate) is the amount equal to the cumulative mark-to-market

[148] *See* § __.2 of the final rule.

change in value to a covered swap entity of a non-cleared swap or non-cleared security-based swap, as measured from the date it is entered into (or, in the case of a non-cleared swap or non-cleared security-based swap that has a positive or negative value to a covered swap entity on the date it is entered into, such positive or negative value plus any cumulative mark-to-market change in value to the covered swap entity of a non-cleared swap or non-cleared security-based swap after such date), less the value of all variation margin previously collected, plus the value of all variation margin previously posted with respect to such non-cleared swap or non-cleared security-based swap.[149] The covered swap entity must collect this amount if the amount is positive, and post this amount if the amount is negative.

Several financial end user commenters stated that this aspect of the 2014 proposal was unclear with regard to the calculation of minimum variation margin requirements. Specifically, these commenters stated that the 2014 proposal appeared to require a covered swap entity to determine minimum variation margin requirements based on the market value of a swap calculated only from the covered swap entity's own perspective, rather than at a mid-market price consistent with current market practice. Commenters stated that the proposed approach would result in dealer exposures being over-collateralized and their counterparties' exposures being under-collateralized.

The Agencies wish to clarify that the reference in the rule text to the "cumulative mark-to-market change in value to a covered swap entity of a non-cleared swap or non-cleared security-based swap" is not designed or intended to have the effect suggested by commenters. The market value used to determine the cumulative mark-to-market change will be mid-market

[149] *See* § __.2 of the final rule defining "variation margin amount."

prices, if that is consistent with the agreement of the parties.[150] The final rule is consistent with market practice in this respect. The rule text's reference to "change in value to a covered swap entity" refers to whether the value change is positive or negative from the covered swap entity's standpoint. This ties to the final rule's requirement for the covered swap entity to post variation margin when the variation margin amount is positive, or collect variation margin when the variation margin amount is negative.

The final rule also permits the calculation of variation margin amounts to recognize netting across the portfolio of non-cleared swaps transacted between the covered swap entity and its counterparty, subject to a number of conditions. These provisions of the rule have been relocated to § __.5 of the final rule, as discussed later in this Supplementary Information.

4. *Frequency*

The final rule largely retains the proposed rule's requirement for variation margin to be posted or collected on a T+1 timeframe. The final rule requires variation margin to be posted or collected no less than once per business day, beginning on the business day following the day of execution. These provisions of the final rule operate in the same way as those discussed earlier in this Supplementary Information, in the description of the final rule's initial margin requirements.

5. *Transactions with "Other Counterparties" and Transactions Exempt from the Margin Requirements Pursuant to the Terrorism Risk Insurance Program Reauthorization Act.*

[150] Additionally, the Agencies note that the final margin requirements should be viewed as minimums. To the extent that two counterparties agree to transfer collateral in addition to the minimum amount required by the final rule, and assuming that doing so would be consistent with safety and soundness, the final rule will not impede them.

Consistent with the 2014 proposal, the final rule requires a covered swap entity to exchange variation margin for non-cleared swaps with swap entities, and financial end users (regardless of whether the financial end user has a material swaps exposure). However, as discussed earlier in this Supplementary Information, the enactment of TRIPRA exempts certain nonfinancial counterparties from the scope of this rulemaking for non-cleared swaps that hedge or mitigate commercial risk.[151] For other counterparties, §__.4(c) of the final rule directs covered swap entities to collect variation margin at such times and in such forms and amounts (if any) that the covered swap entity determines appropriately address the credit risk posed by the counterparty and the risks of such swaps, consistent with the 2014 proposal. These other counterparties include sovereign counterparties, financial entities the final rule specifically excludes from the definition of financial end user, nonfinancial counterparties outside the group of entities covered by the TRIPRA exemption, and nonfinancial counterparties within that group of entities but that are engaging in specific non-cleared swaps or in a manner that does not satisfy the criteria for hedging or mitigating commercial risk.

Overall, this aspect of the variation margin provisions of the final rule is consistent with those for initial margin. The one difference is that all transactions with financial end user counterparties are subject to the variation margin requirements, while only financial end user counterparties with material swaps exposure are subject to initial margin requirements. The

---

[151] The Agencies proposed that covered swap entities collect variation margin from these so-called "commercial end user" counterparties at such times and in such forms and amounts (if any) that the covered swap entity determined appropriately addresses the credit risk posed by the counterparty and the risks of the non-cleared swaps. This is the same treatment the prudential regulators proposed with respect to initial margin, and the views of commenters discussed earlier in this Supplementary Information on this aspect of the initial margin proposal were equally applicable to this aspect of the variation margin proposal.

Agencies generally believe it is appropriate to apply the minimum variation margin requirements to transactions with all financial entity counterparties, not just those with a material swaps exposure, because the daily exchange of variation margin is an important risk mitigant that (i) reduces the build-up of risk that may ultimately pose systemic risk; (ii) imposes a lesser liquidity burden than does initial margin; and (iii) reflects both current market practice and a risk management best practice.

F. Section __.5: Netting Arrangements, Minimum Transfer Amount and Satisfaction of Collecting and Posting Requirements.

1. Netting Arrangements

Section __.5(a) of the final rule permits a covered swap entity to calculate initial margin (using an initial margin model) or variation margin on an aggregate net basis across non-cleared swap transactions with a counterparty that are executed under an EMNA.[152] Although the proposal provided that the margin requirements would not apply to non-cleared swaps entered into before the rule's compliance dates, as a general rule, the proposal provided that if an EMNA covered non-cleared swaps that were entered into before the applicable compliance date, those non-cleared swaps would be subject to the requirements of the rule and must be included in the aggregate netting portfolio for purposes of calculating the required margin.

However, as discussed by several commenters, the Agencies recognize that covered swap entities and their counterparties may wish to separate netting portfolios under a single EMNA. Accordingly, the final rule provides that an EMNA may identify one or more separate netting

[152] Initial margin and variation margin amounts may not be netted against each other under the final rule. In addition, initial margin netting is only for the purposes of calculating the collection amount or post amount under an approved initial margin model, and these amounts may not be netted against each other.

portfolios that independently meet the requirement for close-out netting[153] and to which, under the terms of the EMNA, the collection and posting of margin applies on an aggregate net basis separate from and exclusive of any other non-cleared swaps covered by the agreement. (These separate netting portfolios are commonly covered by separate credit support annexes to the EMNA.) This rule facilitates the ability of the parties to document two separate netting sets, one for non-cleared swaps that are subject to the final rule and one for swaps that are not subject to the margin requirements.[154] A netting portfolio that contains only non-cleared swaps entered into before the applicable compliance date is not subject to the requirements of the final rule. The rule does not prohibit the parties from including one or more pre-compliance-date swaps in the netting portfolio of non-cleared swaps subject to the margin rule, but they will thereby become subject to the final rule's margin requirement, as part of the netting portfolio. Similarly, any netting portfolio that contains any non-cleared swap entered into after the applicable compliance date will subject the entire netting portfolio to the requirements of the final rule.

The netting provisions of the final rule also address the implications of status changes for counterparties. As discussed above, the final rule imposes a requirement to exchange initial margin only with respect to financial end users whose swap portfolios exceed the material swaps exposure threshold. This means a covered swap entity may accumulate a portfolio of swaps with a financial end user below the threshold, subject to a variation margin requirement, and later if the financial end user crosses the threshold, additional swaps entered into after that change in the financial end user's status will be subject to both initial and variation margin requirements. To

[153] *See* §__.2 of the final rule (paragraph 1 of the EMNA definition).

[154] In addition, a covered swap entity may use a holding period equal to the shorter of five business days or the maturity of the portfolio for any swap that would be subject to clearing with an affiliate, provided these swaps must be netted separately from other swaps.

address this possibility, the final rule extends the treatment of separate netting portfolios under a single ENMA beyond pre-compliance-date swaps to include separate netting portfolios for swaps entered into before and after a financial end user's change into a higher risk status.[155]

Also, to address circumstances in which, for example, a covered swap entity enters into a netting agreement with a counterparty whose liquidation regime is somewhat specialized and the covered swap entity cannot conclude after sufficient legal review on a well-founded basis that a netting agreement meets the definition of EMNA in § __.2, § __.5(a)(4) of the final rule requires the covered swap entity to collect the gross margin amount required but may still apply the netting provisions of the rule in determining the amount of margin it must post to the counterparty.

The netting provisions in the final rule are modified from the proposal in order to provide clarifications that address implementation concerns raised by commenters. The proposed rule provided that if non-cleared swaps entered into prior to the applicable compliance date were included in the EMNA, those swaps would be subject to the margin requirements.[156] Under the proposal, a covered swap entity would have needed to establish a new EMNA to cover swaps entered into after the compliance date in order to exclude pre-compliance date swaps. A number of commenters argued that, in order to allow close-out netting, the final rule should not require new master agreements to separate pre- and post-compliance date swaps, and that parties should

[155] As discussed earlier, the change in status might also occur as a counterparty moves in or out of financial end user status entirely, or moves in or out of "other counterparty" status. The final rule extends the separate netting portfolio treatment to all status changes equally.

[156] The netting provisions in the proposal were in § __.4(d) for variation margin and § __.8(b)(2) for initial margin.

be permitted to use credit support annexes that are part of the EMNA instead of new master agreements to distinguish pre- and post-compliance date swaps.[157] The final rule addresses these concerns and preserves close-out netting by allowing an EMNA to identify one or more separate netting portfolios to which the requirements of the final rule apply on an aggregate net basis. Thus, under the final rule, pre-compliance date swaps in the same EMNA as post-compliance date swaps would be subject to the requirements of the final rule unless they are treated under the EMNA as a separately identified netting portfolio.

A few commenters also contended that counterparties should be able to exchange margin on a net basis even where a counterparty is subject to an insolvency regime that may not satisfy the EMNA definition (e.g., certain U.S. pension funds and insurance companies). Certain commenters similarly urged that the final rule should permit the collection and posting on a net basis in foreign jurisdictions without legal frameworks that recognize concepts such as netting. The Agencies believe it would be inconsistent with the purposes and objectives of the rule to permit a covered swap entity to net a counterparty's non-cleared swap obligations to the covered swap entity in determining margin collection amounts, unless the covered swap entity can conclude on a well-founded basis that the netting provisions of the agreement can be enforced against the counterparty (as required in accordance with the final rule's definition of the EMNA). However, commenters noted that requiring covered swap entities to post collateral on a gross basis under circumstances in which there is a risk the counterparty's liquidating agent or receiver

[157] One commenter also requested clarification that the use of an EMNA does not prevent use of a master-master netting agreement. The final rule requires that any non-cleared swaps that are netted for purposes of calculating the margin requirements under the final rule are subject to an EMNA that meets the definition in § __.2 of the final rule regardless of whether or not there is a master-master EMNA.

might not observe the netting requirement actually exposes the covered swap entity to greater risk. The final rule addresses these concerns by allowing the covered swap entity to post the net amount to the counterparty where it cannot conclude that an agreement meets the EMNA definition. In cases where the EMNA does not meet the definition in §__.2, however, the covered swap entity must still collect the gross amount of margin required under the final rule, even if it negotiates to post margin to the counterparty on a net basis.

Certain commenters urged that non-cleared swaps should be permitted to be netted against any other products and exposures if such netting is legally enforceable. The Agencies declined to incorporate this request in the final rule. The Agencies do not believe that it would be appropriate for margin requirements for non-cleared swaps to be offset by netting other products or exposures across markets against other products that may present different concerns about safety and soundness or financial stability, or that are not subject to similar associated margin requirements. Such treatment appears inconsistent with the purposes of the Dodd-Frank Act.

2. Minimum Transfer Amount.

The final rule provides for a minimum transfer amount for the collection and posting of margin by covered swap entities. The final rule does not require a covered swap entity to collect or post margin from or to any individual counterparty unless and until the combined amount of initial and variation margin that must be collected or posted under the final rule, but has not yet been exchanged with the counterparty, is greater than $500,000.[158] This minimum transfer

[158] *See* § __.5(b) of the final rule. The minimum transfer amount only affects the timing of margin collection; it does not change the amount of margin that must be collected

amount is consistent with the 2013 international framework and has been adjusted relative to the amount that appeared in the 2014 proposal in the manner previously described.

The Agencies received a few comments suggesting that the minimum transfer amount should be applied separately to initial margin and variation margin. The final rule has been modified from the proposal to make clear that the minimum transfer amount applies to the combined amount of initial and variation margin. The Agencies believe that the proposal's minimum transfer amount of $500,000 is appropriately sized to generally alleviate the operational burdens associated with making *de minimis* margin transfers and that the amount applies to both initial and variation margin transfers on a combined basis. Another commenter requested confirmation that the rule allows a minimum transfer amount but does not require it. In response to this comment, the Agencies confirm that the minimum transfer amount is allowed but not required under the final rule, and parties are free to collect and post margin below that amount.

3. Satisfaction of Collecting and Posting Requirements.

Under § __.5(c) of the final rule, a covered swap entity shall not be deemed to have violated its obligation to collect or post initial or variation margin from or to a counterparty if: (1) the counterparty has refused or otherwise failed to provide or accept the required margin to or from the covered swap entity; and (2) the covered swap entity has (i) made the necessary efforts to collect or post the required margin, or has otherwise demonstrated upon request to the satisfaction of the appropriate Agency that it has made appropriate efforts to collect or post the

---

once the $500,000 threshold is crossed. For example, if the margin amount due from (or to) the counterparty were to increase from $500,000 to $800,000, the covered swap entity would be required to collect the entire $800,000 (subject to application of any applicable initial margin threshold amount).

required margin, or (ii) commenced termination of the non-cleared swap with the counterparty promptly following the applicable cure period and notification requirements.

The Agencies received a comment on this provision suggesting that, since financial end users would be required to exchange margin with a covered swap entity in amounts determined by the covered swap entity's models, the final rule should allow for a dispute resolution process acceptable to both the covered swap entity and its counterparty. Under the final rule, disputes that may arise between a covered swap entity and its counterparty should be handled pursuant to the terms of the relevant contract or agreement and in the normal course of business. A covered swap entity would not be deemed to have violated its obligation to collect or post initial or variation margin from, or to a counterparty, if the counterparty is acting in accordance with agreed-upon practices to settle a disputed trade.

G. Section __.6: Eligible Collateral.

After reviewing the comments to the 2014 proposal, the Agencies have decided to make a number of changes to the final rule with respect to the list of eligible collateral.

1. Variation Margin

With respect to variation margin, the 2014 proposal would have limited eligible collateral to immediately available cash funds, denominated either in USD or in the currency in which payment obligations under the non-cleared swap are required to be settled. However, after reviewing comments from financial end users of derivatives, such as insurance companies, mutual funds, and pension funds, the Agencies have expanded the list of eligible variation margin for non-cleared swaps between a covered swap entity and financial end users. These commenters generally argued that limiting variation margin to cash is inconsistent with current market practice for financial end users; is incompatible with the 2013 international framework agreement; and would drain the liquidity of these financial end users by forcing them to hold more cash. In response to these comments, the final rule permits assets that are eligible as initial margin to also be eligible as variation margin for swap transactions between a covered swap entity and financial end user, subject to the applicable haircuts for each type of eligible collateral.[159]

This change aligns the rule more closely with market practice. Commenters indicated many types of financial end users exchange variation margin with their swap dealers in the form of non-cash collateral that is compatible with the assets they hold as investments. This practice permits them to maximize their investment income and minimize margin costs, even though these assets are subject to valuation haircuts when posted as variation margin.

The Agencies note however (as described in the 2014 proposal) that most of the variation margin by total volume continues to be in the form of cash exchanged between swap dealers.[160] Therefore, consistent with the 2014 proposal, variation margin exchanged by a covered swap entity with another swap entity must be in the form of immediately available cash funds. Some commenters representing public interest groups favored limiting variation margin exchanged between covered swap entities to cash, whereas some commenters representing the financial sector expressed concern that regulators in other key market jurisdictions have not proposed comparable variation margin restrictions. The Agencies continue to believe that limiting variation margin exchanged between swap entities to cash is consistent with regulatory and

[159] Variation margin is never subject to the segregation requirements set forth in § _.7 of the final rule, regardless of whether it consists of cash or non-cash collateral.

[160] According to the 2015 ISDA margin survey, 77 percent of variation margin received and 77 percent of variation margin delivered is in the form of cash, https://www2.isda.org/functional-areas/research/surveys/margin-surveys/.

industry initiatives to improve standardization and efficiency in the OTC swaps market. Swap entities have access to cash, and its continued use as variation margin between swap entities will reduce the potential for disputes over the value of variation margin collateral, due to the absence of associated market and credit risks. Also, in periods of severe market stress, the ultimate liquidity of cash variation margin exchanged between covered swap entities – which occupy a key position to provide and maintain trading liquidity in the market for non-cleared swaps – should assist in preserving the financial integrity of that market and the stability of the U.S. financial system.

However, for reasons discussed below, the Agencies are revising the final rule to expand the denominations of immediately available cash funds that are eligible. Whereas the 2014 proposal only recognized USD or the currency of settlement, the final rule expands the category to include any major currency.[161]

2. Initial Margin

With respect to initial margin, the final rule includes an expansive list of eligible collateral that is largely consistent with the list set forth in the 2014 proposal.[162] Specifically, in

[161] The final rule defines the following as a "major currency": United States Dollar (USD); Canadian Dollar (CAD); Euro (EUR); United Kingdom Pound (GBP); Japanese Yen (JPY); Swiss Franc (CHF); New Zealand Dollar (NZD); Australian Dollar (AUD); Swedish Kronor (SEK); Danish Kroner (DKK); Norwegian Krone (NOK); and any other currency as determined by the prudential regulator of the covered swap entity.

[162] In the proposed rule, the FCA proposed a new definition of "investment grade" for collateral posted or collected by FCS institutions that is identical to 12 CFR § 1.2(d). The FCA did not receive any comments on this proposed definition of "investment grade." The FCA is adopting this definition in the final rule because it implements section 939A of the Dodd-Frank Act and is compatible with the FCA's safety and soundness authority.

addition to immediately available cash funds, denominated in any major currency or the currency of settlement, the final rule provides that the following collateral may be posted or collected, as appropriate, in satisfaction of the minimum initial margin requirements:

- a security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury;
- a security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, a U.S. government agency (other than the U.S. Department of the Treasury) whose obligations are fully guaranteed by the full faith and credit of the U.S. government;
- a security that is issued by, or fully guaranteed as to the timely payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under applicable regulatory capital rules;
- a publicly traded debt security issued by, or an asset-backed security fully guaranteed as to the timely payment of principal and interest by a U.S. Government-sponsored enterprise that is operating with capital support or another form of direct financial assistance from the U.S. government that enables the repayments of the U.S. Government-sponsored enterprise's eligible securities;
- a publicly traded debt security, but not an asset-backed security, that is issued by a U.S. Government-sponsored enterprise not operating with capital support or another form of direct financial assistance from the U.S. government and that the covered swap entity determines is "investment grade" (as defined by the appropriate prudential regulator);
- a security that is issued by or unconditionally guaranteed as to the timely payment of principal and interest by the Bank for International Settlements, the International Monetary Fund, or a multilateral development bank;
- a publicly traded debt security that the covered swap entity determines is "investment grade" (as defined by the appropriate prudential regulator);
- a publicly traded common equity security that is included in the Standard and Poor's Composite 1500 Index, an index that a covered swap entity's supervisor in a foreign jurisdiction recognizes for the purposes of including publicly traded common equity as initial margin, or any other index for which a covered swap entity can demonstrate that the equities represented are as liquid and readily marketable as those included in the Standard and Poor's Composite 1500 Index;
- certain redeemable government bond funds, described below; and

- gold.

In contrast to broad commenter concerns about the proposal's restrictive treatment of eligible collateral for variation margin, commenters addressing initial margin eligible collateral either generally supported the proposed asset categories or sought limited modifications. Commenters representing public interest groups supported the Agencies' rationale in the 2014 proposal of limiting initial margin collateral so as to exclude assets prone to excessive exposures to credit, market, or foreign exchange risk in times of market stress. Some of these commenters questioned the Agencies' inclusion of equities, expressing concern about the idiosyncratic risks of equity issuers. The Agencies are preserving this aspect of the proposal in the final rule, including the requirement for a minimum 15 percent haircut on equities in the S&P 500 Index and a minimum 25 percent haircut for those in the S&P 1500 Composite Index but not in the S&P 500 Index.[163] The Agencies note that, even with these restrictions designed to address liquidity and volatility, covered swap entities should also take concentrations into account, and prudently manage their acceptance of initial margin collateral, with the idiosyncratic risk of equity – and publicly traded debt – issuers in mind. Some public interest group commenters urged the Agencies to perform annual reviews of the eligible collateral categories and the haircuts. However, the Agencies believe that it is important to consider longer time periods incorporating periods of market stress, and the Agencies calibrated the rule's minimum haircuts accordingly.

Commenters representing the interests of asset managers, mutual funds, and other institutional asset managers asked the Agencies to expand the list of eligible collateral to include

[163] Although equities included in the S&P 500 Index are also included in the S&P 1500 Composite Index, equities in the S&P 500 Index are subject to the 15 percent minimum haircut, not the 25 percent minimum haircut.

money market mutual funds and bank certificates of deposit, in the interests of providing financial end users with a higher yield than cash held by the margin custodian and more liquidity than direct holdings of government or corporate bonds. To accommodate this concern, the final rule adds redeemable securities in a pooled investment fund that holds only securities that are issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury, and cash funds denominated in USD. To provide a parallel collateral option for non-cleared swap portfolios in denominations other than USD, the pooled investment fund may be structured to invest in a pool of securities that are denominated in a common currency and issued by, or fully guaranteed as to the timely payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under applicable regulatory capital rules, and cash denominated in the same currency.

The final rule requires these pooled investment vehicles to issue redeemable securities representing the holder's proportional interest in the fund's net assets, issued and redeemed only on the basis of the fund's net assets prepared each business day after the holder makes its investment commitment or redemption request to the fund. These criteria are similar to those used for bank trust department common trust funds and common investment funds, to facilitate liquidity of the redeemable securities while still protecting holders of the fund's securities from dilution. The final rule also provides that assets of the fund may not be transferred through securities lending, securities borrowing, repurchase agreements, reverse repurchase agreements, or similar arrangements. This is to ensure consistency with the prohibition under § __.7 against custodian rehypothecation of initial margin collateral.

Consistent with the 2014 proposal, the final rule generally does not include asset-backed securities ("ABS"), including mortgage-backed securities ("MBS"), within the permissible category of publicly traded debt securities. However, ABS are included as eligible collateral if they are issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury or another U.S. government agency whose obligations are fully guaranteed by the full faith and credit of the United States government; or if they are fully guaranteed by a U.S. GSE that is operating with capital support or another form of direct financial assistance received from the U.S. government that enables repayment of the securities.

Publicly traded debt securities (that are not ABS) issued by GSEs are included in eligible collateral as long as the issuing GSE is either operating with capital support or another form of direct financial assistance received from the U.S. government that enables full repayment of principal and interest on these securities, or the covered swap entity determines the securities are "investment grade" (as defined by the appropriate prudential regulator).

Although the Agencies received several comments concerning the proposal's treatment of GSE securities, only modest changes have been made in the final rule. Commenters who asked the Agencies to consider GSE securities as eligible collateral for variation margin joined many others who opposed limiting variation margin collateral to cash only, a topic that was addressed in greater detail above.

Commenters stated that GSE debt securities already are widely used as collateral for non-cleared swaps and should continue to be eligible under the final rule given their historically low levels of volatility. A smaller number of the commenters argued that GSE MBS also should be eligible collateral given that markets have accepted GSE MBS as liquid, high-quality securities along with other GSE debt. A number of commenters suggested that GSE debt securities and MBS should qualify as eligible collateral, regardless of whether or not the GSE is operating with capital support or another form of financial assistance from the United States. Some commenters also questioned why the minimum haircut for debt securities of GSEs (operating without capital support or other financial assistance from the United States) is not lower than the minimum haircuts applicable to corporate debt. Another concern that some commenters raised is that the capital and margin rule for non-cleared swaps differs in its treatment of GSE securities from the liquidity coverage ratio rule that the Board, OCC, and FDIC issued in 2014.[164]

In the final rule, the Agencies recognize the unique nature of GSE securities by placing them in a category separate from both securities issued directly by U.S. government agencies and those from non-GSE, private sector issuers. However, the Agencies continue to believe the final rule should treat GSE securities differently depending on whether or not the GSE enjoys explicit government support, in the interests of both the safety and soundness of covered swap entities and the stability of the financial system. GSE debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. government. Existing law, however, authorizes the U.S. Treasury to provide lines of credit, up to a specified amount, to certain GSEs in the event they face specific financial difficulties. An act of Congress would be required to provide adequate support if, for example, a GSE were to experience severe difficulty in selling its securities in

[164] See 79 FR 61439 (October 10, 2014) (*Liquidity Coverage Ratio: Liquidity Risk Measurement Standards*).

financial markets because investors doubted its ability to meet its financial obligations.[165] The treatment of GSE securities by market participants as if those securities were nearly equivalent to U.S. Treasury securities in the absence of explicit U.S. Treasury support creates a potential threat to financial market stability, especially if vulnerabilities arise in markets where one or more GSEs are dominant participants, as occurred during the summer of 2008. The final rule's differing treatment of GSE collateral based on whether or not the GSE has explicit support of the U.S. government helps address this source of potential financial instability and recognizes that securities issued by an entity explicitly supported by the U.S. government might well perform better during a crisis than those issued by an entity operating without such support. The final rule adopts the approach that was used in the proposed rule and assigns the same minimum haircut to both corporate obligations and the debt securities of GSEs that are operating without capital support or another form of financial assistance from the United States. From the Agencies' perspective, this approach facilitates appropriate due diligence when a party considers the creditworthiness of a GSE security that it may accept as collateral.

To avoid so-called "wrong-way risk," the final rule retains the 2014 proposal's provision excluding any securities issued by the counterparty or any of its affiliates. To avoid general wrong-way risk, the final rule continues to exclude securities issued by a bank holding company, a savings and loan holding company, a foreign bank, a depository institution, a market intermediary, or any company that would be one of the foregoing if it were organized under the laws of the United States or any State, or an affiliate of one of the foregoing institutions. For the same reason, the Agencies have expanded this restriction in the final rule also to exclude

[165] Congress provided such support with the passage of the Agricultural Credit Act of 1987 and with the Housing and Economic Recovery Act of 2008.

securities issued by a non-bank systemically important financial institution designated by the Financial Stability Oversight Council. These entities are financial in nature and, like banks or market intermediaries, would be expected to come under significant financial stress in the event of a period of financial stress. Accordingly, the Agencies believe that it is also appropriate to restrict securities issued by these entities as eligible margin collateral to ensure that collected collateral is free from significant sources of "wrong-way risk".

The final rule does not allow a covered swap entity to fulfill the rule's minimum margin requirements with any assets not included in the eligible collateral list, which is comprised of assets that should remain liquid and readily marketable during times of financial stress. The use of alternative types of collateral to fulfill regulatory margin requirements would introduce concerns with pro-cyclicality (for example, the changes in the liquidity, price volatility, or wrong-way risk of collateral during a period of financial stress could exacerbate that stress) and could undermine efforts to ensure that collateral is subject to low credit, market, and liquidity risk. Therefore, the final rule limits the recognition of margin collateral to the aforementioned list of assets.

Counterparties that wish to make use of assets that do not qualify as eligible collateral under the final rule still would be able to pledge those assets with a lender in a separate collateral transformation arrangement, using the cash or other eligible collateral received from that separate arrangement to meet the minimum margin requirements.

3. Currency of Settlement, Collateral Valuation, and Haircuts

For those assets whose values may show volatility during times of stress, the final rule imposes an 8 percent cross-currency haircut, and standardized prudential supervisory haircuts that vary by asset class. When determining how much collateral will be necessary to satisfy the minimum initial margin requirement for a particular transaction, a covered swap entity must apply the relevant standardized prudential supervisory haircut to the value of the eligible collateral. The final rule's haircuts guard against the possibility that the value of non-cash eligible margin collateral could decline during the period between when a counterparty defaults and when the covered swap entity closes out that counterparty's swap positions.

The Agencies have revised the cross-currency haircut applicable to eligible collateral under the final rule. The cross-currency haircut will apply whenever the eligible collateral posted (as either variation or initial margin) is denominated in a currency other than the currency of settlement, except that in the case of variation margin in immediately available cash funds in any major currency are never subject to the haircut. The amount of the cross-currency haircut remains 8 percent, as it was in the 2014 proposal. The Agencies' have decided to eliminate the haircut on variation margin provided in immediately available cash funds denominated in all major currencies because the cash funds are liquid at the point of counterparty default, and there are robust markets in the major currencies that allow conversion or hedging to the currency of settlement or termination at relatively low cost. The Agencies are including in the final rule the cross-currency haircut for all eligible non-cash variation and initial margin collateral, in consideration of the limitations on market liquidity that can frequently arise on those assets in periods of market stress.

In response to commenters' request for clarification, the Agencies have revised the final rule text for the cross-currency haircut to refer to the "currency of settlement," and have eliminated the corresponding formulation offered for comment in the 2014 proposal.[166] Commenters requested that the Agencies provide guidance about the rule's application to current market practice incorporating contractual provisions specifying an agreed-upon currency of settlement, transport, transit currencies and termination currencies.[167]

In identifying the "currency of settlement" for purposes of this final rule, the Agencies will look to the contractual and operational practice of the parties in liquidating their periodic settlement obligations for a non-cleared swap in the ordinary course, absent a default by either party. To provide greater clarity, the Agencies have added a new definition of "currency of settlement" to the rule. The Agencies have defined "currency of settlement" to mean a currency in which a party has agreed to discharge payment obligations related to a non-cleared swap, a non-cleared security-based swap, a group of non-cleared swaps, or a group of non-cleared security-based swaps subject to a master agreement at the regularly occurring dates on which such payments are due in the ordinary course.

For eligible non-cash initial margin collateral, the final rule expressly carves out of the cross-currency haircut assets denominated in a single termination currency designated as payable to the non-posting counterparty as part of the EMNA. The final rule accommodates agreements

[166] The 2014 proposal was formulated as "the currency in which payment obligations under the swap are required to be settled." Proposed Rule, §__.6(a)(1)(ii). In the Supplementary Information published as part of the 2014 proposal, the Agencies addressed this language, noting that the entirety of the contractual obligations between the parties should be considered, including the terms of a master agreement governing the non-cleared swaps. The Agencies requested comment whether current market practices that would raise difficulties or concerns about identifying the appropriate settlement currency, from a contractual or operational standpoint. 79 Fed. Reg. 57348, 57371 (September 24, 2014).

[167] The guidance the Agencies are providing about currencies of settlement is specific to the application of this final rule on margin collecting and posting requirements for uncleared swaps.

under which each party has a different termination currency. If the non-posting counterparty has the option to select among more than one termination currency as part of the agreed-upon termination and close-out process, the agreement does not meet the final rule's single termination currency condition. However, the single termination currency condition does not rule out an EMNA establishing more than one discrete netting set and establishing separate margining and early termination provisions for such a select netting set with its own single termination currency.[168]

As an alternative to the 8 percent cross-currency haircut, commenters urged the Agencies to permit any cross-currency sensitivity between the swap portfolio credit exposure and the margin collateral provided against that exposure to be measured as a component of the margin required to be exchanged under the rule. The Agencies are concerned this alternative presupposes the covered swap entity's certain knowledge, at the time margin amounts must be determined, of the collateral denomination to be posted by the counterparty in response to the margin call and the denomination of future settlement payments. The likelihood of such information being predictably available to the covered swap entity is not consistent with commenters' depiction of the amount of optionality exercised with respect to these factors by swap market participants in current market practice.

The 8 percent foreign currency haircut – to the extent it arises in application of the final rule – is additive to the final rule's standardized prudential supervisory haircuts that vary by asset class. These haircuts – set forth in Appendix B to the final rule – are unchanged from the 2014 proposal. They have been calibrated to be broadly consistent with valuation changes observed

[168] As discussed above, the final rule permits discrete netting sets under a single eligible master netting agreement, subject to conditions specified in §__.5(a)(3)(ii).

during periods of financial stress, as noted above. Although commenters suggested the Agencies permit covered swap entities to determine haircuts through the firm's internal models, the Agencies believe the simpler and more transparent approach of the standardized haircuts is more than adequate to establish appropriately conservative discounts on eligible collateral. The final rule permits initial margin calculations to be performed using an initial margin model in recognition of the fact that swaps and swap portfolios are characterized by a number of complex and inter-related risks that depend on the specifics of the swap and swap portfolio composition and are difficult to quantify in a simple, transparent and cost-effective manner. The exercise of establishing appropriate haircuts based on asset class of eligible collateral across long exposure periods is much simpler as the risk associated with a position in any particular margin eligible asset can be reasonably and transparently determined with readily available data and risk measurement methods that are widely accepted.

Finally, because the value of collateral may change, a covered swap entity must monitor the value and quality of collateral previously collected or posted to satisfy minimum initial margin requirements. If the value of such collateral has decreased, or if the quality of the collateral has deteriorated so that it no longer qualifies as eligible collateral, the covered swap entity must collect or post additional collateral of sufficient value and quality to ensure that all applicable minimum margin requirements remain satisfied on a daily basis.

4. Other Collateral

Commenters representing commercial end users, such as energy sector firms, agricultural producers and processors, and manufacturing firms, requested that the Agencies confirm that these counterparties, which were not subject to minimum initial margin determined under the standardized approach or internal model of the covered swap entity in the 2014 proposal, could continue using the diverse types of assets and guarantees they currently employ in securing and supporting their non-cleared swap transactions with swap dealers. Consistent with the 2014 proposal, § __.6(f) of the final rule states that covered swap entities may collect or post initial variation margin that is not required pursuant to the rule in any form of collateral.

The Dodd-Frank Act provides that in prescribing margin requirements, the Agencies shall permit the use of noncash collateral, as the Agencies determine to be consistent with (1) preserving the financial integrity of markets trading swaps; and (2) preserving the stability of the U.S. financial system. The Agencies believe that the eligibility of certain non-cash collateral, subject to the conditions and restrictions contained in the final rule, is consistent with the Dodd-Frank Act, because the use of such non-cash collateral is consistent with preserving the financial integrity of markets by trading swaps and preserving the stability of the U.S. financial system. The non-cash collateral permitted is highly liquid and resilient in times of stress and the rule does not permit collateral exhibiting significant wrong-way risk. The use of different types of eligible collateral pursuant to the requirements of the final rule should also incrementally increase liquidity in the financial system.

G. Section __.7: Segregation of Collateral.

1. The Final Rule

The final rule establishes minimum standards for the safekeeping of collateral. Section __.7(a) addresses requirements for when a covered swap entity posts any collateral other than variation margin. Posting collateral to a counterparty exposes a covered swap entity to risks in recovering such collateral in the event of its counterparty's insolvency. To address these risks and to protect the safety and soundness of the covered swap entity, §__.7(a) requires a covered swap entity that posts any collateral other than variation margin with respect to a non-cleared swap to require that such collateral be held by one or more custodians that are not the covered swap entity, its counterparty, or an affiliate of either counterparty. This requirement applies to initial margin posted by a covered swap entity pursuant to §__.3(b), as well as other collateral that is not variation margin that is not required by this rule but is posted by a covered swap entity for other reasons, including negotiated arrangement with its counterparty, such as initial margin posted to a financial end user that does not have material swaps exposure or initial margin posted to another covered swap entity even though the amount was less than the $50 million initial margin threshold amount.

Section __.7(b) addresses requirements for when a covered swap entity collects initial margin required by §__.3(a). Under §__.7(b), the covered swap entity shall require that initial margin collateral collected pursuant to §__.3(a) be held at one or more custodians that are not the covered swap entity, its counterparty, or an affiliate of either counterparty. Because the collection of initial margin does not expose the covered swap entity to the same risk of counterparty default as when a covered swap entity posts collateral, the segregation requirements for initial margin that a covered swap entity collects are less stringent than the requirements for posting collateral. As a result, §__.7(b) applies only to initial margin that a covered swap entity collects as required by § __.3(a), rather than all collateral collected.

For collateral subject to §__.7(a) or §__.7(b), § __.7(c) requires the custodian to act pursuant to a custodial agreement that is legal, valid, binding, and enforceable under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or similar proceedings. Such a custodial agreement must prohibit the custodian from rehypothecating, repledging, reusing or otherwise transferring (through securities lending, securities borrowing, repurchase agreement, reverse repurchase agreement, or other means) the funds or other property held by the custodian. Cash collateral may be held in a general deposit account with the custodian if the funds in the account are used to purchase other forms of eligible collateral, such eligible noncash collateral is segregated pursuant to § __.7, and such purchase takes place within a time period reasonably necessary to consummate such purchase after the cash collateral is posted as initial margin.[169]

Section ___.7(d) provides that, notwithstanding this prohibition on rehypothecating, repledging, reusing or otherwise transferring the funds or property held by the custodian, the posting party may substitute or direct any reinvestment of collateral, including, under certain conditions, collateral collected pursuant to §__.3(a) or posted pursuant to §__.3(b).

In particular, for initial margin collected pursuant to §___.3(a) or posted pursuant to §___.3(b), the posting party may substitute only funds or other property that meet the requirements for eligible collateral under § __.6 and where the amount net of applicable discounts described in Appendix B would be sufficient to meet the requirements of §__.3. The posting party also may direct the custodian to reinvest funds only in assets that would qualify as eligible collateral under §__.6 and ensure that the amount net of applicable discounts described in Appendix B would be sufficient to meet the initial margin requirements of §__.3. In the cases of both substitution and reinvestment, the final rule requires the covered swap entity to ensure that the value of eligible collateral net of discounts that is collected or posted remains equal to or above the minimum requirements contained in §__.3. In addition, the restrictions on the substitution and reinvestment of collateral described above do not apply to cases where a covered

[169] As described in section 6, collateral other than certain forms of cash is subject to a haircut. As a result, when cash collateral is used to purchase other forms of eligible collateral, a haircut will need to be applied.

swap entity has posted or collected more collateral than is required under §__.3. In such cases, the initial margin that has been posted or collected in satisfaction of §__.3 is subject to the restrictions, but any additional collateral that has been posted is not subject to the restrictions. As noted above, any additional collateral that has been *collected* by the covered swap entity is not subject to any of the requirements of §__.7.

No segregation of variation margin. Section 7 does not require collateral that is collected or posted as variation margin to be held by a third-party custodian or subject such collateral to restrictions on rehypothecation, repledging, or reuse. Consequently, subject to negotiations between the counterparties, a covered swap entity could collect cash posted to it in satisfaction of § __.4(b) from a counterparty without establishing a separate account for the counterparty. Similarly, a covered swap entity's counterparty would not be required to segregate cash funds posted as variation margin by the covered swap entity. The same is true with respect to eligible non-cash collateral exchanged as variation margin with a financial end user pursuant to §__.6(b); the segregation and custody requirements of §__.7 do not apply.

Section __.6(b) of the final rule permits eligible non-cash collateral to be posted as variation margin for swaps between a covered swap entity and a financial end user. In such circumstances, a covered swap entity or its financial end user counterparty could reach an agreement under which either party could itself hold non-cash collateral posted by the other and such non-cash collateral could be rehypothecated, repledged, or reused.

The Agencies received several comments regarding §__.7. Several commenters that operate as custodian banks requested clarification whether the final rule's prohibition against the custodian rehypothecating, repledging, reusing or otherwise transferring initial margin funds or property means that a custodian bank is not permitted to accept cash funds that it holds pursuant to §__.7 as a general deposit, and use such funds as it would any other funds placed on deposit with it.

Under §__.6, eligible collateral for initial margin includes "immediately available cash funds" that are denominated in a major currency or the currency of settlement for the non-cleared swap. It is not practical for cash funds to be held by a custodian as currency that remains the property of the posting party with a security interest being granted to its counterparty, e.g., by placing such currency in a safety deposit box or in the custodian's vault. Rather, the custodian banks explained in their joint comment letter that, under their current business practices, when a customer provides them with cash funds to hold as a custodian, the custodian bank accepts the funds as a general deposit, with the funds becoming property of the custodian bank and the customer holding a contractual debt obligation, i.e., a general deposit account, of the custodian bank. When holding cash under the arrangement described by the custodian bank commenters, a custodian is, in fact, not a custodian of a discrete asset but rather a recipient of cash funds under a contractual arrangement that establishes a debt obligation to be paid on demand—i.e., the custodian is acting as a bank. When such a customer has pledged cash funds as collateral under the arrangements described by the custodian bank commenters, the customer's property interest is the deposit account liability that the custodian bank owes to the customer.

Posting a general deposit account as initial margin raises unique concerns that are not present when eligible non-cash collateral is posted as initial margin. Permitting initial margin collateral to be held in the form of a deposit liability of the custodian bank is inconsistent with the final rule's prohibition against rehypothecation of such collateral. In addition, employing a deposit liability of the custodian bank – or another depository institution – is inconsistent with the final rule's prohibition in §__.6(d) against use of obligations issued by a financial firm, because of “wrong way” risk. On the other hand, as a practical matter, it is very difficult to eliminate cash entirely. For example, the final rule’s T+1 margin collection requirement means that it will often be necessary to use cash to cover the first days of a margin call. In addition, income generated by non-cash assets in custody will be paid in cash. Collateral reinvestments involving replacement of one category of non-cash asset with another category of non-cash asset may create cash balances between settlements. While the parties all have strong business incentives to manage and limit these cash fund balances, eliminating them entirely would result in a number of inefficiencies.

To address these concerns, the Agencies have revised the final rule to allow cash funds that are placed with a custodian bank in return for a general deposit obligation to serve as eligible initial margin collateral only in specified circumstances. However, the rule requires the posting party to direct the custodian to re-invest the deposited funds into eligible non-cash collateral of some type, or the posting party to deliver eligible non-cash collateral to substitute for the deposited funds. As noted above, the appropriate haircut must be applied. This reinvestment must occur within a reasonable period of time after the initial placement of cash collateral to satisfy the initial margin requirement, and the amount of eligible collateral must be sufficient to cover the initial margin amount in light of the applicable haircut on the non-cash collateral pursuant to Appendix B of the final rule.

Covered swap entities must appropriately oversee their own initial margin collateral posting and that of their counterparties in order to constrain the use of cash funds, and achieve efficient reinvestment of cash funds in excess of operational and liquidity needs into eligible margin securities. The banking agencies have long required banking organizations that engage in material swaps activities to create and maintain counterparty credit risk exposure management practices, including policies and procedures appropriate to evaluate and manage exposures that could arise not only from margin collateral liquidity and operational concerns, but also collateral-product correlations, volatility, and concentrations.[170] In connection with implementing the final rule, covered swap entities should ensure these procedures are adequate to assess the levels of cash necessary under the circumstances of each counterparty relationship, and to ensure the custodian will be directed to reinvest the remainder in non-cash collateral promptly, or that the posting party will substitute non-cash assets promptly, as applicable.

Several commenters supported the requirement that initial margin be held at a third party custodian that was not affiliated with either the covered swap entity or its counterparty. Some commenters, however, requested that the final rule allow affiliated custodians. These commenters expressed concern about complexities that additional parties bring to the relationship, as well as reservations about the capacity and availability of established custodians in the marketplace. After considering these comments, the Agencies have retained the requirement that the custodian be unaffiliated with either the covered swap entity or its counterparty. On balance, the Agencies are more concerned that customer confidence in a particular covered swap entity could be correlated with customer confidence in the affiliated custodian, especially in times of high market stress, whereas the use of independent custodians should offer counterparties a greater measure of confidence. Thus, the Agencies believe that it is necessary for the safety and soundness of covered swap entities and to minimize risk to the financial system that collateral be held by a custodian that is neither a counterparty to the swap nor an affiliate of either counterparty. This arrangement protects both counterparties from the

---

[170] *See, e.g.*, Interagency Supervisory Guidance on Counterparty Credit Risk Management (2011).

risk of the initial margin being held as part of one counterparty's estate (or its affiliate's estate) in the event of failure, and therefore not available to the other counterparty.

Section __.7(c)(2) requires that the custodial agreement be a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions. Some commenters requested that the final rule clarify that the only relevant jurisdiction is that of the custodian. The ultimate purpose of the custody agreement is twofold: (1) that the initial margin be available to a covered swap entity when its counterparty defaults and a loss is realized that exceeds the amount of variation margin that has been collected as of the time of default; and (2) that the initial margin be returned to the covered swap entity after its swap obligations have been fully discharged.

The jurisdiction of the custodian is one of the relevant jurisdictions for these purposes. Thus, a covered swap entity must conduct sufficient legal review to conclude with a well-founded basis and maintain sufficient written documentation of that legal review that in the event of a legal challenge, including one resulting from default or from receivership, conservatorship, insolvency, liquidation, or similar proceedings of the custodian, the relevant court or administrative authorities would find the custodial agreement to be legal, valid, binding, and enforceable by the covered swap entity under the law applicable to the custodian. A covered swap entity would also be expected to establish and maintain written procedures to monitor possible changes in relevant law and to ensure that the agreement continues to be legal, valid, binding, and enforceable under that law.

The jurisdiction of a covered swap entity's counterparty, however, is also a relevant jurisdiction. The covered swap entity would need to ascertain whether, if a counterparty were to become insolvent, or otherwise be placed under the control of a resolution authority, there would be a legal basis to set aside the custodial arrangement, allowing the resolution authority to reclaim for the estate assets that the counterparty had placed with the custodian. Thus, the covered swap entity would have to conduct a sufficient legal review to conclude with a well-founded basis that in the event of a legal challenge, including one resulting from default or from receivership, conservatorship, insolvency, liquidation, or similar proceedings of the counterparty, the relevant court or administrative authorities would find the custodial agreement to be legal, valid, binding, and enforceable by the covered swap entity under the law applicable to the counterparty.

Several commenters requested that the segregation requirement be optional, rather than required. The Agencies proposed the mandatory custodian requirements in §__.7 aware that sections 4s(l) of the Commodity Exchange Act and section 3E(f) of the Securities Exchange Act require a swap dealer and security-based swap dealer, respectively, to provide a counterparty with the option of requiring that its funds or other property supplied as initial margin be held in a segregated account at an independent third-party custodian. The Agencies continue to believe that requiring initial margin collateral to be segregated at an independent third-party custodian will help to ensure the safety and soundness of covered swap entities subject to the rule and offset the risk to the financial system arising from the use of non-cleared swaps.

The Agencies believe that requiring a covered swap entity to place initial margin collateral it collects at an independent third party custodian will provide greater customer confidence that the collateral will be available to be returned upon the closeout of a swap, particularly in times of financial stress. Additionally, the Agencies believe requiring a covered swap entity to ensure that any initial margin collateral it posts is placed at an independent third-party custodian will enhance the safety and soundness of the covered swap entity by protecting it from the risk that initial margin collateral could be held as part of the counterparty's estate in the event of the counterparty's failure.

Several commenters requested that the final rule allow greater flexibility in segregation arrangements. These commenters requested that the final rule permit arrangements such as title transfer and charge-back of margin, segregation of margin on the books of the covered swap entity or within an affiliate if such collateral is insulated from the covered swap entity's insolvency. The Agencies do not believe that the alternative arrangements suggested by the commenters adequately ensure the safety and soundness of the covered swap entity nor adequately offset the risk to the financial system arising from the use of non-cleared swaps.

One commenter recommended that the final rule allow limited rehypothecation that would meet the requirements of the 2013 international framework if a model for such rehypothecation could be developed for use by counterparties. The commenter also noted that other regulators may permit rehypothecation and, if so, a prohibition would create a competitive disadvantage for market participants subject to the Agencies' rule. However the commenter did not propose a specific model for limited rehypothecation. The Agencies have not revised the proposed regulation to accommodate a potential future model that may be developed. Should such a model be developed, the Agencies could consider such a model at that time.

One commenter requested that the final rule clarify that the required custodian arrangements be tri-party, i.e., entered into pursuant to an agreement between the covered swap entity, its counterparty, and the custodian. The commenter expressed concern that if a covered swap entity's counterparty is not a party to the custodial agreement, it would not be in contractual privity with the unaffiliated custodian, and the covered swap entity essentially would exercise exclusive control over its counterparty's initial margin. The Agencies believe the specific structure of the custody arrangements required by the rule are better left, on balance, to negotiations of the parties, in accordance with the specific concerns of those parties. Tri-party custody may be an optimal arrangement for some firms, while for others, it has not typically been sought under established market practice.

H. Section __.8: Initial Margin Models and Standardized Amounts.

1. Final Rule

a. Initial Margin Models

As in the proposed rule, the final rule adopts an approach whereby covered swap entities may calculate initial margin requirements using an approved initial margin model. As in the case of the proposal, the final rule also requires that the initial margin amount be set equal to a model's calculation of the potential future exposure of the non-cleared swap consistent with a one-tailed 99 percent confidence level over a 10-day close-out period. More specifically, under the final rule, initial margin models must capture all of the material risks that affect the non-cleared swap including material non-linear price characteristics of the swap.[171] For example, the initial margin calculation for a swap that is an option on an underlying asset, such as an option on a credit default swap contract, would be required to capture material non-linearities arising from changes in the price of the underlying asset or changes in its volatility. Moreover, the margin calculations for derivatives in distinct product-based asset classes, such as equity and credit, must be performed separately without regard to derivatives contracts in other asset classes. Each derivative contract must be assigned to a single asset class in accordance with the classifications in the final rule (i.e., foreign exchange or interest rate, commodity, credit, and

[171] *See* § __.8(d)(9) of the final rule.

equity). The presence of any common risks or risk factors across asset classes cannot be recognized for initial margin purposes.

The Agencies' belief is that these modeling standards should ensure a robust initial margin regime for non-cleared swaps that sufficiently limits systemic risk and reduces potential counterparty exposures.

Some commenters suggested that the proposal's requirement that the model include all material non-linear price characteristics in the underlying non-cleared swap was too stringent and should be relaxed. The Agencies have decided to retain this aspect of the quantitative modeling requirements in the final rule. The Agencies are concerned that the non-cleared swap market will be comprised of a large number of complex and bespoke swaps that will display significant non-linear price characteristics that will have a direct effect on their risk exposure. Accordingly, the final rule requires that all material non-linear price characteristics of the non-cleared swap be considered in assessing the risk of the swap. There may be non-linear price characteristics of a particular non-cleared swap that are not material in assessing its risk profile. In such cases these non-linear price characteristics need not be explicitly included in the initial margin model. The Agencies expect that in determining whether or not a given non-linear price characteristic is material, covered swap entities will engage in a holistic review of the non-cleared swap's risk profile and make determinations based on the totality of the non-cleared swap's risks.

All initial margin models must be approved by a covered swap entity's prudential regulator before being used for margin calculation purposes. In the event that a model is not approved, initial margin calculations would have to be performed according to the standardized initial margin approach that is detailed in Appendix A and discussed below.

In addition to the requirement that the models appropriately capture all material sources of risk, as discussed above, the final rule contains a number of standards and criteria that must be satisfied by initial margin models. These standards relate to the technical aspects of the model as well as broader oversight and governance standards. These standards are broadly similar to modeling standards that are already required for internal regulatory capital models of banks.

More specifically, under the final rule a covered swap entity must periodically, and no less than annually, review its initial margin model in light of developments in financial markets and modeling technologies and make appropriate adjustments to the model. Relatedly, the data used to calibrate and execute the initial margin model must also be reviewed no less frequently than annually to ensure that the data is appropriate for the products for which initial margin is being calculated. Different, additional or more granular data series may, at certain times, become available that would provide more accurate measurements of the risks that the initial margin model is intended to capture.

In addition to this regular review process, the final rule also requires that robust oversight, control and validation mechanisms be in place to ensure the integrity and validity of the initial margin model and related processes. More specifically, the final rule requires that the model be independently validated prior to implementation and on an ongoing basis which would also include a monitoring process that includes back-tests of the model and related analyses to ensure that the level of initial margin being calculated is consistent with the underlying risk of the swap being margined. Initial margin models must also be subject to explicit escalation procedures that would make any significant changes to the model subject to internal review and approval before taking effect. Under the final rule, any such review and approval must be based on demonstrable analysis that the change to the model results in a model that is consistent with the requirements of § __.8. Furthermore, under the final rule, any such changes or extensions of the initial margin model must be communicated to the relevant Agency 60 days prior to taking effect to give the Agency the opportunity to rescind its prior approval or subject it to additional conditions.

Some commenters suggested that the model governance, control and oversight standards of the proposed rule were too strict and should not be so closely aligned with the model governance requirements for bank capital models. One commenter suggested that since initial margin amounts must be agreed to between counterparties, it is not practical to require strict model governance standards.

The Agencies believe that strong model governance, oversight and control standards are crucial to ensuring the integrity of the initial margin model so as to provide for margin requirements that are commensurate with the risk of non-cleared swaps. Moreover, the Agencies are aware that there will be incentives to economize on initial margin and that strong governance standards that are intended to result in robust and risk-appropriate initial margin amounts is of critical importance. One commenter suggested that the initial margin model not be required to be back-tested against the initial margin requirements for similar cleared swaps. In light of the clear competitive forces that will exist between cleared and non-cleared swaps, the Agencies believe that it is appropriate to compare the initial margin requirements of non-cleared swaps to those of similar cleared swaps. Further, the Agencies understand that comparable cleared swaps with observable initial margin standards may not always be available given the complexity and variety of non-cleared swaps. Nevertheless, the Agencies believe that where similar swaps trade on a cleared and non-cleared basis, such comparisons are useful and informative.

One commenter suggested that where a covered swap entity is regulated by a foreign regulator and the foreign regulator has approved an initial margin model on the basis of comparable standards, the Agencies should defer to the approval of the foreign regulator and should not require Agency approval of the initial margin model. While the Agencies appreciate the global nature of the swaps market as well as the requirement to engage in close cross-border coordination with foreign regulators, the Agencies are required by statute to require initial and variation margin requirements that are appropriate for the risk of the non-cleared swaps. Accordingly, each Agency must find that any covered swap entity subject to its regulation is in compliance with all aspects of that Agency's margin requirements including the standards for initial margin models. Accordingly, while the Agencies expect to coordinate and communicate with foreign regulators regarding covered swap entities that are regulated by both the Agencies and foreign regulators, the final rule requires any quantitative initial margin model to adhere to the standards of the final rule and be approved by the relevant Agency.

One commenter suggested that the frequency with which data must be reviewed and revised as necessary should be annual rather than monthly to better align with other aspects of the proposal that require certain governance processes to be conducted on an annual rather than monthly basis. The Agencies believe that harmonizing the frequency with which certain model governance processes must be performed will reduce the costs associated with the regular oversight and maintenance of the initial margin model without meaningfully altering the overall standards for model governance. Accordingly, the final rule requires that data used in the initial margin model be reviewed and revised as necessary on an annual rather than monthly basis.

Initial margin models will be reviewed for approval by the appropriate Agency upon the request of a covered swap entity. Models that are reviewed for approval will be analyzed and subjected to a number of tests by the appropriate Agency to ensure that the model complies with the requirements of the final rule. Given that covered swap entities may engage in highly specialized business lines with varying degrees of intensity, it is expected that specific initial margin models may vary across covered swap entities. Accordingly, the specific analyses that will be undertaken in the context of any single model review may have to be tailored to the specific uses for which the model is intended. The nature and scope of initial margin model reviews are expected to be generally similar to reviews that are conducted in the context of other model review processes such as those relating to the approval of internal models for bank regulatory capital purposes. Initial margin models will also undergo periodic supervisory reviews to ensure that they remain compliant with the requirements of the proposed rule and are consistent with existing best practices over time.

Given the complexity and diverse nature of non-cleared swaps it is expected that covered swap entities may choose to make use of vendor supplied products and services in developing their own initial margin models. The final rule does not place any limits or restrictions on the use of vendor supplied model components such as specific data feeds, computing environments or calculation engines beyond those requirements that must be satisfied by any initial margin model. In particular, the relevant Agency will conduct a holistic review of the entire initial margin model and assess whether the model and related inputs and processes meet the requirements of the final rule.

To the extent that a covered swap entity uses vendor supplied inputs in conjunction with its own internal inputs and processes, an Agency's model approval decision will apply to the specific initial margin model used by a covered swap entity and not to a generally available vendor supplied model. To the extent that one or more vendors provide models or model-related inputs (e.g., calculation engines) that, in conjunction with the covered swap entities' own internal methods and processes, are part of an approved initial margin model, an Agency may also approve those vendor models. Model-related inputs may also be approved for use by other covered swap entities though that determination will be made on a case-by-case basis depending on the entirety of the processes that are employed in the application of the vendor supplied inputs and models by a covered swap entity.

i. Ten-Day Close-Out Period Assumption.

Since non-cleared swaps are expected to be less liquid than cleared swaps, the final rule specifies a minimum close-out period for the initial margin model of 10 business days, compared with a typical requirement of 3 to 5 business days used by CCPs.[172] Moreover, the required 10-day close-out period assumption is consistent with counterparty credit risk capital requirements for banks. Accordingly, to the extent that non-cleared swaps are expected to be less liquid than cleared swaps and to the extent that related capital rules which also mitigate counterparty credit risk similarly require a 10-day close-out period assumption, the Agencies' view is that a 10-day close-out period assumption for margin purposes is appropriate.[173]

Under the final rule, the initial margin model calculation must be performed directly over a 10-day close out period. In the context of bank regulatory capital rules, a long horizon calculation (such as 10 days) may, under certain circumstances, be indirectly computed by making a calculation over a shorter horizon (such as 1 day) and then scaled to the longer 10-day horizon according to a fixed rule to be consistent with the longer 10-day horizon. The rule does

[172] *See* § __.8(d)(1) of the final rule.

[173] In cases where a swap has a remaining maturity of less than 10 days, the remaining maturity of the swap, rather than 10 days, may be used as the close-out period in the margin model calculation.

not provide this option to covered swap entities using an approved initial margin model. The Agencies' view is that the rationale for allowing such indirect calculations that rely on scaling shorter horizon calculations to longer horizons has largely been based on computational and cost considerations that were material in the past but are much less now, in light of advances in computational speeds and reduced computing costs.

The Agencies received a number of comments concerning the length of the assumed close-out period used in the initial margin calculations. One commenter suggested the 10-day period was too long and suggested a close-out period of three to five days was adequate to ensure sufficient time to close out or hedge a defaulting counterparty's swap contract. Another commenter suggested a 10-day close-out period was too short and the resulting initial margins would not always be larger and more conservative than initial margins charged on cleared swaps.

The Agencies believe that a ten-day close-out period is appropriate for determining the level of initial margin in the final rule. Non-cleared swaps are expected to be less liquid and less frequently traded than cleared swaps which typically require initial margin amounts consistent with a three to five day close-out period. Accordingly, it is appropriate that the close-out period applied to non-cleared swaps be longer than that which is generally applied to cleared swaps. At the same time, the Agencies are aware that it may not be the case that the regulatory minimum required initial margin on a non-cleared swap will always be larger than the initial margin required on any related cleared swap as margining practices at CCPs vary from one CCP to another and may exceed minimum required margin levels due to the specific risk of the swap in question or the margining practices of the CCP. Moreover, given the complexity and diversity of the non-cleared swap market, the Agencies believe that it is not possible and unnecessary to prescribe a specific and different close-out horizon for each type of non-cleared swap that may exist in the marketplace. The Agencies do believe that it is appropriate for a covered swap entity to use a close-out period longer than ten-days in those circumstances in which the specific risk of the swap indicates that doing so is prudent. In terms of specifying a regulatory minimum requirement, however, the Agencies believe that a ten-day close-out period is sufficiently long to generally guard against the heightened risk of less liquid, non-cleared swaps.

ii. Recognition of Portfolio Risk Offsets.

The final rule permits a covered swap entity to use an internal initial margin model that reflects offsetting exposures, diversification, and other hedging benefits within four broad risk categories: commodities, credit, equity, and foreign exchange and interest rates (considered together as a single asset class) when calculating initial margin for a particular counterparty if the non-cleared swaps are executed under the same EMNA.[174] The final rule does not permit an initial margin model to reflect offsetting exposures, diversification, or other hedging benefits across those broad risk categories.[175] As a specific example, if a covered swap entity entered into two non-cleared credit swaps and two non-cleared commodity swaps with a single counterparty under an EMNA, the covered swap entity could use an approved initial margin model to perform two separate initial margin calculations: the initial margin collection amount calculation for the non-cleared credit swaps and the initial margin collection amount calculation for the non-cleared commodity swaps. Each calculation could recognize offsetting and diversification within the non-cleared credit swaps and within the non-cleared commodity swaps. The result of the two separate calculations would then be summed together to arrive at the total

[174] *See* § __.8(d)(3) of the final rule.

[175] *Id.*

initial margin collection amount for the four non-cleared swaps (two non-cleared credit swaps and two non-cleared commodity swaps).

The Agencies received comments on a range of issues that broadly relate to the recognition of portfolio risk offsets.

iii. Single commodity asset class.

One commenter requested that the rule specify only a single commodity asset class rather than the four separate asset classes that were specified in the proposal (agricultural commodities, energy commodities, metal commodities and other commodities). Under the proposal, initial margin on non-cleared commodity swaps would be calculated separately for each sub-asset class within the broader commodities asset class. The commenter suggested that there are significant and relatively stable correlations across related commodity categories that should not be ignored for hedging and margining purposes. The commenter also noted that commodity index swaps are a significant source of non-cleared commodity swap activity and that these swaps comprise exposures to each of the four commodity sub-asset classes that were identified in the proposal. Accordingly, the commenter suggested, implementing the proposal's four separate sub-asset class categories would not be appropriately risk sensitive and would be difficult and burdensome to implement for a significant class of commodity swaps.

The Agencies have considered this comment and have decided to group all non-cleared commodity swaps into a single asset class for initial margin calculation purposes. The Agencies believe that there is enough commonality across different commodity categories to warrant recognition of conceptually sound and empirically justified risk offsets. Moreover, the Agencies note that both the proposal and the final rule take a relatively broad view of the other asset classes: equity, credit, interest rates and foreign exchange. In prescribing the granularity of the asset classes there is a clear trade-off between simplicity and certainty around the stability of hedging relationships in narrowly defined asset classes and the greater flexibility and risk sensitivity that is provided by broader asset class distinctions. Therefore, the Agencies have decided to adopt a commodity asset class definition that is consistent with the other three asset classes and is appropriate in light of current market practices and conventions.

iv. Risk offsets between asset classes.

One commenter suggested that the margin requirements should be more reflective of risk offsets that exist between disparate asset classes such as equity and commodities. As was expressed in the proposal, however, the Agencies are of the view that the qualitative and quantitative basis for allowing for risk offsets among non-cleared swaps within a given, and relatively broad, asset class such as equities is conceptually stronger and better supported by historical data and experience than is the basis for recognizing such offsets across disparate asset classes such as foreign exchange and commodities. Non-cleared swaps that trade within a given asset class, such as equities, are likely to be subject to similar market fundamentals and dynamics as the underlying instruments themselves trade in related markets and represent claims on related financial assets. In such cases, it is more likely that a stable and systematic relationship exists that can form the conceptual and empirical basis for applying risk offsets.

To the contrary, non-cleared swaps in disparate asset classes such as foreign exchange and commodities are generally unlikely to be influenced by similar market fundamentals and dynamics that would generally suggest a stable relationship upon which reasonable risk offsets could be based. Rather, to the extent that empirical data and analysis suggest some degree of risk offset exists between swaps in disparate asset classes, this relationship may change unexpectedly over time in ways that could demonstrably change and weaken the assumed risk offset. Accordingly, the Agencies have decided to allow for risk offsets that have a sound conceptual and empirical basis across non-cleared swaps within the broad asset classes of equity, credit, commodity, and interest rates and foreign exchange but not to allow risk offsets across swaps in differing asset classes. Moreover, the Agencies note that the final asset class described above is interest rates and foreign exchange taken as a group. Accordingly, the final rule will allow conceptually sound and empirically supported risk offsets between an interest rate swap on a foreign interest rate and a currency swap in a foreign currency.

v. *Offsets across risk factors.*

Some commenters suggested that initial margin models should allow for offsets across risk factors even if these risk factors are present in non-cleared swaps across multiple asset classes such as equity and credit. For example, the commenters stated that both an equity swap and a credit swap may be exposed to some amount of interest rate risk. The commenters suggested that the interest rate risk inherent in the equity and credit swaps should be recognized on a portfolio basis so that any offsetting interest rate exposure across the two swaps could be recognized in the initial margin model. This approach would effectively require that all non-cleared swaps be described in terms of a number of “risk factors” and the initial margin model would consider the exposure to each risk factor separately. The initial margin amount required on a portfolio of non-cleared swaps would then be computed as the sum of the amounts required for each risk factor.

This "risk factor" based approach described above is different from the Agencies' proposal. Under the proposal, initial margin on a portfolio of non-cleared swaps was calculated on a product-level basis. In terms of the above example, initial margin would have been calculated separately for the equity swap and calculated separately for the credit swap. In the case of both the equity and credit swap, interest rate risk in the swap would have been modeled and measured without regard to the interest rate exposure of the other swap. The total initial margin requirement would have been the sum of the initial margin requirement for the equity swap and the credit swap. Accordingly, no offset would have been recognized between any potentially offsetting interest rate exposure in the equity and credit swap.

The Agencies have considered the commenters' "risk factor" based approach described above and have decided not to adopt this approach, but to adopt the Agencies' proposed approach in the final rule for a number of reasons.

First, a product-based approach to calculating initial margin is clear and transparent. In many market segments it is quite common to report and measure swap exposures on a product-level basis.[176] As an example, the Bank for International Settlements regularly publishes data on the outstanding notional amounts of OTC derivatives on a product-level basis. In addition, existing trade repositories, such as the DTCC global trade repositories for interest rate and credit swaps, report credit and interest rate derivatives on a product-level basis. Moreover, a risk factor based approach has the potential to be opaque and unwieldy. Modern derivative pricing models that are used by banks and other market participants may employ hundreds of risk factors that are not standardized across products or models.

[176] http://www.bis.org/statistics/dt1920a.pdf.

While it is the case that some swaps may have hybrid features that make it challenging to assign them to one specific asset class, the Agencies believe that the incidence of this occurrence will be relatively uncommon and can be dealt with under the final rule. In particular, as of December 2014, the Bank for International Settlements reported that of the roughly $630 trillion in gross notional outstanding, roughly 3.6 percent of these contracts cannot be allocated to one of the following broad asset categories: foreign exchange, interest rate, equity, commodity and credit. The Agencies also note that this fraction has declined from roughly 6.6 percent in June 2012 which suggests that the challenges associated with such hybrid swaps are declining over time. In such cases where the allocation of a particular non-cleared swap to a specific asset class is not uncontroversial, the Agencies expect an allocation to be made based on whichever broad asset class represents the preponderance of the non-cleared swap's overall risk profile.

Second, a product-level initial margin model is well aligned with current practice for cleared swaps. Some clearinghouses that offer multiple swaps for clearing, such as the CME, do allow for risk offsets within an asset class but do not generally allow for any risk offsets across asset classes. Again, as a specific example, the CME offers both cleared interest rate and credit default swaps. The CME's initial margin model is a highly sophisticated risk management model that does allow for offsetting among different credit swaps and among different interest rate swaps but does not allow for risk offsets between interest rate and credit swaps. This approach to calculating initial margin also provides a significant amount of transparency as market participants, regulators and the public can assess the extent to which trading activity in specific asset classes generates counterparty exposures that require initial margin. To the extent that some risk factors may cut across more than one asset class, the use of a risk-factor-based margining approach would make evaluating the quantum of risk posed by the trading activity in any one set of products difficult to measure and manage on a systematic basis which poses significant challenges to users of non-cleared swaps as well as regulators and the broader public who have an interest in monitoring and evaluating the risks of different non-cleared swap activities.

Third, the Agencies note that the final rule's product-level approach to initial margin explicitly allows for risk offsets though the precise form of these offsets differs from a "risk factor" based approach. The Agencies believe that conceptually sound and empirically justified risk offsets for initial margin are appropriate and have included such offsets in the final rule. In general, there are a large number of possible approaches that could be taken to allow for such offsets. The Agencies have considered the alternatives raised by the commenters and have adopted in the final rule an approach to recognizing risk offsets that provides for a significant amount of hedging and diversification benefits while also promoting transparency and simplicity in the margining framework.

vi. Product offsets.

Some commenters suggested that for the purposes of calculating model-based initial margin amounts, portfolio offsets should be recognized between non-cleared swaps, cleared swaps and other products such as positions in securities. The Agencies' authority under the Dodd-Frank Act for prescribing margin requirements on non-cleared swaps relates only to non-cleared swaps and not to other products even if those products are themselves, at times, traded in conjunction with non-cleared swaps. In particular, sections 731 and 764 of the Dodd-Frank Act require that the margin requirements be "imposed on all swaps that are not cleared" and that those requirements "be appropriate for the risk associated with non-cleared swaps held as a swap dealer or major swap participant."[177] The Agencies believe that it is appropriate for the margin requirements to be reflective of the risks in a covered swap entity's portfolio of non-cleared swaps and not to recognize risks – either as offsets or sources of additional risk – from other products that are not subject to the margin requirements of the final rule.

vii. Stress Calibration.

In addition to a time horizon of 10 trading days and a one-tailed confidence level of 99 percent, the final rule requires the initial margin model to be calibrated to a period of financial stress.[178] In particular, the initial margin model must employ a stress period calibration for each broad asset class (commodity, credit, equity, and interest rate and foreign exchange). The stress period calibration employed for each broad asset class must be appropriate to the specific asset class in question. While a common stress period calibration may be appropriate for some asset classes, a common stress period calibration for all asset classes would be considered appropriate only if it is appropriate for each specific underlying asset class. Also, the time period used to inform the stress period calibration must include at least one year, but no more than five years of equally-weighted historical data. This final rule's requirement is intended to balance the tradeoff between shorter and longer data spans. Shorter data spans are sensitive to evolving market conditions but may also overreact to short-term and idiosyncratic spikes in volatility, resulting in procyclical margin requirements. Longer data spans are less sensitive to short-term market developments but may also place too little emphasis on periods of financial stress, resulting in lower initial margins. Also, the requirement that the data be equally weighted will establish a

[177] *See* Dodd-Frank Act sections 731 and 764.

[178] *See* § __.8(d)(13) of the final rule.

degree of consistency in model calibration while also ensuring that particular weighting schemes do not result in procyclical margin requirements during short-term bouts of heightened volatility.

Calibration to a stress period helps to ensure that the resulting initial margin requirement is robust to a period of financial stress during which swap entities and financial end user counterparties are more likely to default, and counterparties handling a default are more likely to be under pressure. The stress calibration requirement also reduces the systemic risk associated with any increase in margin requirements that might occur in response to an abrupt increase in volatility during a period of financial stress, as initial margin requirements will already reflect a historical stress event.

One commenter suggested that the overall level of the proposed initial margin requirements were too high and that the proposed requirement to calibrate the initial margin model to a period of financial stress was too conservative. The Agencies have considered this comment but continue to believe that the overall level of the initial margin requirements is consistent with the goals of prescribing margin requirements that are appropriate for the risk of non-cleared swaps and the safety and soundness of the covered swap entity. Moreover, the requirement to calibrate the initial margin model to a period of financial stress has two important benefits. First, margin requirements that are consistent with a period of financial stress will help to ensure that counterparties are sufficiently protected against the type of severe financial stresses that are most likely to have systemic consequences. Second, calibrating margins to a period of financial stress should have the effect of reducing the extent to which margins are pro-cyclical. Specifically, since margin levels will be consistent with a period of above average market volatility and risk, a moderate rise in risk levels should not require any increase or re-evaluation of margin levels. In this sense, margin requirements will be less likely to increase abruptly following a market shock. There may be circumstances in which the financial system experiences a significant financial stress that is even greater than the stress to which initial margins have been calibrated. In these cases, initial margin requirements will rise as margin levels are re-calibrated to be consistent with the new and greater stress level. The Agencies expect such occurrences to be relatively infrequent and, ultimately, any risk-sensitive and empirically-based method for calibrating a risk model must exhibit some sensitivity to changing financial market risks and conditions.

viii. Cross-currency Swaps.

As discussed above, an approved initial margin model must generally account for all of the material risks that affect the non-cleared swap. An exception to this requirement has been made in the specific case of cross-currency swaps. In a cross-currency swap, one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs upon the inception of the swap, with a reversal of the exchange of principal at a later date that is agreed upon at the inception of the swap.

Under the final rule, an initial margin model need not recognize any risks or risk factors associated with the foreign exchange transactions associated with the fixed exchange of principal embedded in a cross-currency swap as defined in § __.2 of the final rule. The initial margin model must recognize all risks and risk factors associated with all other payments and cash flows that occur during the life of the cross-currency swap. In the context of the standardized margin approach, described in Appendix A and further below, the gross initial margin rates have been set equal to those for interest rate swaps. This treatment recognizes that cross-currency swaps are subject to risks arising from fluctuations in interest rates but does not recognize any risks associated with the fixed exchange of principal since principal is typically not exchanged on interest rate swaps.

ix. Frequency of Margin Calculation.

The final rule requires that an approved initial margin model be used to calculate the required initial margin collection amount on a daily basis. In cases where the initial margin collection amount increases, this new amount must be used as the basis for determining the amount of initial margin that must be collected from a financial end user with material swaps exposure or a swap entity counterparty. In addition, when a covered swap entity faces a financial end user with material swaps exposure, the covered swap entity must also calculate the initial margin collection amount from the perspective of its counterparty on a daily basis. In the event that this amount increases, the covered swap entity must use this new amount as the basis for determining the amount of initial margin that it must post to its counterparty. In cases where this amount decreases, the new amount would represent the new minimum required amount of initial margin. Accordingly, any previously collected or posted collateral in excess of this amount would represent additional initial margin collateral that, subject to bilateral agreement, could be returned.

The use of an approved initial margin model may result in changes to the initial margin collection amount on a daily basis for a number of reasons. First, the characteristics of the swaps that have a material effect on their risk may change over time. As an example, the credit quality of a corporate reference entity upon which a credit default swap contract is written may undergo a measurable decline. A decline in the credit quality of the reference entity would be expected to have a material impact on the initial margin model's risk assessment and the resulting initial margin collection amount. More generally, as the swaps' relevant risk characteristics change, so will the initial margin collection amount. In addition, any change to the composition of the swap portfolio that results in the addition or deletion of swaps from the portfolio would result in a change in the initial margin collection amount. Second, the underlying parameters and data that are used in the model may change over time as underlying conditions change. As an example, in the event that a new period of financial stress is encountered in one or more asset classes, the initial margin model's risk assessment of a swap's overall risk may change as a result. While the stress period calibration is intended to reduce the extent to which small or moderate changes in the risk environment influence the initial margin model's risk assessment, a significant change in the risk environment that affects the required stress period calibration could influence the margin model's overall assessment of the risk of a swap. Third, quantitative initial margin models are expected to be maintained and refined on a continuous basis to reflect the most accurate risk assessment possible with available best practices and methods.[179] As best practice risk management models and methods change, so too may the risk assessments of initial margin models.

b. Standardized Initial Margins.

Under the final rule, covered swap entities that are either unable or unwilling to make the technology and related infrastructure investments necessary to maintain an initial margin model may elect to use standardized initial margins. The standardized initial margins are detailed in Appendix A of the final rule.

[179] Section__.8(c)(3) of the final rule would require any material change to the model be communicated to the relevant Agency before taking effect. The Agencies, however, do anticipate that some changes will be made to initial margin models on an ongoing basis consistent with regular and ongoing maintenance and oversight that will not require Agency notification.

i. Gross Initial Margins and Recognition of Offsets Through the Application of the Net-to-Gross Ratio.

Under the final rule, standardized initial margins depend on the asset class (commodity, equity, credit, foreign exchange and interest rate) and, in the case of credit and interest rate asset classes, further depend on the duration of the underlying non-cleared swap.

In addition, the standardized initial margin requirement allows for the recognition of risk offsets through the use of a net-to-gross ratio in cases where a portfolio of non-cleared swaps is executed under an EMNA. The net-to-gross ratio compares the net current replacement cost of the non-cleared portfolio (in the numerator) with the gross current replacement cost of the non-cleared portfolio (in the denominator). The net current replacement cost is the cost of replacing the entire portfolio of swaps that are covered under the EMNA. The gross current replacement cost is the cost of replacing those swaps that have a strictly positive replacement cost under the EMNA. As an example, consider a portfolio that consists of two non-cleared swaps under an EMNA in which the mark-to-market value of the first swap is $10 (i.e., the covered swap entity is owed $10 from its counterparty) and the mark-to-market value of the second swap is -$5 (i.e., the covered swap entity owes $5 to its counterparty). Then the net current replacement cost is $5 ($10-$5), the gross current replacement cost is $10, and the net-to-gross ratio would be 5/10 or 0.5.[180]

[180] Note that in this example, whether or not the counterparties have agreed to exchange variation margin has no effect on the net-to-gross ratio calculation, i.e., the calculation is performed without considering any variation margin payments. This is intended to ensure that the net-to-gross ratio calculation reflects the extent to which the non-cleared swaps generally offset each other and not whether the counterparties have agreed to exchange variation margin. As an example, if a swap dealer engaged in a single sold credit derivative with a counterparty, then the net-to-gross calculation would be 1.0 whether or not the dealer received variation margin from its counterparty.

The net-to-gross ratio and gross standardized initial margin amounts (provided in Appendix A) are used in conjunction with the notional amount of the transactions in the underlying swap portfolio to arrive at the total initial margin requirement as follows:

Standardized Initial Margin=0.4 x Gross Initial Margin + 0.6 x NGR x Gross Initial Margin

where:

Gross Initial Margin= the sum of the notional value multiplied by the appropriate initial margin requirement percentage from Appendix A of each non-cleared swap under the EMNA; and

NGR= net-to-gross ratio

As a specific example, consider the two-swap portfolio discussed above. Suppose further that the swap with the mark-to-market value of $10 is a sold 5-year credit default swap with a notional value of $100 and the swap with the mark-to-market value of -$5 is an equity swap with a notional value of $100. The standardized initial margin requirement would then be:

$$[0.4 \times (100 \times 0.05 + 100 \times 0.15) + 0.6 \times 0.5 \times (100 \times 0.05 + 100 \times 0.15)]=8+6=14.$$

The Agencies further note that the calculation of the net-to-gross ratio for margin purposes must be applied only to swaps subject to the same EMNA and that the calculation is performed <u>across</u> transactions in disparate asset classes within a single EMNA such as credit and equity in the above example (i.e., all non-cleared swaps subject to the same EMNA and subject to the final rule’s requirements can net against each other in the calculation of the net-to-gross ratio, as opposed to the modeling approach that allows netting only within each asset class). This approach is consistent with the standardized counterparty credit risk capital requirements. Also, the equations are designed such that benefits provided by the net-to-gross ratio calculation are limited by the standardized initial margin term that is independent of the net-to-gross ratio, i.e., the first term of the standardized initial margin equation which is 0.4 x Gross Initial Margin. Finally, if a counterparty maintains multiple non-cleared swap portfolios under one or multiple EMNAs, the standardized initial margin amounts would be calculated separately for each portfolio with each calculation using the gross initial margin and net-to-gross ratio that is relevant to each portfolio. The total standardized initial margin would be the sum of the standardized initial margin amounts for each portfolio. One commenter suggested that the Agencies adopt an altogether different approach to computing standardized initial margins in a manner consistent with the standardized approach for measuring counterparty credit risk exposures that was finalized and published by the BCBS in March 2014. This approach is intended to be used in bank regulatory capital requirements for the purposes of computing capital requirements for counterparty credit risk resulting from OTC derivative exposures.

The Agencies have decided not to adopt this approach in the final rule for several reasons. First, the standardized approach for counterparty credit risk has been developed for counterparty capital requirement purposes and, while clearly related to the issue of initial margin for non-cleared swaps, it is not entirely clear that this framework can be transferred to a simple and transparent standardized initial margin framework without modification. Second, the standardized counterparty credit risk approach that has been published by the BCBS is not intended to become effective until January 2017 which follows the initial compliance date of the final rule. Accordingly, the Agencies expect that some form of the standardized approach will be proposed by U.S. banking regulators prior to January 2017. Following the notice and comment period, a final rule for capitalizing counterparty credit risk exposures will be finalized in the United States. Once these rules are in place and effective it may be appropriate to consider adjusting the approach in this rule to standardized initial margins. Prior to the new capital rules being effective in the United States for the purpose for which they were intended, the Agencies do not believe it would be appropriate to incorporate the standardized approach to counterparty credit risk that has been published by the BCBS into the final margin requirements for non-cleared swaps.

One commenter suggested modifying the proposed approach to standardized initial margin amounts to reflect greater granularity. Among other things, this commenter suggested increasing the number of asset categories recognized by the standardized initial margin table. In the final rule, the Agencies have adopted the proposed approach to standardized initial margins. The Agencies acknowledge the desire to reflect greater granularity in the standardized approach but also note that the approach in the final rule distinguishes among four separate asset classes and various maturities. The Agencies also note that no commenter provided a specific and fully articulated suggestion on how to modify the standardized approach to achieve greater flexibility without becoming overly burdensome. The Agencies also note that the standardized initial margins are a minimum margin requirement. Accordingly, covered swap entities and their counterparties are free to develop standardized margin schedules that reflect greater granularity than the final rule's standardized approach so long as the resulting amounts would in all circumstances be at least as large as those required by the final rule's standardized approach to initial margin. Accordingly, the final rule affords covered swap entities and their counterparties the opportunity to develop simple and transparent margin schedules that reflect the granular and specific nature of the swap activity being margined.

ii. Calculation of the Net-to-Gross Ratio for Initial Margin Purposes.

The final rule's standardized approach to initial margin depends on the calculation of a net-to-gross ratio. In the context of performing margin calculations, it must be recognized that at the time non-cleared swaps are entered into it is often the case that both the net and gross current replacement cost is zero. This precludes the calculation of the net-to-gross ratio. In cases where a new swap is being added to an existing portfolio that is being executed under an existing EMNA, the net-to-gross ratio may be calculated with respect to the existing portfolio of swaps. In cases where an entirely new swap portfolio is being established, the initial value of the net-to-gross ratio should be set to 1.0. After the first day's mark-to-market valuation has been recorded for the portfolio, the net-to-gross ratio may be re-calculated and the initial margin amount may be adjusted based on the revised net-to-gross ratio.

iii. Frequency of Margin Calculation.

The final rule requires that the standardized initial margin collection amount be calculated on a daily basis. In cases where the initial margin collection amount increases, this new amount must be used as the basis for determining the amount of initial margin that must be collected from a financial end user with material swaps exposure or a swap entity. In addition, when a covered swap entity faces a financial end user with material swaps exposure, the covered swap entity must also calculate the initial margin collection amount from the perspective of its counterparty on a daily basis. In the event that this amount increases, the covered swap entity must use this new amount as the basis for determining the amount of initial margin that it must post to its counterparty. In the event that this amount decreases, this new amount would also serve as the basis for the minimum required amount of initial margin. Accordingly, any previously collected or posted initial margin over and above the new requirement could, subject to bilateral agreement, be returned.

iv. Daily Calculation.

As in the case of internal-model-generated initial margins, the margin calculation under the standardized approach must also be performed on a daily basis. Since the standardized initial margin calculation depends on a standardized look-up table (presented in Appendix A), there is somewhat less scope for the initial margin collection amounts to vary on a daily basis. At the same time, however, there are some factors that may result in daily changes in the initial margin collection amount resulting from standardized margin calculations. First, any changes to the notional size of the swap portfolio that arise from any addition or deletion of swaps from the portfolio would result in a change in the standardized margin amount. As an example, if the notional amount of the swap portfolio increases as a result of adding a new swap to the portfolio then the standardized initial margin collection amount would increase. Second, changes in the net-to-gross ratio that result from changes in the mark-to-market valuation of the underlying swaps would result in a change in the standardized initial margin collection amount. Third, changes to characteristics of the swap that determine the gross initial margin (presented in Appendix A) would result in a change in the standardized initial margin collection amount. As an example, the gross initial margin applied to interest rate swaps depends on the duration of the swap. An interest rate swap with a duration between zero and two years has a gross initial margin of one percent while an interest rate swap with duration of greater than two years and less than five years has a gross initial margin of two percent. Accordingly, if an interest rate swap's duration declines from above two years to below two years, the gross initial margin applied to it would decline from two to one percent. Accordingly, the standardized initial margin collection amount will need to be computed on a daily basis to reflect all of the factors described above.

c. Combined Use of Internal Model Based and Standardized Initial Margins.

The Agencies expect that some covered swap entities may choose to adopt a mix of internal models and standardized approaches to calculating initial margin requirements. For example, it may be the case that a covered swap entity engages in some swap transactions on an infrequent basis to meet client demands but the level of activity does not warrant all of the costs associated with building, maintaining and overseeing a quantitative initial margin model. Further, some covered swap entity clients may value the transparency and simplicity of the standardized approach. In such cases, the Agencies expect that it would be acceptable to use the standardized approach to margin such swaps.

Under certain circumstances it may be appropriate to employ both a model based and standardized approach to calculating initial margins. At the same time, the Agencies are aware that differences between the standardized approach and internal model based margins across different types of swaps could be used to "cherry pick" the method that results in the lowest margin requirement. Rather, the choice to use one method over the other should be based on fundamental considerations apart from which method produces the most favorable margin results. Similarly, the Agencies do not anticipate there should be a need for covered swap entities to switch between the standardized or model-based margin method for a particular counterparty, absent a significant change in the nature of the entity's swap activities. The Agencies expect covered swap entities to provide a rationale for changing methodologies to their supervisory Agency if requested. The Agencies will monitor for evasion of the swap margin requirements through selective application of the model and standardized approach as a means of lowering the margin requirements.

I. Section __.9: Cross-border Application of Margin Requirements.

In global markets, counterparties organized in different jurisdictions often transact in non-cleared swaps. Section 9 of the final rule addresses the cross-border applicability of the proposed margin rules to covered swap entities.

1. Excluded swaps

Section __.9 of the final rule excludes from coverage of the rule's margin requirements any foreign non-cleared swap of a foreign covered swap entity.[181] A "foreign covered swap entity" is any covered swap entity that is *not* (i) an entity organized under U.S. or State law, including a U.S. branch, agency, or subsidiary of a foreign bank; (ii) a branch or office of an entity organized under U.S. or State law; or (iii) an entity that is a subsidiary of an entity organized under U.S. or State law. Accordingly, under the final rule, only a covered swap entity that is organized under foreign law and is not a subsidiary of a U.S. company (such as a foreign bank) would be eligible for treatment as a foreign covered swap entity; neither a foreign branch of a U.S. bank nor a foreign subsidiary of a U.S. company would be considered a foreign covered swap entity under the final rule. The swap activities of the foreign branch or subsidiary have the potential to expose the U.S. bank or parent to significant legal, contractual, or reputational risks. Transactions of a foreign branch or subsidiary of a U.S. company could also have direct and significant connection with activities in, and effect on, commerce of the United States and therefore affect systemic risk in the United States. Similarly, neither a U.S. branch of a foreign bank nor a U.S. subsidiary of a foreign company would be considered a foreign covered swap entity under the final rule, since they operate directly in the United States.

[181] Section 2(i) of the Commodity Exchange Act, as amended by section 722 of the Dodd-Frank Act, provides that the provisions of the Commodity Exchange Act, as amended by section 722 of the Commodity Exchange Act relating to swaps "shall not apply to activities outside the United States unless those activities . . . have a direct and significant connection with activities in, or effect on, commerce of the United States."

The final rule's definition of "foreign non-cleared swap or foreign non-cleared security-based swap" covers any non-cleared swap of a foreign covered swap entity to which neither the counterparty nor any guarantor (on either side) is (i) an entity organized under U.S. or State law, including a U.S. branch, agency, or subsidiary of a foreign bank or a natural person who is a resident of the United States; (ii) a branch or office of an entity organized under U.S. or State law; or (iii) a swap entity that is a subsidiary of an entity organized under U.S. or State law. As a result, foreign non-cleared swaps could include swaps with a foreign bank or with a foreign subsidiary of a U.S. bank or bank holding company, so long as neither the subsidiary nor the U.S. parent is a covered swap entity. A foreign swap would not include a swap with a foreign branch of a U.S. bank or a U.S. branch or subsidiary of a foreign bank.

The final rule's approach to excluded swaps largely follows the proposed approach with a few minor modifications. The foreign non-cleared swap definition has been modified to make clear that a natural person resident of the United States cannot be the guarantor of a swap that would qualify for the foreign exclusion. In addition, this definition has been modified to make clear that neither the counterparty nor the guarantor can be a swap entity (as opposed to a covered swap entity, as proposed) that is a subsidiary of an entity that is organized under the laws of the United States or any State.

One commenter urged that U.S. branches and agencies of foreign banks transacting with foreign counterparties with no guarantee from a U.S. entity should be able to treat their non-cleared swaps as excluded foreign swap transactions that are not subject to this rule because the branch is part of the same legal entity as its foreign parent.[182] The Agencies have not modified

[182] This commenter argued that, at a minimum, application of the final rule should depend solely on whether the swap is booked to the U.S. branch or agency and that the location of personnel or agents should have no bearing on whether the swap gives rise to

the final rule to treat transactions of a U.S. branch or agency of a foreign bank with a foreign counterparty that is not guaranteed by a U.S. entity as a foreign non-cleared swap of a foreign covered swap entity. Such branches and agencies clearly operate within the United States and could pose risk to the U.S. financial system. Moreover, and as described further below, such U.S. branches and agencies of foreign banks would be eligible for substituted compliance under the final rule and be able to comply with a foreign margin rule if the Agencies make a comparability determination with respect to the applicable foreign margin rule.

Another commenter urged that the final rule should not apply to a covered swap entity that is a subsidiary of a U.S. parent where the subsidiary is not guaranteed by the U.S. entity. The Agencies have not modified the rule in this manner, as subsidiaries of a U.S. covered swap entity could pose risk to the U.S. covered swap entity and the U.S. financial system. As described more fully below, however, these subsidiaries may be able to take advantage of substituted compliance determinations under the final rule.

In the proposed rule, the definitions of foreign covered swap entity and foreign non-cleared swap included a test that looked to the existence of "control" by an entity organized under the laws of the United States. One commenter expressed concern about the proposal's lack of clarity with respect to the meaning of "control" in these circumstances. The final rule has been modified in these two provisions to replace "controlled by" with the term "subsidiary" which is defined by reference to financial consolidation in section 2 of the final rule.[183] The

---

risks to the United States financial system. Another commenter stated that it is not clear whether margin rules would apply if a swap transaction with a foreign counterparty is booked by a foreign swap entity but arranged, negotiated, or executed by persons operating from a U.S. branch of such swap entity. The Agencies would generally consider the entity to which the swap is booked as the counterparty for purposes of this section.

[183] *See* §__.2 of the final rule.

Agencies believe that these modifications address this commenter's concerns with respect to the proposal's use of the definition of "control."

Certain commenters also expressed concern that the proposed rule did not make clear when a counterparty was a U.S. person for purposes of determining whether a swap qualified as a foreign non-cleared swap, which would be excluded under the proposed rule. One commenter, for example, suggested that the final rule adopt a "U.S. person" definition to make clear how foreign covered swap entities can determine whether a counterparty that is a financial end user is either a U.S. or foreign entity.[184] Similarly, another commenter urged the Agencies to incorporate a "principal place of business" test into the definition of foreign non-cleared swap or foreign non-cleared security-based swap.[185] The Agencies have not adopted the changes recommended by these commenters but have retained the bright-line proposed test that looks to the jurisdiction of organization. As a consequence, the Agencies would consider the place of incorporation of a particular entity to be the location of the entity for purposes of this rule.

b. Guarantees.

The requirement that no U.S. entity may guarantee either party's obligation under the swap in order for the swap to be excluded from the rule is intended to prevent instances where a U.S. entity, through a guarantee, effectively assumes ultimate responsibility for the performance of a counterparty's obligations under the swap. In particular, the Agencies are concerned that,

[184] One commenter cited CFTC Proposal, 79 FR 59,898 at 59,916 (October 3, 2014), arguing that an investment company based in the Cayman Island with U.S. investors that enters into a non-cleared swap with a foreign covered swap entity cannot be sure whether it would be subject to U.S. laws.

[185] This commenter argued that the proposal classifies funds organized outside of the United States but with a U.S. principal place of business through a U.S.-based fund manager as a foreign entity and recommended following the approach of the CFTC and SEC in their cross-border guidance. Two commenters stated that the Agencies should adopt the CFTC entity-level approach.

without such a requirement, swaps could be structured in a manner that would evade application of the margin requirements to U.S. swaps. Swaps guaranteed by a U.S. entity would also have a direct and significant connection with activities in, and an effect on, commerce of the United States and thus affect systemic risk in the United States.

Section 9(g) of the final rule defines “guarantee” to mean an arrangement pursuant to which one party to a non-cleared swap has rights of recourse against a third-party guarantor, with respect to its counterparty’s obligations under the non-cleared swap. For these purposes, a party to a non-cleared 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 swap. In addition, 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 third-party guarantor with respect to the counterparty’s obligations under the non-cleared swap, such arrangement will be deemed a guarantee of the counterparty’s obligations under the swap by the other guarantor. The definition of guarantee has implications for the swaps that are excluded from the rule as well as for the swaps that are eligible for a compliance determination under §__.9(d) and the ability to meet the requirements of §__.9(f) in jurisdictions where segregation is unavailable.

In the proposal, the Agencies requested comment on whether the rule should clarify and define the concept of “guarantee” to better ensure that those swaps that pose risks to U.S. insured depository institutions would be included within the scope of the rule. Some commenters urged the Agencies to define the term “guarantee.” While one commenter supported use of a broad definition of guarantee that includes cross-default provisions, keepwell arrangements or liquidity puts, another commenter argued that a guarantee should be defined to constitute an express, legally enforceable arrangement providing foreign counterparties with recourse to the U.S. guarantor. Another commenter argued that cross-default provisions would not generally give a swap counterparty any direct right of access against the specified entity and should not be treated as a guarantee.

In order to provide additional clarity on the meaning of guarantee for purposes of §__. 9, the final rule requires one party to have rights of recourse against a third-party guarantor; however, in order to address potential concerns about evasion, the Agencies will deem a guarantee to exist, if the third-party guarantor has a guarantee from one or more additional third-party guarantors, with respect to the obligations under the non-cleared swap. The Agencies believe that a definition of "guarantee" that is narrowly targeted to the particular swap obligation provides clarity through a bright-line test that can be applied consistently and is appropriately limited in scope. For example, if a foreign registered German Bank covered swap entity ("Party W") enters into a swap with a non-covered swap entity, foreign subsidiary of a U.S. covered swap entity ("Party X"), and Party X has a guarantee from a third-party guarantor that is a foreign affiliate of Party X ("Party Y"), who then, in turn has a guarantee from its U.S. covered swap entity parent entity ("Parent Z"), the Agencies would deem a guarantee to exist between Party X and Parent Z, on Party X's swap obligations.

c. Substituted compliance.

In addition to the exclusion for certain swaps described above, the final rule would permit certain covered swap entities to comply with a foreign regulatory framework for non-cleared swaps if the Agencies jointly determine that such foreign regulatory framework is comparable to the requirements of the Agencies' rule. The development of the 2013 international framework makes it more likely that regulators in multiple jurisdictions will adopt margin rules for non-cleared swaps that are comparable. In light of the 2013 international framework, the final rule would allow certain non-U.S. covered swap entities to comply with the margin requirements of the final rule by complying with a foreign jurisdiction's margin requirements, subject to the Agencies' determination that the foreign rule is comparable to this final rule and appropriate for the safe and sound operation of the covered swap entity, taking into account the risks associated with the non-cleared swaps. These determinations would be made on a jurisdiction-by-jurisdiction basis. Furthermore, the Agencies' determination may be conditional or unconditional. The Agencies could, for example, determine that certain provisions of the foreign regulatory framework are comparable to the requirements of the final rule but that other aspects are not comparable for purposes of substituted compliance.

Under the final rule, certain types of covered swap entities operating in foreign jurisdictions would be able to meet the requirement of the final rule by complying with the foreign requirement in the event that a comparability determination is made by the Agencies, regardless of the location of the counterparty, provided that the covered swap entity's obligations under the swap are not guaranteed by a U.S. entity (other than a U.S. branch, agency, or subsidiary of a foreign bank) or by a natural person who is a U.S. resident. If a covered swap entity's obligations under a swap are guaranteed by a U.S. entity or natural person who is a U.S. resident, the swap would not be eligible for substituted compliance. Foreign covered swap entities (defined as discussed above) and foreign subsidiaries of U.S. depository institutions or Edge or agreement corporations would be eligible to take advantage of a comparability determination.

In addition, U.S. branches and agencies of foreign banks would be permitted to comply with the foreign requirement for which a determination was made, provided their obligations under the swap are not guaranteed by a U.S. entity or by a natural person who is a resident of the United States. While such branches and agencies clearly operate within the United States, this treatment reflects the principle that branches and agencies are part of the parent organization. Under this approach, foreign branches and agencies of U.S. banks would not be eligible for substituted compliance and would be required to comply with the U.S. requirement for the same reason. The Agencies are aware of concerns regarding potential competitive disadvantages that could arise as U.S. covered swap entities compete with U.S. branches and agencies of foreign banks in the market for non-cleared swaps. The Agencies' believe that this concern would be addressed through the comparability determination process. A foreign jurisdiction with a substantially different margin requirement that resulted in a demonstrable competitive advantage over U.S. covered swap entities is unlikely to have processes that are comparable to the U.S. compliance requirements. Moreover, a foreign margin requirement that provides significant competitive advantages to foreign entities through a lower margin requirement would result in a general increase in systemic risk and weaker incentives for central clearing, relative to the U.S. margin requirements. Accordingly, it is unlikely that such foreign requirements would be determined comparable by the Agencies, in which case the U.S. branch or agency of a foreign bank would be required to comply with the U.S. requirement.

Certain commenters urged the Agencies to permit substituted compliance for comparable rules to the greatest possible degree in order to mitigate cross-border conflicts and inconsistencies in the application of margin requirements. A number of comments expressed concern about the application of multiple different sets of rules on cross-border swap transactions, which they argued could deter cross-border swap transactions. A few commenters argued that counterparties should be able to agree which of their jurisdictions' margin requirements will apply to a swap, as long as both jurisdictions' requirements are consistent with international standards. The Agencies believe that the availability of substituted compliance determinations in the final rule serve to mitigate these concerns while at the same time ensuring that applicable margin rules in a foreign jurisdiction would be comparable to this final rule.

Some commenters argued that foreign branches of U.S. swap entities as well as foreign covered swap entities that are guaranteed by a U.S. entity[186] should be able to take advantage of substituted compliance determinations. Some of these commenters argued that foreign branches of U.S. swap entities and foreign covered swap entities that are guaranteed by a U.S. entity would be subject to foreign margin requirements and that making substituted compliance available to them is necessary to avoid conflicts with foreign laws. The Agencies have declined to modify the final rule in this respect as transactions of a foreign branch of a U.S. entity could have a direct and significant connection with activities in, and effect on, commerce of the United States. While such branches and agencies clearly operate within a foreign jurisdiction, this treatment reflects the principle that branches and agencies are part of the parent, as noted above. The requirement that no U.S. affiliate may guarantee the counterparty's obligation was intended to prevent instances where such an affiliate, through a guarantee, effectively assumes ultimate responsibility for the performance of the counterparty's obligations under the swap. In particular, the Agencies are concerned that, without such a requirement, swaps with a U.S.

[186] One commenter argued that if the Agencies decide to apply the final rule to foreign swap transactions based on the presence of a U.S. guarantee, they should only do so if that guarantee constitutes an express legally enforceable arrangement providing foreign swap counterparties with recourse to the U.S. guarantor. As noted above, the final rule defines the term "guarantee" for purposes of this section.

counterparty could be structured, through the use of an overseas affiliate, in a manner that would evade application of the proposed margin requirements to U.S. swaps. Swaps guaranteed by a U.S. entity would also have a direct and significant connection with activities in, and an effect on, commerce of the United States and thus affect systemic risk in the United States.

The Agencies have, however, modified the final rule to make clear that there is no restriction on the U.S. branch, or agency of a foreign bank providing a guarantee to a covered swap entity eligible for compliance with a foreign margin regime. The Agencies believe that since a U.S. branch or agency of a foreign bank can be the covered swap entity eligible for substituted compliance, there should be no restriction on guarantees by these entities.

d. Substituted compliance for posting to foreign counterparties.

Under the final rule, if a foreign counterparty is subject to a foreign regulatory framework that has been determined to be comparable by the Agencies, a covered swap entity's posting requirement would be satisfied by posting (in amount, form, and at such time) as required by the foreign counterparty's margin collection requirement, provided that the foreign counterparty does not have a guarantee from an entity organized under the laws of the United States or any State (including a U.S. branch, agency, or subsidiary of a foreign bank) or a natural person who is resident of the United States or a branch or office of an entity organized under the laws of the United States or any State. In these cases, the collection requirement of the foreign counterparty would suffice to ensure two-way exchange of margin. For example, if a U.S. bank that is a covered swap entity enters into a swap with a foreign hedge fund that does not have a U.S. guarantee and that is subject to a foreign regulatory framework for which the Agencies have made a comparability determination, the U.S. bank must collect the amount of margin as required under the U.S. rule, but need post only the amount of margin that the foreign hedge fund is required to collect under the foreign regulatory framework.

One commenter argued that allowing a U.S. entity to rely on substituted compliance only in connection with its obligation to post initial margin would make a U.S. covered swap entity uncompetitive in foreign markets. Certain commenters suggested that if one counterparty to a swap is subject to a comparable foreign regulation, the entire transaction should be eligible for substituted compliance.[187] The final rule has not been modified in this respect. One commenter urged that covered swap entities should not be required to post margin in cross-border transactions.[188] The Agencies also have not modified the rule to provide that covered swap entities are not required to post margin in transactions with foreign counterparties as this would be inconsistent with the overall approach of the final rule that generally requires two-way margin. As described above, the Agencies also believe that requiring a covered swap entity to post margin to other financial entities could forestall a build-up of potentially destabilizing exposures in the financial system. The final rule's approach therefore is designed to ensure that covered swap entities transacting with other swap entities and with financial end users in non-cleared swaps will be collecting and posting appropriate minimum margin amounts with respect to those transactions.

---

[187] One commenter explained that it could disadvantage non-U.S. hedge funds if one set of regulations does not govern any particular transaction and recommended adoption of the CFTC's "entity-level approach" where a hedge fund that enters into a swap with a non-U.S. swap dealer that is not guaranteed by a U.S. person, substituted compliance would be possible if the parties elect to follow the rules of a foreign regime). Another commenter provided an example where a foreign covered swap entity operating in a jurisdiction where there has been no comparability determination transacts with a counterparty in a jurisdiction where there has been a comparability determination.

[188] This commenter recommended following the approach set out in the EU and Japanese Margin Proposals.

The final rule is modified from the proposal to contain the additional limitation that the counterparty cannot have a guarantee from a U.S. entity. The purpose of this change was to align with the CFTC cross-border proposal. The Agencies also believe that, in order for a counterparty to be able to collect pursuant to a foreign margin framework, the counterparty should not be guaranteed by a U.S. entity. This modification is also in alignment with the CFTC's cross-border proposal.

e. Compliance determinations.

The final rule provides that the Agencies will jointly make a determination regarding the comparability of a foreign regulatory framework that will focus on the outcomes produced by the foreign framework as compared to the U.S. framework. Moreover, as margin requirements are complex and have a number of related aspects (e.g., margin posting requirements, margin collection requirements, model requirements, eligible collateral, and segregation requirements), the Agencies would take a holistic view of the foreign regulatory framework that appropriately considers the outcomes produced by the entire framework. More specifically, the Agencies generally will not require that every aspect of a foreign regulatory framework be comparable to every aspect of the U.S. framework, but will require that the outcomes achieved by both frameworks are comparable. The Agencies propose to consider factors such as the scope, objectives, and specific provisions of the foreign regulatory framework and the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised, by the relevant foreign regulatory authorities.

The Agencies would accept requests for a comparability determination for a foreign regulatory framework from a covered swap entity that is eligible for substituted compliance under the final rule. Once the Agencies make a favorable comparability determination for a foreign regulatory framework, any covered swap entity that could comply with the foreign framework will be allowed to do so (i.e., they will not have to make a specific request). The Agencies expect to consult with the relevant foreign regulatory authorities before making a determination.

Certain commenters expressed support for the Agencies' proposal to take a holistic view of the foreign regulatory framework that considers outcomes produced by the entire framework. A few commenters urged the Agencies to evaluate foreign regulations based on the 2013 international framework when making substituted compliance determinations. One commenter urged the Agencies to provide specific standards and conditions that will be used in determinations. The Agencies expect that substituted compliance determinations will be on a case-by-case basis, would consider a number of aspects related to margin requirements, and could be partial.

One commenter argued that trade associations and foreign regulators should be allowed to make requests for a substituted compliance determination with respect to a foreign regulatory framework. The Agencies continue to believe it is appropriate to accept such requests only from covered swap entities that are subject to the requirements under the final rule and have not modified the final rule to accept requests from trade groups or foreign regulators. Moreover, and as explained above, the Agencies plan to consult with the relevant foreign regulatory authorities prior to making a determination with respect to substituted compliance.

g. Jurisdictions where segregation is unavailable.

Section __.9(f) is a new provision in the final rule that is meant to address concerns raised by commenters on the proposal. A number of commenters argued that the Agencies should incorporate a de minimis exception for swap activities conducted in jurisdictions for which substituted compliance is not available, including in jurisdictions that do not have a legal framework to support netting and segregation.[189]

Section __.9(f) provides that the requirements to post and segregate collateral do not apply to a non-cleared swap entered into by a foreign branch of a U.S. depository institution or a foreign subsidiary of a U.S. depository institution, Edge corporation, or agreement corporation if certain requirements are met, including:

- Inherent limitations in the legal or operational infrastructure in the foreign jurisdiction make it impracticable for the covered swap entity and the counterparty to post any form of eligible initial margin collateral recognized pursuant to §__.6(b) in compliance with the segregation requirements of §__.7;

- The covered swap entity is subject to foreign regulatory restrictions that require the covered swap entity to transact [in] the non-cleared swap or non-cleared security-based swap with the counterparty through an establishment within the foreign jurisdiction and do not accommodate the posting of collateral for the non-cleared swap or non-cleared security-based swap outside the jurisdiction;

- The counterparty to the non-cleared swap or non-cleared security-based swap is not, and the counterparty's obligations under the non-cleared swap or non-cleared security-based swap are not guaranteed by: (i) An entity organized under the laws of the United States or any State or a natural person who is a resident of the United States; or (ii) A branch or office of an entity organized under the laws of the United States or any State;

- The covered swap entity collects initial margin for the non-cleared swap or non-cleared security-based swap in accordance with §__.3(a) in the form of cash pursuant to §__.6(b)(1), and posts and collects variation margin in accordance with §__.4(a) in the form of cash pursuant to §__.6(b)(1); and

- The [Agency] provides the covered swap entity with prior written approval for the covered swap entity's reliance on this subsection for the foreign jurisdiction.

An Agency would only provide a covered swap entity with prior written approval to engage in swap transactions pursuant to this §__. 9(f) where the swap entity met all of the conditions

[189] One commenter noted that the CFTC conditioned the exception on the volume of such transactions not exceed five percent of the total aggregate volume of swaps entered into by the U.S. swap entity.

described above. In particular, a covered swap entity would need to demonstrate that foreign regulatory restrictions would not allow the swap to occur in another jurisdiction that would accommodate the posting and segregation of collateral.

h. *Transition period.*

Certain commenters suggested a transition period between when a comparability determination is published and when the margin rules go into effect so that substituted compliance determinations are made prior to implementation of the final rule.[190] Section __.1(e) of the final rule describes the phase-in period for the final rule established under the international framework. To the extent that a covered swap entity becomes subject to the requirements of this final rule prior to the Agencies making a substituted compliance determination, the covered swap entity would be subject to the U.S. margin rule until such time as a comparability determination is made by the Agencies.

J. *Section __.10: Documentation of Margin Matters.*

Under the final rule, a covered swap entity must execute trading documentation with each counterparty that is a swap entity or a financial end user regarding credit support arrangements. The documentation must provide the covered swap entity the contractual rights and obligations to collect and post initial and variation margin in such amounts, in such form, and under such circumstances as are required by the rule. The documentation must also specify the methods, procedures, rules, and inputs for determining the value of each non-cleared swap for purposes of

[190] One commenter urged the Agencies to make comparability determinations for other major jurisdictions with, or shortly following, the final rule without the need for an application process to enable market participants to take comparability requirements into account during the implementation process.

calculating variation margin and the procedures by which any disputes concerning the valuation of non-cleared swaps or the valuation of assets collected or posted as initial margin or variation margin may be resolved. Finally, the documentation must also describe the methods, procedures, rules, and inputs used to calculate initial margin for non-cleared swaps entered into between the covered swap entity and the counterparty.

In the proposed rule, the Agencies requested comment on whether the final rule should deem compliance with the applicable CFTC or SEC documentation requirement as compliance with this rule. A few commenters recommended against deferring to the CFTC documentation requirements, arguing that those requirements are deficient for purposes of resolving disputes related to initial margin, while other commenters recommended that the documentation requirements be removed or simplified because the issue is already addressed in CFTC regulations.

The Agencies have decided to include the proposed documentation standards in the final rule with certain revisions in light of comments. The Dodd-Frank Act amended the Commodity Exchange Act and the Securities Exchange Act to require the Commissions to adopt documentation standards for the swap entities they regulate.[191] To date, the SEC has not adopted documentation standards for security-based swap dealers and major security-based swap participants related to margin.[192]

While the CFTC has established requirements regarding documentation for swap dealers and major swap participants that are similar to those being adopted by the Agencies, important

[191] Commodity Exchange Act section 4s(i), 7 U.S.C. § 6s(i); Securities Exchange Act section 15F(i), 15 U.S.C. 78o-10(i).

[192] To date, the SEC has adopted standards with respect to confirmations for security-based swaps. 77 FR 55904 (September 11, 2012).

differences remain.[193] For example, the Agencies' final rule requires that covered swap entities address in their documentation dispute resolution procedures for disputes regarding the value of swaps as well as the value of assets collected or posted as margin. The CFTC documentation rule, however, only requires procedures for resolving disputes regarding the value of swaps, not the value of collateral, and such procedures for resolving swap valuation disputes need not be addressed if the documentation addresses alternative methods for determining the value of a swap in the event of the unavailability or other failure of input required to value the swap.[194] Given the important role that documentation will play in implementing the margin requirements set out in this final rule and the importance of those requirements for the safety and soundness of covered swap entities, the Agencies believe it is essential for them to adopt documentation requirements pursuant to their own authorities.

Certain commenters recommended against requiring parties to lock in either at the inception of their trading relationship or upon the relevant compliance date for margin requirements on non-cleared swaps dispositive valuation methods as opposed to agreed steps and processes for arriving at valuations. Other commenters wrote that the documentation section is overly prescriptive in requiring that the documentation specify inputs used in determining initial and variation margin because the inputs may vary from swap to swap and will change over the lifetime of the swap. Instead, the commenter recommended that the focus should be on requiring parties to share the actual inputs being used to determine initial margin and variation margin at any particular point in time upon request. To address these concerns, in the final rule, a covered swap entity's documentation would need to describe its methods, procedures, rules, and inputs

[193] 17 CFR § 504(b)(4).

[194] 17 CFR § 504(b)(4)(ii).

for determining the value of non-cleared swaps, rather than specify such elements for initial margin.

K. Section __.11: Special rules for affiliate swaps.

The final rule contains a special section for swaps between a covered swap entity and its affiliates. This section provides that the requirements of the rule generally apply to a non-cleared swap or non-cleared security-based swap with an affiliate unless the swap is excluded from coverage under §__.1(d) or a special rule applies. This section also makes clear that to the extent of any inconsistency between this section and any other provision of the final rule, this special section will apply.

As an example, collection of initial margin is not addressed in this special section. Since there is no special provision for collection of margin for affiliate swaps, the requirements of §__.3(a) apply and a covered swap entity is required to collect initial margin from its affiliate pursuant to §__.3(a) under the final rule. When a covered swap entity transacts with another swap entity that is an affiliate, the covered swap entity must collect at least the amount of initial margin required under the final rule.[195] Likewise, the swap entity counterparty also will be required, under margin rules that are applicable to that swap entity, to collect a minimum amount of initial margin from the covered swap entity. Accordingly, covered swap entities will both collect and post a minimum amount of initial margin when transacting with another swap entity. Where a covered swap entity transacts with another swap entity that is an affiliate, this will result in a collect-and-post regime for initial margin among affiliated swap entities.

Section __.11(b)(1) provides that the requirement for a covered swap entity to post initial

[195] CFTC and SEC rules will determine the collection requirement for a swap entity that is not a covered swap entity.

margin under § __.3(b) does not apply with respect to any non-cleared swap or non-cleared security-based swap with a counterparty that is an affiliate. As § __.3(b) generally requires posting to financial end user counterparties with material swaps exposures, covered swap entities would not need to post initial margin to affiliate counterparties that are financial end users with material swaps exposure. However, the final rule requires that a covered swap entity calculate the amount of initial margin that would be required to be posted to an affiliate that is a financial end user with material swaps exposure pursuant to § __.3(b) and provide documentation of such amount to each affiliate on a daily basis.

In addition, under the final rule, each affiliate may be granted an initial margin threshold of $20 million for purposes of calculating the amount of initial margin to be collected from an affiliate counterparty in accordance with § __.3(a) or for calculating the amount of initial margin that would have been posted to an affiliate counterparty in order to provide documentation of this amount to the affiliate. The final rule also provides that, for purposes of this calculation, an entity shall not count a non-cleared swap or non-cleared security-based swap that is exempt pursuant to § __.1(d).

To the extent that a covered swap entity collects from an affiliate initial margin required by §__.3(a) in the form of collateral other than cash, the covered swap entity may serve as the custodian for the non-cash collateral or have an affiliate serve as the custodian. Such non-cash initial margin collateral collected by a covered swap entity would be subject to all the other requirements of the rule. However, initial margin collateral collected from an affiliate in cash would be subject to all of the requirements of the rule, including the requirement in § __.7 for a third-party custodian that is not an affiliate of the covered swap entity. Altering the requirement in section __.7(b) that non-cash initial margin collateral be held at a custodian that is neither the covered swap entity or the affiliate, or an affiliate of either party, for non-cleared swaps between a covered swap entity and its affiliate is appropriate because the Agencies expect there will be increased transparency for inter-affiliate transactions, use of common valuation modeling, which will lower the likelihood of valuation discrepancies, and greater ease in transferring non-cash collateral between affiliates than would otherwise be the case for swaps with an unaffiliated counterparty.

The final rule also provides that an inter-affiliate swap that would have been required to be cleared but for a clearing exemption will be subject to the initial margin collection requirement. The covered swap entity may, however, choose to calculate the initial margin amount using a 5-day margin period of risk instead of a 10-day margin period of risk under §__.8(d)(1). The final rule permits a covered swap entity using the standardized approach to reduce the initial margin amount on these transactions by 30 percent, in line with the general provision that risk and initial margin increase with the square root of the holding period horizon and the square root of five divided by 10 is roughly 0.7. However, the final rule does not permit a covered swap entity to compute its initial margin requirement on a portfolio basis with swaps that are margined on a 5-day basis with those swaps that are margined on a 10-day basis. Rather, the covered swap entity must calculate initial margin separately for those swaps margined on a 5-day basis and those swaps margined on a 10-day basis.[196] The total initial margin that the final rule provides must be collected on the portfolio is equal to the aggregate initial margin required

[196] Among swaps margined on a 5-day basis the covered swap entity must calculate the initial margin requirements in accordance with all of the requirements of §__.8. Likewise when computing the initial margin requirements for swaps margined on a 10-day basis the covered swap entity must comply with all of the requirements of §__.8.

to be collected on the netting sets with a 5-day holding period and that which is required to be collected on the netting sets with a 10-day holding period.

For additional clarity, this section of the rule also provides that a covered swap entity shall collect and post variation margin with respect to a non-cleared swap or non-cleared security-based swap with any counterparty that is an affiliate as provided in § __.4. As in the case of initial margin, the final rule provides that variation margin is not required on any swap that is exempt pursuant to § __.1(d).

The proposal would have covered swaps between banks that are covered swap entities and their affiliates that are financial end users, including affiliates that are subsidiaries of a bank, such as operating subsidiaries, Edge Act subsidiaries, agreement corporation subsidiaries, financial subsidiaries, and lower-tier subsidiaries of such subsidiaries. In the preamble to the proposal, the Agencies noted that other applicable laws require transactions between banks and their affiliates to be on an arm's length basis. In particular, section 23B of the Federal Reserve Act provides that many transactions between a bank and its affiliates (as defined under that rule)[197] must be on terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to the bank as those prevailing at the time for comparable transactions with or involving nonaffiliated companies.[198]

Commenters including members of Congress were generally critical of this aspect of the proposal. Specifically, a significant number of commenters argued that requiring margin generally, and initial margin in particular, on all inter-affiliate swaps was unnecessary for

---

[197] The Agencies note that the Federal Reserve Act and the Board's Regulation W define "affiliate" differently than the term is defined in this final rule. *See* 12 U.S.C. 371c(b); 12 CFR 223.2.

[198] 12 U.S.C. 371c-1(a).

systemic stability. These commenters asserted that as inter-affiliate swaps are often conducted for internal risk management reasons, and such swaps do not increase the overall risk profile or leverage of the group. Instead, commenters argued, requiring margin on inter-affiliate swaps could discourage effective risk-management, increase group-wide third-party credit risk, and reduce liquidity. Commenters also argued for consistency with other international swap margin proposals that generally would not require margin on inter-affiliate swaps. Commenters also argued that requiring margin for inter-affiliate swaps would undermine the exemption from clearing requirements for such swaps. Finally, commenters criticized the proposal's coverage of affiliate swaps as duplicative of the restrictions and requirements under sections 23A and 23B of the Federal Reserve Act.

While some commenters urged that any required margin for inter-affiliate swaps should be limited to variation margin, which is already generally exchanged among affiliate counterparties, certain commenters suggested alternatives to a full two-way collect-and-post regime for initial margin for affiliate swaps. For example, a number of commenters proposed that instead of each covered swap entity posting and collecting segregated initial margin to and from its affiliate, the covered swap entity would only collect from its affiliate (subject to a wholly owned subsidiary exemption and a de minimis exemption) and the covered swap entity would be permitted to segregate the initial margin within its group, so as to prevent undue third-party custodial risk. These commenters further argued that certain highly regulated affiliates like U.S. bank holding companies should benefit from an exception to initial margin requirements. These commenters further urged that if the Agencies decided a one-way initial margin requirement is not adequate, the Agencies should permit the common parent of an affiliate pair to post a single amount of segregated initial margin in which each affiliate would have a security interest. The Agencies believe that the modifications in the final rule address many of the concerns raised by commenters with respect to the treatment of inter-affiliate swaps. The final rule requires a covered swap entity to collect initial margin from swap entity and financial end user affiliates as suggested by some commenters. As noted above, this will result in a collect-and-post regime where two covered swap entities that are affiliates transact with each other. However, a covered swap entity would not be required to post initial margin to affiliates that are financial end users. A covered swap entity would, however, be required to calculate the amount of initial margin that would be required to be posted to an affiliate under § __.3(b) for affiliates that are financial end users with material swaps exposure and provide documentation of such amount to each such affiliate on a daily basis. Documenting the amount of initial margin that would be posted to affiliates will help promote strong risk management practices as covered swap entities will have an additional real time measure of the amount of risk that is being incurred on swaps with their affiliate counterparties.

In addition, two-way variation margin, which many commenters indicated was already market practice, would be required on inter-affiliate swaps where a covered swap entity transacts with a swap entity or financial end user affiliate. The Agencies believe that these modifications, combined with the revised definitions of affiliate and subsidiary, should address many of the concerns raised by commenters on the proposed rule.

The final rule also modifies the initial margin threshold requirement of the proposal for affiliate swaps. Commenters requested clarification on how the proposed rule's $65 million initial margin threshold would be applied for inter-affiliate transactions with a covered swap entity. The final rule provides that a covered swap entity may apply a $20 million initial margin threshold to each of its affiliates. For example, if a covered swap entity engages in three inter-affiliate swaps with an initial margin amount of $100 million each with three separate affiliates, the total amount of initial margin that the covered swap entity would be required to collect would be (($100m - $20m) + ($100m - $20m) + ($100m - $20m)) = $240m.

In addition, as suggested by commenters, a covered swap entity may elect to use an affiliated custodian bank to hold non-cash collateral received as initial margin, provided that the restrictions on rehypothecating, repledging, or reusing such collateral in section 7(c) of the final rule will also apply to such non-cash collateral. However, the affiliated custodian bank will not be permitted to hold initial margin cash collateral, which must be held at a third-party custodian and promptly reinvested in non-cash collateral pursuant to § __.6.

Some commenters urged the Agencies to clarify that a holding company may provide margin required to be collected by a covered swap entity from an affiliate. Section 3(a) of the final rule requires a covered swap entity to collect initial margin from a counterparty that is a financial end user with material swap exposure or that is a swap entity. This requirement applies to both affiliate and non-affiliate counterparties. The rule does not prohibit the margin that a covered swap entity must collect on swaps with its affiliated counterparty from being supplied by the parent holding company. For example, a covered swap entity may act as custodian for non-cash collateral of its parent holding company. To the extent the non-cash collateral was not encumbered to secure some other obligation of the parent holding company (either to the covered swap entity, another affiliate, or unrelated party), the holding company may arrange with its affiliate to use this excess non-cash collateral to satisfy the covered swap entity's requirement to collect initial margin under this rule.[199] Under the final rule, the covered swap entity must have

[199] The holding company may provide cash collateral to the covered swap entity provided that the cash collateral is subject to the requirements of the final rule. Under the final rule, cash collateral that a covered swap entity acquires to meet the requirement to collect initial margin from an

full authority to apply this non-cash collateral to the affiliate's obligations in the event of default, free of any claim by the parent holding company that would interfere with the covered swap entity's rights in the non-cash collateral. Moreover, no aspect of the arrangement may compromise or condition the restrictions on treatment of initial margin collateral in the final rule, including the segregation and rehypothecation requirements of §§__.7 and __.11, or the covered swap entity's interests in the collateral.

Sections 731 and 764 of the Dodd-Frank Act require that the margin requirements offset the greater risk to swap entities from the use of swaps that are not cleared and help ensure the safety and soundness of the covered swap entity and are appropriate for the risk associated with the non-cleared swap entity. The Agencies believe that the modifications in the final rule are responsive to the commenters' concerns about the proposal's requirement that covered swap entities collect and post initial margin from and to affiliates and are also consistent with the statute. The requirement for covered swap entities to collect initial margin from, but not to post initial margin to, affiliates should help to protect the safety and soundness of covered swap entities in the event of an affiliated counterparty default. At the same time, the final rule does not permit such inter-affiliate swaps, which may be significant in number and notional amount, to remain unmargined and thus to pose a risk to systemic stability. Further, applying a lower threshold amount to each affiliate should permit smaller, end-user types of affiliates to benefit from a lower, but non-zero, amount of credit that can be extended to them, while ensuring that the covered swap entity collects initial margin from its larger affiliates with higher numbers and notional amounts of swaps. Similarly, permitting inter-affiliate swaps that are not cleared

---

affiliate under section __.3(a), including cash provided by a holding company, must be held at a custodian that is neither the covered swap entity nor an affiliate, subject to the requirements of section __.7(c).

pursuant to an exemption from clearing to use a 5-day margin period of risk recognizes that such swaps are typically standardized and, thus, appropriate for a treatment that recognizes their lesser risk. The Agencies believe that the final rule's provisions for inter-affiliate swaps balance the concerns raised by commenters about the impact of full two-way margin on inter-affiliate swaps while at the same time, consistent with the statute, taking into account the risk of these swaps and protecting the safety and soundness of covered swap entities.

Finally, the Agencies note that banks may be subject to additional regulatory restrictions on inter-affiliate swap transactions, such as those that may be required by sections 23A and 23B of the Federal Reserve Act. Compliance with the margin requirements in this final rule does not ensure compliance with other related regulatory requirements that may also limit or otherwise regulate inter-affiliate swap transactions and banks would be expected to comply with all required regulatory requirements related to inter-affiliate swap transactions.

L. Section __.12: Capital.

The Agencies are adopting this section of the rule as proposed. The proposal would have required a covered swap entity to comply with any risk-based and leverage capital requirements already applicable to that covered swap entity as part of its prudential regulatory regime. In the last few years, the banking agencies have strengthened regulatory capital requirements for banking organizations through adoption of the revised capital framework as well as through other rulemakings.[200] The revised capital framework introduced a new common equity tier 1

[200] *See* 78 FR 62018 (October 11, 2013) and 79 FR 20754 (April 14, 2014). The revised capital framework also reorganized the banking agencies' capital adequacy guidelines into a harmonized, codified set of rules, located at 12 CFR part 3 (national banks and Federal savings associations); 12 CFR part 217 (state member banks, bank holding companies, and savings and loan holding companies); 12 CFR part 324 (state nonmember banks and state savings associations). The requirements of 12 CFR parts 3, 217 and 324

capital ratio and a supplementary leverage ratio, raised the minimum tier 1 ratio and, for certain banking organizations, raised the leverage ratio, implemented strict eligibility criteria for regulatory capital instruments, and introduced a standardized methodology for calculating risk-weighted assets. Further, the revised capital framework adopted by the banking agencies and the proposal were intended to operate as complementary regimes that minimize or eliminate duplication of requirements. Accordingly, the final rule, unchanged from the proposal, requires a covered swap entity to comply with risk-based and leverage capital requirements already applicable to the covered swap entity as follows:

- In the case of covered swap entities that are banking organizations,[201] the elements of the revised capital framework that are applicable to the covered entity and have been adopted by the appropriate Federal banking agency under 12 U.S.C. 3907 and 3909 (International Lending Supervision Act), 12 U.S.C. 1462(s) (Home Owners' Loan Act), and section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o);
- In the case of a foreign bank, any state branch or state agency of a foreign bank, the capital standards that are applicable to such covered entity under the Board's Regulation Y (12 CFR 225.2(r)(3)) or the Board's Regulation YY (12 CFR part 252);
- In the case of an Edge corporation or an Agreement corporation, the capital standards applicable to an Edge corporation engaged in banking pursuant to the Board's Regulation K (12 CFR 211.12(c));
- In the case of any "regulated entity" under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (i.e., Fannie Mae and its affiliates, Freddie Mac and its affiliates, and the Federal Home Loan Banks), the risk-based capital level or such other amount applicable to the covered swap entity as required by the Director of FHFA pursuant to 12 U.S.C. 4611;

---

became effective on January 1, 2014, for banking organizations subject to the advanced approaches capital rules, and as of January 1, 2015 for all other banking organizations.

[201] Banking organizations include national banks, state member banks, state non-member banks, Federal savings associations, state savings associations, top-tier bank holding companies domiciled in the United States not subject to the Board's Small Bank Holding Company Policy Statement (12 CFR part 225, appendix C)), as well as top-tier savings and loan holding companies domiciled in the United States, other than (i) savings and loan holding companies subject to the Board's Small Bank Holding Company Policy Statement and (ii) certain savings and loan holding companies that are substantially engaged in insurance underwriting or commercial activities.

- In the case of Farmer Mac, the capital adequacy regulations set forth in 12 CFR part 652; and
- In the case of any FCS institution (other than Farmer Mac), the capital regulations set forth in 12 CFR part 615.[202] The FCA proposed revisions to the capital rules for all FCS institutions, except Farmer Mac, that are broadly consistent with Basel III.

The Agencies did not receive comment on these capital-related provisions. The Agencies believe that compliance with the regulatory capital rules described above is sufficient to offset the greater risk, relative to the risk of centrally cleared swaps, to the swap entity and the financial system arising from the use of non-cleared swaps, and would help ensure the safety and soundness of the covered swap entity. In particular, the regulatory capital rules incorporated by reference into the final rule have already addressed, in a risk-sensitive and comprehensive manner, the safety and soundness risks posed by a covered swap entity's swaps positions.[203] In addition, the Agencies believe that these regulatory capital rules sufficiently take into account

[202] *See* § __.12 of final rule.

[203] For example, with respect to interest rate, foreign exchange rate, credit, equity and precious metal derivative contracts that are not cleared, banking organizations subject to the revised capital framework are subject to a capital requirement based on the type of contract and remaining maturity, and that takes into account counterparty credit risk as well as the credit-risk-mitigating factors of collateral. Banking organizations subject to the advanced approaches rules may use internal models for calculating capital requirements for non-cleared derivatives. *See* 12 CFR part 3, subparts D and E (OCC); 12 CFR part 217, subparts D and E (Board); 12 CFR § 324, subparts D and E (FDIC), each as applicable. The FCA's capital requirements for FCS institutions other than Farmer Mac expressly address derivatives transactions. *See* 12 CFR 615.5201 and 615.5212. The FCA's capital requirements for Farmer Mac indirectly address derivatives transactions in the operational risk component of the statutorily mandated risk-based capital stress test model. *See* 12 CFR part 652, subpart B, Appendix A. The FCA, through the Office of Secondary Market Oversight, closely monitors and supervises all aspects of Farmer Mac's derivatives activities, and the FCA believes existing requirements and supervision are sufficient to ensure safe and sound operations in this area. However, the FCA is considering enhancements to the model and in the future may revise the model to more specifically address derivatives transactions. FHFA's predecessor agencies used a methodology similar to that endorsed by the BCBS prior to the development of the Basel III framework to develop the risk-based capital rules applicable to those entities now regulated by FHFA.

and address the risks associated with the swaps positions of a covered swap entity. As a result, the Agencies have not adopted any particular separate capital requirements.

IV. Quantitative Impact of Margin Requirements

A. *Overview*.

The final rule will apply the initial margin and variation margin requirements to non-cleared swaps that are entered into by a covered swap entity over a substantial phase-in period that begins in September 2016. The final rule will not require an immediate or retroactive application of initial margin or variation margin for any swap entered into prior to the relevant compliance date of the final rule.

Because the requirements will not be applied retroactively, no new initial margin or variation margin requirements will be imposed on non-cleared swaps entered into prior to the relevant compliance date until those transactions are rolled over or renewed. The only requirements that will apply to a pre-compliance date transaction are the initial margin and variation margin requirements to which the parties to the transaction had previously agreed by contract.

This section addresses the potential cost of initial margin requirements, a topic that received considerable attention from commenters. The agencies also note that the exchange of initial margin is in aggregate not solely a cost, since for every dollar of initial margin provided by a posting entity, the collecting entity receives an additional dollar of protection from potential loss. In addition, the posting and collection of margin should reduce build-ups of large unsecured derivatives positions that can adversely affect financial stability. As articulated throughout this preamble, the Agencies believe the final rule will achieve these financial stability benefits in a way that is responsive to the concerns of commenters and consistent with the statutory mandate.

The new requirements will have an impact on the costs of engaging in new non-cleared swaps after the applicable compliance date. In particular, the final rule sets out requirements for initial and variation margin that represent a significant change from current industry practice in many circumstances. Since the 2011 proposal was released, a number of analyses have been conducted that attempt to estimate the total amount of initial margin that would be required by the new margin rules. Given the complexity of this final rule and its inter-relationship to other rulemakings, these analyses are subject to considerable uncertainty. In particular, these analyses make a number of assumptions regarding: (i) the level of market activity in the future, (ii) the amount of central clearing in the future, and (iii) the level of financial market volatility and risk that will determine initial margin requirements. These studies also make a number of additional assumptions which have a measurable influence on the analysis. Notwithstanding these uncertainties, the Agencies' believe that the analysis and data that appear in these studies are useful to gauge the approximate amount of initial margin that will be required by the new requirements for non-cleared swaps. At the same time, the Agencies also understand that the precise impact of the requirements will depend on a number of factors, such as the size of the market for uncleared swaps, that are difficult to forecast and will evolve over time as market participants respond to the new requirements. As such, it is not possible to specify in advance the precise impact of the final rule's requirements.

Below is a discussion of a selection of studies that have been conducted in the recent past that relate to a margin framework similar to the final rule. Specifically, each of these studies uses the 2013 international framework in estimating the total amount of initial margin collateral that will be required. While this final rule is largely consistent with the 2013 international framework, the two are not identical. Therefore, the results of these studies are limited by these differences.

B. *Initial Margin Requirements.*

The final rule will require an exchange of initial margin by many market participants, which represents a significant change in market practice. The total amount of initial margin that will be required at a point in time is an important input into an estimate of the costs of the new requirements. The table below presents estimates of the total amount of initial margin that will be required by U.S. swap entities and their counterparties once the requirements are fully implemented, that is, at the end of the phase-in period and after existing swaps are rolled into new swaps.

Estimated Initial Margin Requirements	
Source	*Initial Margin Estimate ($Billions)*
ISDA – Model Based	280
BCBS-IOSCO – Model Based	315
ISDA – Standardized	3,570

The initial margin estimates provided in the table above are taken from two different studies that have examined the impact of the 2013 international framework on overall initial margin requirements. The studies were conducted by the BCBS and IOSCO[204] and ISDA.[205] Each of these studies reports an estimate of the *global* impact of margin requirements. In particular, these estimates include the impact of margin requirements on foreign financial institutions and their counterparties, in addition to U.S. financial institutions and their counterparties. In order to better align the studies' estimates with the impact of the final U.S. rules, the estimates in the table above have been reduced by 65 percent to reflect the fact that U.S. financial institutions and their counterparties account for roughly 35 percent of the global derivatives market.[206] The estimate reported in the table above from the BCBS-IOSCO study reflects the estimate among those provided in the study that is most consistent with the final rules.[207] Two estimates from the ISDA study are presented in the table above reflecting a high and low estimate. Both the ISDA low estimate and the BCBS-IOSCO estimate assume that all initial margin requirements are calculated according to an internal model with parameters consistent with those required by the final rules. The ISDA high estimate assumes that all initial

[204] *See* Basel Committee on Banking Supervision and the International Organization of Securities Commissions (2013), *Margin Requirements for Non-Centrally Cleared Derivatives: Second Consultative Document*, report (Basel, Switzerland: Bank for International Settlements, February).

[205] Documents on initial margin requirements are available on the International Swaps and Derivatives Association Website.

[206] See ISDA Research Notes: Concentration of OTC Derivatives Among Major Dealers, Issue 4, 2010. In addition, the data that was collected by the BCBS-IOSCO to estimate the required initial margin amounts was collected at the holding company level and included swap exposures and resulting initial margin amounts for distinct legal entities that are not prudentially regulated but would be regulated by the CFTC and SEC. Since the data cannot be disaggregated at the legal entity level no attempt to isolate the initial margin amounts required only by prudentially regulated entities has been made. Accordingly, the amounts reported in the table reflect initial margin amounts from exposures of entities that would be regulated as covered swap entities as well as other entities not regulated as covered swap entities.

[207] The BCBS-IOSCO impact study discusses the impact of several different margin regimes, *e.g.*, regimes with and without an initial margin threshold.

margin requirements are calculated according to a standardized margin approach. Further, the standardized approach assumed in the ISDA study does not allow for the recognition of any offsets which are allowed by the application of the net-to-gross ratio under the final rule.[208] Ultimately, swap dealers will choose whether to calculate initial margin amounts according to the final rule's standardized approach or an internal model. While it is not possible to forecast with certainty which method will be most widely adopted, there are several reasons to expect a models-based margin methodology to predominate. Specifically, most covered swap entities represent large, internationally active and sophisticated derivative dealers that already use internal risk management models to assess initial margin amounts when they require initial margin from existing swap counterparties. In addition, the derivative dealer industry has already begun to develop a quantitative initial margin model, the ISDA-SIMM model, that it expects will be used to comply with the requirements of the final rule. Accordingly, the Agencies expect the costs of the final rule to be more consistent with the costs associated with the model-based rather than standardized initial margin amounts.[209]

As discussed above, these estimates represent the total amount of initial margin that will be required at a point in time once the requirements have been fully phased in and all existing non-cleared swaps have been rolled over into new non-cleared swaps. Accordingly, the full amount of initial margin amount estimates provided in the table above will not be realized until, at the earliest, 2019.

[208] The ISDA study was conducted based on the BCBS-IOSCO February 2013 consultative document which did not include any recognition of offsets in the standardized initial margin regime. Recognition of offsets was included in the final 2013 international framework.

[209] A description of the ISDA SIMM model and related documentation can be found at: https://www2.isda.org/functional-areas/wgmr-implementation/.

The amounts reported in the table above reflect estimated amounts of initial margin that will be required under the final rule but do not reflect the cost of providing these amounts by covered swap entities and their counterparties. The cost of providing initial margin collateral depends on the difference between the cost of raising additional funds and the rate of return on the assets that are ultimately pledged as initial margin. In some cases, it may be that some entities providing initial margin, such as pension funds and asset managers, will provide assets as initial margin that they already own and would have owned even if no requirements were in place. In such cases, the economic cost of providing initial margin collateral is expected to be low. In other cases, entities engaging in non-cleared swaps will have to raise additional funds to secure assets that can be pledged as initial margin. The greater the cost of their marginal funding relative to the rate of return on the initial margin collateral, the greater the cost of providing collateral assets. It is difficult, however, to estimate these costs with any precision due to differences in marginal funding costs across different types of entities as well as differences in marginal funding costs over time and differences in the rate of return on different collateral assets that may be used to satisfy the initial margin requirements. Despite these uncertainties, one approach to approximating the funding cost associated with securing initial margin collateral assets would be to compare the yield or rate of return on a typical collateral asset that can be used to satisfy initial margin collateral and the cost of funding the asset through debt financing. Finally, it should be noted that this approach to estimating the cost of the initial margin requirements fully incorporates the requirement that initial margin collateral not be rehypothecated. If rehypothecation were allowed initial margin collected by a swap dealer from one counterparty could be used to offset any margin the swap dealer would be required to post on an offsetting swap transaction thereby reducing the overall stock of initial margin required.

All of the presented cost estimates assume that every dollar of initial margin must be financed from an outside source and invested in an initial margin eligible asset thereby reflecting the requirement that no initial margin is rehypothecated, repledged or reused.

Because banks are a significant market participant in the non-cleared swap market, the debt cost of banks may serve as a useful representative indicator of the cost of funding collateral, though the debt costs banks face may differ substantially from the debt cost faced by other market participants. In terms of collateral assets, the final rule provides for a wide array of collateral assets to be used to satisfy initial margin collateral. One specific asset that is an eligible form of collateral is U.S. Treasury securities. Since U.S. Treasury securities are relatively low yielding assets when compared to other forms of eligible collateral such as equities and corporate bonds, using the yield on U.S. Treasury securities to gauge the incremental cost of obtaining initial margin collateral will tend to result in a conservative estimate of the overall incremental cost of funding initial margin collateral.

The table below presents the twenty-fifth percentile, median and seventy-fifth percentile of five-year CDS spreads for a collection of large banks from January 2004 through August of 2015.[210] Because a CDS spread reflects the cost of insuring against the default of a debt issuer, it can also be interpreted as the incremental cost of a debt issuer to borrow funds over and above the risk-free rate of interest which is typically identified with the yield available on U.S. Treasury securities. Accordingly, the table below provides an estimate of the range of

[210] The data represent five-year CDS quotes on the following banks: Bank of America, Bank of New York-Mellon, Citigroup, Goldman Sachs, J.P. Morgan, Morgan Stanley, State Street, Wells Fargo, Barclays, Credit Suisse, Deutsche Bank, and UBS.

incremental funding costs that a large bank would face to finance the purchase of five-year U.S. Treasury collateral.

Large Bank Incremental Cost of Financing U.S. Treasury Collateral (%)		
25th Percentile	Median	75th Percentile
0.24	0.78	1.30

The table shows that the incremental cost of funding U.S. Treasury collateral ranges from 24 basis points to 130 basis points for the large banks included in the analysis from 2004 through 2015.

This incremental funding cost can be combined with the estimates of the total amount of initial margin collateral in the previous table to arrive at an estimate of the annual cost of funding initial margin collateral. Specifically, the estimate amount of initial margin is multiplied by the incremental funding cost depicted in the table above to determine the annual funding cost.

Any estimate constructed in this fashion is subject to a number of limitations that have been described earlier. In particular, the estimates of the total amount of initial margin collateral required by the rule is subject to a number of uncertainties including but not limited to the total amount of non-cleared swap activity that will continue to exist in the future. In addition, the incremental funding costs of financing initial margin collateral depends on the specific characteristics of both the entity sourcing the collateral and the collateral asset being sourced. Importantly, in at least some cases swap market participants will pledge assets as initial margin that they already hold and would not need to raise funds to source any additional collateral. In such cases, the incremental cost of the collateral requirements are expected to be low.

The table below presents a matrix of the annual cost estimates associated with the initial margin requirements. The three rows of the matrix correspond to the BCBS-IOSCO, ISDA-Model Based and ISDA Standardized initial margin amounts that were presented and discussed above. The three columns of the matrix refer to the 25th percentile, median and 75th percentile incremental funding cost estimates that were described earlier. Each cell of the matrix presents an annual cost estimate that is computed by multiplying the initial margin amount identified in each row by the incremental funding cost identified in each column. The amounts presented in the table below are reported in millions.

Estimated Annual Costs of Initial Margin Requirements ($millions)			
Incremental Funding Cost/Initial Margin Estimate	25th Percentile	Median	75th Percentile
ISDA– Model Based	672	2,184	3,640
BCBS-IOSCO – Model Based	756	2,457	4,095
ISDA – Standardized	8,568	27,846	46,410

The estimated annual costs of the initial margin requirements range from $672 million to roughly $46 billion depending on the specific initial margin estimate and incremental funding cost that is used to compute the estimate.

C. *Inter-affiliate Initial Margin Requirements.*

The final rule requires that covered swap entities collect initial margin from their affiliate counterparties but does not require that covered swap entities post initial margin to their affiliate counterparties (other than affiliate counterparties that are also covered swap entities required to collect). The quantitative estimates of the amount of initial margin required by the final rule that were presented above did not account for transactions between affiliates. Accordingly, while the estimates of the cost of the initial margin requirements provided above span a wide range, these estimates do not explicitly account for the cost associated with the requirement that covered swap entities collect initial margin from their affiliates. It is difficult to precisely estimate the additional amount of collateral that would be required as a result of the inter-affiliate margin requirements. One commenter, however, provided an analysis of the inter-affiliate swap transactions for several financial firms which is useful to gauge the additional collateral that may be required as a result of the inter-affiliate margin requirements.

The commenter contended that an analysis conducted by several large financial institutions indicated that both collecting and posting initial margin collateral among all affiliates would effectively double the amount, i.e., result in a one-hundred percent increase, of initial margin that these institutions would be required to collect and post relative to the amount of collateral that these institutions would be required to post to non-affiliates.[211] The provisions of the final rule, however, do not require full two-way margin from all affiliate counterparties. In particular, under the final rule, there is a requirement for covered swap entities to collect initial margin from affiliates but there is no requirement to post initial margin to an affiliate (that is not also a covered swap entity). Assuming that the amounts collected and posted are of a similar magnitude, the one-hundred percent increase cited by the commenter would only translate into approximately a fifty percent increase relative to the total amount of collateral collected and posted between non-affiliates.[212] In addition, the final rule only requires that covered swap entities collect initial margin from their affiliates. Swap transactions between affiliates in which

[211] *See* ISDA Letter (January 16, 2015).

[212] The Agencies understand that the exact size of the reduction will vary from covered swap entity to covered swap entity depending on the nature of the specific swaps in question, as well as whether or not the corporate group has more than one covered swap entity – in which case swaps between such affiliates would require both the collection and posting of initial margin.

neither counterparty is a covered swap entities are not subject to the requirements of the final rule.

Finally, the final rule also allows covered swap entities to calculate the required initial margin amounts assuming a 5-day margin period of risk for any swap transactions that would have to be cleared but are not cleared due to the clearing exemption for inter-affiliate transactions. Under the standardized approach to initial margin in the final rule, the initial margin requirements on such transactions are reduced by 30 percent. Accordingly, the total amount of initial margin required to be collected on inter-affiliate transactions would be reduced even further depending on the fraction of transactions margined on a 5-day rather than 10-day basis.

After adjusting for specific features of the final rule, the analysis provided by the commenter suggests an additional increase in initial margin requirements and the cost of financing initial margin of less than fifty percent relative to the amount that will be collected and posted among non-affiliates. The Agencies recognize that available data and methods do not permit a precise estimate of the total amount of initial margin that will be required as a result of the inter-affiliate margin requirements. The Agencies believe that the estimates discussed above are useful in providing guidance on the general magnitude of the requirements but that the specific amounts required could be substantially greater or lesser than the amounts described above for a variety of reasons. First, the analysis described above depends on a number of assumptions and changes to these assumptions could result in significant changes in the resulting estimates. Second, and importantly, the estimates described above depend on the existing configuration of swap transactions between affiliates. It is likely that the behavior of swap market participants, including affiliate counterparties, will respond to incentives created by these swap margin requirements. Such changes could have a dramatic effect on the pattern of affiliate swap transactions which would itself have a significant impact on the amounts of initial margin that are ultimately collected on inter-affiliate transactions.

D. *Variation Margin Requirements.*

The final rule will also require that variation margin be exchanged between covered swap entities and certain of their counterparties. The Agencies believe that the impact of such requirements are low in the aggregate because: (i) regular exchange of variation margin is already a well-established market practice among a large number of market participants, and (ii) exchange of variation margin simply redistributes resources from one entity to another in a manner that imposes no aggregate liquidity costs. A reduction in liquid assets available to the entity that post variation margin is offset by an increase in the liquid assets available to the entity receiving the variation margin. The Agencies have modified the final rule from the proposal to allow swap counterparties that are not swap entities to post non-cash collateral to satisfy variation margin requirements. Accordingly, swap users such as insurance companies and asset managers that want to stay fully invested will be able to utilize existing assets and collateral to meet the variation margin requirements without having to liquidate assets and raise cash. As a result, these swap users will not suffer a reduction in the rate of return on their investment portfolios that would be experienced if a significant cash buffer had to be raised to satisfy the final rule's variation margin requirements.

VII. Effective Date.

Subject to certain exceptions, 12 U.S.C. 4802(b) provides that new regulations and amendments to regulations prescribed by a Federal banking agency which impose additional reporting, disclosures, or other new requirements on an insured depository institution shall take effect on the first day of a calendar quarter which begins on or after the date on which the regulations are published in final form unless (1) the agency determines, for good cause published with the regulation, that the regulation should become effective before such time; (2) the regulation is issued by the Board of Governors of the Federal Reserve System in connection with the implementation of monetary policy; or (3) the regulation is required to take effect on a date other than the date determined under this paragraph pursuant to any other Act of Congress.[213] In accordance with this provision, the final rule will be effective on April 1, 2016 as required under 12 U.S.C. 4802(b).

VIII. Administrative Law Matters.

A. *Paperwork Reduction Act Analysis.*

Certain provisions of the final rule contain "collection of information" requirements within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501-3521). In accordance with the requirements of the PRA, the Agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The OMB control number for the OCC is 1557-0251, the FDIC is 3064-0180, and the Board is 7100-0364. In addition, as

[213] With respect to swaps, section 754 of the Dodd-Frank Act provides that unless otherwise provided in this title, the provisions of this subtitle shall take effect on the later of 360 days after the date of the enactment of this subtitle or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of this subtitle. Section 774 of the Dodd-Frank Act contains a similar provision for security-based swaps. The Agencies believe that these two provisions are not inconsistent with an effective date of April 1, 2016.

permitted by the PRA, the Board proposes to extend for three years, with revision, the Reporting Requirements Associated with Regulation KK (Margin and Capital Requirements for Covered Swaps Entities) (Reg KK; OMB No. 7100-0364). The information collection requirements contained in this joint notice of final rulemaking have been submitted to OMB for review and approval by the OCC and FDIC under section 3507(d) of the PRA and section 1320.11 of OMB's implementing regulations (5 CFR 1320). The Board reviewed the final rule under the authority delegated to the Board by OMB.

The final rule contains requirements subject to the PRA. The reporting requirements are found in §§ _.8(c), _.8(d), _.8(f)(3), and _.9(e). The recordkeeping requirements are found in §§ _.2 definition of "eligible master netting agreement," item 4, _.5(c)(2)(i), _.7(c), _.8(e), _.8(f), _.8(g), _.8(h), _.10, and _.11(b)(1). These information collection requirements would implement sections 731 and 764 of the Dodd-Frank Act, as mentioned in the Abstract below. The Agencies received a number of comments on the custody agreement in section _.7(c). No PRA burden was taken in the proposed rule; however, based on the comments received, the Agencies will take recordkeeping burden for this section. Also, the Agencies received a number of comments on the posting of initial margin by an affiliate of a covered swap entity with respect to swaps between the covered swap entity and the affiliate. Based on the comments received, the Agencies created a new section _.11, and the agencies will take recordkeeping burden for section _.11(b)(1).

The Agencies have a continuing interest in the public's opinions of collections of information. At any time, commenters may submit comments regarding the burden estimate, or any other aspect of this collection of information, including suggestions for reducing the burden, to the addresses listed in the ADDRESSES section. A copy of the comments may also be submitted to the OMB desk officer for the agencies (1) by mail to U.S. Office of Management and Budget, 725 17th Street NW, 10235, Washington, DC 20503; (2) by facsimile to 202–395–6974; or (3) by e-mail to: oira_submission@omb.eop.gov, Attention, Federal Banking Agency Desk Officer.

Proposed Information Collection

Title of Information Collection: Reporting and Recordkeeping Requirements Associated with Margin and Capital Requirements for Covered Swap Entities.

Frequency of Response: Annual, daily, and event-generated.

Affected Public: The affected public of the OCC, FDIC, and Board is assigned generally in accordance with the entities covered by the scope and authority section of their respective final rule. Businesses or other for-profit.

Respondents:

OCC: Any national bank or subsidiary thereof, Federal savings association or subsidiary thereof, or Federal branch or agency of a foreign bank that is registered as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant.

FDIC: [TO BE ADDED BY FDIC]

Board: [TO BE ADDED BY BOARD]

FHFA: [TO BE ADDED BY FHFA]

FCA: [TO BE ADDED BY FCA]

Abstract: Sections 731 and 764 of the Dodd-Frank Act would require the Agencies to adopt rules jointly to establish capital requirements and initial and variation margin requirements for such entities on all non-cleared swaps and non-cleared security-based swaps in order to offset the greater risk to such entities and the financial system arising from the use of swaps and security-based swaps that are not cleared.

Reporting Requirements

Section _.8 establishes standards for initial margin models. These standards include (1) a requirement that the covered swap entity receive prior approval from the relevant Agency based on demonstration that the initial margin model meets specific requirements (§§ _.8(c)(1) and _.8(c)(2)); (2) a requirement that a covered swap entity notify the relevant Agency in writing 60 days before extending use of the model to additional product types, making certain changes to the initial margin model, or making material changes to modeling assumptions (§ _.8(c)(3)); (3) a variety of quantitative requirements, including requirements that the covered swap entity validate and demonstrate the reasonableness of its process for modeling and measuring hedging benefits, demonstrate to the satisfaction of the relevant Agency that the omission of any risk factor from the calculation of its initial margin is appropriate, demonstrate to the satisfaction of the relevant Agency that incorporation of any proxy or approximation used to capture the risks of the covered swap entity's non-cleared swaps or non-cleared security-based swaps is appropriate, periodically review and, as necessary, revise the data used to calibrate the initial margin model to ensure that the data incorporate an appropriate period of significant financial stress (§§ _.8(d)(5), _.8(d)(10), _.8(d)(11), _.8(d)(12), and _.8(d)(13)). Also, if the validation process reveals any material problems with the initial margin model, the covered swap entity must promptly notify the Agency of the problems, describe to the Agency any remedial actions being taken, and adjust the initial margin model to ensure an appropriately conservative amount of required initial margin is being calculated (§ _.8(f)(3)).

Section _.9(e) allows a covered swap entity to request that the prudential regulators make a substituted compliance determination and must provide the reasons therefore and other required supporting documentation. A request for a substituted compliance determination must include a description of the scope and objectives of the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps; the specific provisions of the foreign regulatory framework for non-cleared swaps and security-based swaps (scope of transactions covered; determination of the amount of initial and variation margin required; timing of margin requirements; documentation requirements; forms of eligible collateral; segregation and rehypothecation requirements; and approval process and standards for models); the supervisory compliance program and enforcement authority exercised by a foreign financial regulatory authority or authorities in such system to support its oversight of the application of the non-cleared swap and security-based swap regulatory framework; and any other descriptions and documentation that the prudential regulators determine are appropriate. A covered swap entity may make a request under this section only if directly supervised by the authorities administering the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps.

Recordkeeping Requirements

Section _.2 defines terms used in the proposed rule, including the definition of "eligible master netting agreement," which provides that a covered swap entity that relies on the agreement for purpose of calculating the required margin must (1) conduct sufficient legal review of the agreement to conclude with a well-founded basis that the agreement meets specified criteria and (2) establish and maintain written procedures for monitoring relevant changes in law and to ensure that the agreement continues to satisfy the requirements of this section. The term "eligible master netting agreement" is used elsewhere in the proposed rule to specify instances in which a covered swap entity may (1) calculate variation margin on an aggregate basis across multiple non-cleared swaps and security-based swaps and (2) calculate initial margin requirements under an initial margin model for one or more swaps and security-based swaps.

Section _.5(c)(2)(i) specifies that a covered swap entity shall not be deemed to have violated its obligation to collect or post margin from or to a counterparty if the covered swap entity has made the necessary efforts to collect or post the required margin, including the timely initiation and continued pursuit of formal dispute resolution mechanisms, or has otherwise demonstrated upon request to the satisfaction of the Agency that it has made appropriate efforts to collect or post the required margin.

Section _.7(c) requires the custodian to act pursuant to a custody agreement that (1) prohibits the custodian from rehypothecating, repledging, reusing, or otherwise transferring (through securities lending, securities borrowing, repurchase agreement, reverse repurchase agreement or other means) the collateral held by the custodian, except that cash collateral may be held in a general deposit account with the custodian if the funds in the account are used to purchase an asset, such asset is held in compliance with this section _.7, and such purchase takes place within a time period reasonably necessary to consummate such purchase after the cash collateral is posted as initial margin and (2) is a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding. A custody agreement may permit the posting party to substitute or direct any reinvestment of posted collateral held by the custodian, provided that, with respect to collateral collected by a covered swap entity pursuant to section _.3(a) or posted by a covered swap entity pursuant to § __.3(b), the agreement requires the posting party to substitute only funds or other property that would qualify as eligible collateral under section _.6, and for which the amount net of applicable discounts described in Appendix B would be sufficient to meet the requirements of section _.3 and direct reinvestment of funds only in assets that would qualify as eligible collateral under section _.6, and for which the amount net of applicable discounts described in Appendix B would be sufficient to meet the requirements of section _.3.

Section _.8 establishes standards for initial margin models. These standards include (1) a requirement that a covered swap entity review its initial margin model annually (§ _.8(e)); (2) a requirement that the covered swap entity validate its initial margin model initially and on an ongoing basis, describe to the relevant Agency any remedial actions being taken, and report internal audit findings regarding the effectiveness of the initial margin model to the covered swap entity's board of directors or a committee thereof (§§ _.8(f)(2), _.8(f)(3), and _.8(f)(4)); (3) a requirement that the covered swap entity adequately document all material aspects of its initial margin model (§ _.8(g)); and (4) that the covered swap entity must adequately document internal authorization procedures, including escalation procedures, that require review and approval of any change to the initial margin calculation under the initial margin model, demonstrable analysis that any basis for any such change is consistent with the requirements of this section, and independent review of such demonstrable analysis and approval (§ _.8(h)).

Section _.10 requires a covered swap entity to execute trading documentation with each counterparty that is either a swap entity or financial end user regarding credit support arrangements that (1) provides the contractual right to collect and post initial margin and variation margin in such amounts, in such form, and under such circumstances as are required; and (2) specifies the methods, procedures, rules, and inputs for determining the value of each non-cleared swap or non-cleared security-based swap for purposes of calculating variation margin requirements, and the procedures for resolving any disputes concerning valuation.

Section _.11(b)(1) provides that the requirement for a covered swap entity to post initial margin under section _.3(b) does not apply with respect to any non-cleared swap or non-cleared security-based swap with a counterparty that is an affiliate. A covered swap entity shall calculate the amount of initial margin that would be required to be posted to an affiliate that is a financial end user with material swaps exposure pursuant to section _.3(b) and provide documentation of such amount to each affiliate on a daily basis.

Estimated Burden per Response:

Reporting Burden

§§ _.8(c) and _.8(d): 240 hours.
§ _.8(f)(3): 50 hours.
§ _.9(e): 10 hours.

Recordkeeping Burden

§§ _.2, _.8(g), and _.10: 5 hours.
§§ _.5(c)(2)(i): 4 hours.
§§ _.7(c): 100 hours.
§§ _.8(e) and _.8(f): 40 hours.
§§ _.8(h): 20 hours.
§§ _.11(b)(1): 1 hour.

OCC
Number of respondents: 20.
Total estimated annual burden: 14,780 hours.

FDIC[214]

[214] [RESERVED]

[TO BE ADDED BY FDIC]

Board
[TO BE ADDED BY BOARD]

B. *Regulatory Flexibility Act Analysis*

Regulatory Flexibility Act Analysis

OCC: The Regulatory Flexibility Act, 5 U.S.C. 601 et seq. (RFA), requires an agency, in connection with a final rule, to prepare a Final Regulatory Flexibility Analysis describing the impact of the final rule on small entities, or to certify that the final rule would not have a significant economic impact on a substantial number of small entities. For purposes of the RFA, the Small Business Administration (SBA) defines small entities as those with $550 million or less in assets for commercial banks and savings institutions, and $38.5 million or less in assets for trust companies.

As of December 31, 2014, the OCC supervised 1,101 small entities.[215]

As described in the SUPPLEMENTARY INFORMATION section of the preamble, a covered swap entity will be required to exchange initial margin with a financial entity counterparty only if the counterparty has a material swaps exposure. No OCC-supervised small entities qualify as swap entities or financial end users with a material swaps exposure. Thus,

[215] The number of small entities supervised by the OCC is determined using the SBA's size thresholds for commercial banks and savings institutions, and trust companies, which are $550 million and $38.5 million, respectively. Consistent with the General Principles of Affiliation 13 CFR §121.103(a), the OCC counts the assets of affiliated financial institutions when determining if we should classify a bank we supervise as a small entity. The OCC used December 31, 2014 to determine size because a "financial institution's assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year." See footnote 8 of the U.S. Small Business Administration's *Table of Size Standards*.

under the final rule, no small entities will have to post initial margin. The final rule also provides for a minimum transfer amount for the collection and posting of margin by covered swap entities. Under the final rule, a covered swap entity need not collect or post initial or variation margin from or to any individual counterparty unless the required cumulative amount of initial and variation margin is greater than $500,000.

The final rule generally exempts swap transactions for all OCC-supervised institutions with assets of $10 billion or less. Thus, the OCC estimates that the final rule will not have a significant impact on a substantial number of OCC-supervised small entities.

Board: [TO BE ADDED BY BOARD]

FDIC: [TO BE ADDED BY FDIC]

FHFA: [TO BE ADDED BY FHFA]

FCA: [TO BE ADDED BY FCA]

C. *OCC Unfunded Mandates Reform Act of 1995 Determination*

The OCC has analyzed the final rule under the factors in the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1532). Under this analysis, the OCC considered whether the final rule includes a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year (adjusted annually for inflation).

The OCC has determined this proposed rule is likely to result in the expenditure by the private sector of $100 million or more in any one year (adjusted annually for inflation). The OCC has prepared an impact analysis and identified and considered alternative approaches. When the final rule is published in the *Federal Register*, the full text of the OCC's analysis will available at: http://www.regulations.gov, Docket ID OCC–2011-0008.

Text of the Common Rules
(All Agencies)

The text of the common rules appears below:

[PART] [ ]— [Reserved]
MARGIN AND CAPITAL REQUIREMENTS FOR COVERED SWAP ENTITIES

__.12 Capital.

Appendix A to [Part] [ ] -- Standardized Minimum Initial Margin Requirements for Non-cleared Swaps and Non-cleared Security-based Swaps

Appendix B to [Part] [ ] -- Margin Values for Cash and Eligible Noncash Margin Collateral

§ __.1 *Authority, purpose, scope, exemptions and compliance dates.*

(a) *[RESERVED]*

(b) *[RESERVED]*

(c) *[RESERVED]*

(d) *[RESERVED]*

(e) *Compliance dates.* Covered swap entities shall comply with the minimum margin requirements of this [part] on or before the following dates for non-cleared swaps and non-cleared security-based swaps entered into on or after the following dates —

(1) September 1, 2016 with respect to the requirements in § __.3 for initial margin and § __.4 for variation margin for any non-cleared swaps and non-cleared security-based swaps, where both:

(i) the covered swap entity combined with all its affiliates; and

(ii) its counterparty combined with all its affiliates, have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps for March, April and May 2016 that exceeds $3 trillion, where such amounts are calculated only for business days; and

(iii) in calculating the amounts in paragraphs (e)(1)(i) and (e)(1)(ii) of this section, an entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time, and shall not count a swap or security-based swap that is exempt pursuant to paragraph (d) of this section.

(2) March 1, 2017 with respect to the requirements in § __.4 for variation margin for any other covered swap entity with respect to non-cleared swaps and non-cleared security-based swaps entered into with any other counterparty.

(3) September 1, 2017 with respect to the requirements in § __.3 for initial margin for any non-cleared swaps and non-cleared security-based swaps, where both:

(i) the covered swap entity combined with all its affiliates; and

(ii) its counterparty combined with all its affiliates, have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps for March, April and May 2017 that exceeds $2.25 trillion, where such amounts are calculated only for business days; and

(iii) in calculating the amounts in paragraphs (e)(3)(i) and (e)(3)(ii) of this section, an entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time, and shall not count a swap or security-based swap that is exempt pursuant to paragraph (d) of this section.

(4) September 1, 2018 with respect to the requirements in § __.3 for initial margin for any non-cleared swaps and non-cleared security-based swaps, where both:

(i) the covered swap entity combined with all its affiliates; and

(ii) its counterparty combined with all its affiliates, have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps for March, April and May 2018 that exceeds $1.5 trillion, where such amounts are calculated only for business days; and

(iii) in calculating the amounts in paragraphs (e)(4)(i) and (e)(4)(ii) of this section, an entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time, and shall not count a swap or security-based swap that is exempt pursuant to paragraph (d) of this section.

(5) September 1, 2019 with respect to the requirements in § __.3 for initial margin for any non-cleared swaps and non-cleared security-based swaps, where both:

(i) the covered swap entity combined with all its affiliates; and

(ii) its counterparty combined with all its affiliates, have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps for March, April and May 2019 that exceeds $0.75 trillion, where such amounts are calculated only for business days; and

(iii) in calculating the amounts in paragraphs (e)(5)(i) and (e)(5)(ii) of this section, an entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time, and shall not count a swap or security-based swap that is exempt pursuant to paragraph (d) of this section.

(6) September 1, 2020 with respect to the requirements in § __.3 for initial margin for any other covered swap entity with respect to non-cleared swaps and non-cleared security-based swaps entered into with any other counterparty.

(f) Once a covered swap entity must comply with the margin requirements for non-cleared swaps and non-cleared security-based swaps with respect to a particular counterparty based on the compliance dates in paragraph (e) of this section, the covered swap entity shall remain subject to the requirements of this [part] with respect to that counterparty.

(g)(1) If a covered swap entity's counterparty changes its status such that a non-cleared swap or non-cleared security-based swap with that counterparty becomes subject to stricter margin requirements under this [part] (such as if the counterparty's status changes from a financial end user without material swaps exposure to a financial end user with material swaps exposure), then the covered swap entity shall comply with the stricter margin requirements for any non-cleared swap or non-cleared security-based swap entered into with that counterparty after the counterparty changes its status.

(2) If a covered swap entity's counterparty changes its status such that a non-cleared swap or non-cleared security-based swap with that counterparty becomes subject to less strict margin requirements under this [part] (such as if the counterparty's status changes from a financial end user with material swaps exposure to a financial end user without material swaps exposure), then the covered swap entity may comply with the less strict margin requirements for any non-cleared swap or non-cleared security-based swap entered into with that counterparty after the counterparty changes its status as well as for any outstanding non-cleared swap or non-cleared security-based swap entered into after the applicable compliance date in paragraph (e) of this section and before the counterparty changed its status.

§ __.2 *Definitions.*

Affiliate. A company is an affiliate of another company if:

(1) Either company consolidates the other on financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles, the International Financial Reporting Standards, or other similar standards;

(2) Both companies are consolidated with a third company on a financial statement prepared in accordance with such principles or standards;

(3) For a company that is not subject to such principles or standards, if consolidation as described in paragraph (1) or (2) of this definition would have occurred if such principles or standards had applied; or

(4) [Agency] has determined that a company is an affiliate of another company, based on [Agency's] conclusion that either company provides significant support to, or is materially subject to the risks or losses of, the other company.

Bank holding company has the meaning specified in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

Broker has the meaning specified in section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4)).

Business day means any day other than a Saturday, Sunday, or legal holiday.

Clearing agency has the meaning specified in section 3(a)(23) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(23)).

Company means a corporation, partnership, limited liability company, business trust, special purpose entity, association, or similar organization.

Counterparty means, with respect to any non-cleared swap or non-cleared security-based swap to which a person is a party, each other party to such non-cleared swap or non-cleared security-based swap.

Cross-currency swap means a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs on the date the swap is entered into, with a reversal of the exchange of principal at a later date that is agreed upon when the swap is entered into.

Currency of settlement means a currency in which a party has agreed to discharge payment obligations related to a non-cleared swap, a non-cleared security-based swap, a group of non-cleared swaps, or a group of non-cleared security-based swaps subject to a master agreement at the regularly occurring dates on which such payments are due in the ordinary course.

Day of execution means the calendar day at the time the parties enter into a non-cleared swap or non-cleared security-based swap, provided:

(1) If each party is in a different calendar day at the time the parties enter into the non-cleared swap or non-cleared security-based swap, the day of execution is deemed the latter of the two dates; and

(2) If a non-cleared swap or non-cleared security-based swap is

(i) Entered into after 4:00 p.m. in the location of a party; or

(ii) Entered into on a day that is not a business day in the location of a party, then the non-cleared swap or non-cleared security-based swap is deemed to have been entered into on the immediately succeeding day that is a business day for both parties, and both parties shall determine the day of execution with reference to that business day.

Dealer has the meaning specified in section 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(5)).

Depository institution has the meaning specified in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

Derivatives clearing organization has the meaning specified in section 1a(15) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(15)).

Eligible collateral means collateral described in § __.6.

Eligible master netting agreement means a written, legally enforceable agreement provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default following any stay permitted by paragraph (2) of this definition, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the covered swap entity the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(i) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.), Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5381 et seq.), the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended (12 U.S.C. 4617), or the Farm Credit Act of 1971, as amended (12 U.S.C. 2183 and 2279cc), or laws of foreign jurisdictions that are substantially similar to the U.S. laws referenced in this paragraph 2(i) in order to facilitate the orderly resolution of the defaulting counterparty; or

(ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph 2(i) of this definition;

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and

(4) A covered swap entity that relies on the agreement for purposes of calculating the margin required by this part must:

(i) Conduct sufficient legal review to conclude with a well-founded basis (and maintain sufficient written documentation of that legal review) that:

(A) The agreement meets the requirements of paragraph (2) of this definition; and

(B) In the event of a legal challenge (including one resulting from default or from receivership, conservatorship, insolvency, liquidation, or similar proceeding), the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions; and

(ii) Establish and maintain written procedures to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of this definition.

Financial end user means

(1) Any counterparty that is not a swap entity and that is:

(i) A bank holding company or an affiliate thereof; a savings and loan holding company; a U.S. intermediate holding company established or designated for purposes of compliance with 12 CFR 252.153; or a nonbank financial institution supervised by the Board of Governors of the Federal Reserve System under Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5323);

(ii) A depository institution; a foreign bank; a Federal credit union or State credit union as defined in section 2 of the Federal Credit Union Act (12 U.S.C. 1752(1) & (6)); an institution that functions solely in a trust or fiduciary capacity as described in section 2(c)(2)(D) of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)(D)); an industrial loan company, an industrial bank, or other similar institution described in section 2(c)(2)(H) of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)(H));

(iii) An entity that is state-licensed or registered as—

(A) A credit or lending entity, including a finance company; money lender; installment lender; consumer lender or lending company; mortgage lender, broker, or bank; motor vehicle title pledge lender; payday or deferred deposit lender; premium finance company; commercial finance or lending company; or commercial mortgage company; except entities registered or licensed solely on account of financing the entity's direct sales of goods or services to customers;

(B) A money services business, including a check casher; money transmitter; currency dealer or exchange; or money order or traveler's check issuer;

(iv) A regulated entity as defined in section 1303(20) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4502(20)) or any entity for which the Federal Housing Finance Agency or its successor is the primary federal regulator;

(v) Any institution chartered in accordance with the Farm Credit Act of 1971, as amended, 12 U.S.C. § 2001 et. seq.,that is regulated by the Farm Credit Administration;

(vi) A securities holding company; a broker or dealer; an investment adviser as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)); an investment company registered with the U.S. Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.); or a company that has elected to be regulated as a business development company pursuant to section 54(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-53(a));

(vii) A private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80-b-2(a)); an entity that would be an investment company under section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3) but for section 3(c)(5)(C); or an entity that is deemed not to be an investment company under section 3 of the Investment Company Act of 1940 pursuant to Investment Company Act Rule 3a-7 (17 CFR 270.3a-7) of the U.S. Securities and Exchange Commission;

(viii) A commodity pool, a commodity pool operator, or a commodity trading advisor as defined, respectively, in section 1a(10), 1a(11), and 1a(12) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(10), 1a(11), and 1a(12)); a floor broker, a floor trader, or introducing broker as defined, respectively, in 1a(22), 1a(23) and 1a(31) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(22), 1a(23), and 1a(31)); or a futures commission merchant as defined in 1a(28) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(28));

(ix) An employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002);

(x) An entity that is organized as an insurance company, primarily engaged in writing insurance or reinsuring risks underwritten by insurance companies, or is subject to supervision as such by a State insurance regulator or foreign insurance regulator;

(xi) An entity, person or arrangement that is, or holds itself out as being, an entity, person, or arrangement that raises money from investors, accepts money from clients, or uses its own money primarily for the purpose of investing or trading or facilitating the investing or trading in loans, securities, swaps, funds or other assets for resale or other disposition or otherwise trading in loans, securities, swaps, funds or other assets; or

(xii) An entity that would be a financial end user described in paragraph (1) of this section or a swap entity, if it were organized under the laws of the United States or any State thereof.

(2) The term "financial end user" does not include any counterparty that is:

(i) A sovereign entity;

(ii) A multilateral development bank;

(iii) The Bank for International Settlements;

(iv) An entity that is exempt from the definition of financial entity pursuant to section 2(h)(7)(C)(iii) of the Commodity Exchange Act of 1936 (7 U.S.C. 2(h)(7)(C)(iii)) and implementing regulations; or

(v) An affiliate that qualifies for the exemption from clearing pursuant to section 2(h)(7)(D) of the Commodity Exchange Act of 1936 (7 U.S.C. 2(h)(7)(D)) or section 3C(g)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c-3(g)(4)) and implementing regulations.

Foreign bank means an organization that is organized under the laws of a foreign country and that engages directly in the business of banking outside the United States.

Foreign exchange forward has the meaning specified in section 1a(24) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(24)).

Foreign exchange swap has the meaning specified in section 1a(25) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(25)).

Initial margin means the collateral as calculated in accordance with §__.8 that is posted or collected in connection with a non-cleared swap or non-cleared security-based swap.

Initial margin collection amount means —

(1) In the case of a covered swap entity that does not use an initial margin model, the amount of initial margin with respect to a non-cleared swap or non-cleared security-based swap that is required under Appendix A of this part; and

(2) In the case of a covered swap entity that uses an initial margin model pursuant to § __.8, the amount of initial margin with respect to a non-cleared swap or non-cleared security-based swap that is required under the initial margin model.

Initial margin model means an internal risk management model that:

(1) Has been developed and designed to identify an appropriate, risk-based amount of initial margin that the covered swap entity must collect with respect to one or more non-cleared swaps or non-cleared security-based swaps to which the covered swap entity is a party; and

(2) Has been approved by [Agency] pursuant to § __.8 of this [part].

Initial margin threshold amount means: An aggregate credit exposure of $50 million resulting from all non-cleared swaps and non-cleared security-based swaps between a covered swap entity and its affiliates, and a counterparty and its affiliates. For purposes of this calculation, an entity shall not count a swap or security-based swap that is exempt pursuant to § __.1(d).

Major currency means:

(1) United States Dollar (USD);

(2) Canadian Dollar (CAD);

(3) Euro (EUR);

(4) United Kingdom Pound (GBP);

(5) Japanese Yen (JPY);

(6) Swiss Franc (CHF);

(7) New Zealand Dollar (NZD);

(8) Australian Dollar (AUD);

(9) Swedish Kronor (SEK);

(10) Danish Kroner (DKK);

(11) Norwegian Krone (NOK); or

(12) Any other currency as determined by [Agency].

Margin means initial margin and variation margin.

Market intermediary means a securities holding company; a broker or dealer; a futures commission merchant as defined in 1a(28) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(28)); a swap dealer as defined in section 1a(49) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(49)); or a security-based swap dealer as defined in section 3(a)(71) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(71)).

Material swaps exposure for an entity means that an entity and its affiliates have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards, and foreign exchange swaps with all counterparties for June, July, and August of the previous calendar year that exceeds $8 billion, where such amount is calculated only for business days. An entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time. For purposes of this calculation, an entity shall not count a swap or security-based swap that is exempt pursuant to § __.1(d).

Multilateral development bank means the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and 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 [Agency] determines poses comparable credit risk.

Non-cleared swap means a swap that is not cleared by a derivatives clearing organization registered with the Commodity Futures Trading Commission pursuant to section 5b(a) of the Commodity Exchange Act of 1936 (7 U.S.C. 7a-1(a)) or by a clearing organization that the Commodity Futures Trading Commission has exempted from registration by rule or order pursuant to section 5b(h) of the Commodity Exchange Act of 1936 (7 U.S.C. 7a-1(h)) .

Non-cleared security-based swap means a security-based swap that is not, directly or indirectly, submitted to and cleared by a clearing agency registered with the U.S. Securities and Exchange Commission pursuant to section 17A(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1(b)(1)) or by a clearing agency that the U.S. Securities and Exchange Commission has exempted from registration by rule or order pursuant to section 17A(k) of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1(k).

Prudential regulator has the meaning specified in section 1a(39) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(39)).

Savings and loan holding company has the meaning specified in section 10(n) of the Home Owners' Loan Act (12 U.S.C. 1467a(n)).

Securities holding company has the meaning specified in section 618 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 1850a).

Security-based swap has the meaning specified in section 3(a)(68) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(68)).

Sovereign entity means a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government.

State means any State, commonwealth, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, or the United States Virgin Islands.

Subsidiary. A company is a subsidiary of another company if*:*

(1) The company is consolidated by the other company on financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles, the International Financial Reporting Standards, or other similar standards;

(2) For a company that is not subject to such principles or standards, if consolidation as described in paragraph (1) of this definition would have occurred if such principles or standards had applied; or

(3) [Agency] has determined that the company is a subsidiary of another company, based on [Agency's] conclusion that either company provides significant support to, or is materially subject to the risks of loss of, the other company.

Swap has the meaning specified in section 1a(47) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(47)).

Swap entity means a person that is registered with the Commodity Futures Trading Commission as a swap dealer or major swap participant pursuant to the Commodity Exchange Act of 1936 (7 U.S.C. 1 et seq.), or a person that is registered with the U.S. Securities and Exchange Commission as a security-based swap dealer or a major security-based swap participant pursuant to the Securities Exchange Act of 1934 (15 U.S.C 78a et seq.).

U.S. Government-sponsored enterprise means an entity established or chartered by the U.S. government to serve public purposes specified by federal statute but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. government.

Variation margin means collateral provided by one party to its counterparty to meet the performance of its obligations under one or more non-cleared swaps or non-cleared security-based swaps between the parties as a result of a change in value of such obligations since the last time such collateral was provided.

Variation margin amount means the cumulative mark-to-market change in value to a covered swap entity of a non-cleared swap or non-cleared security-based swap, as measured from the date it is entered into (or, in the case of a non-cleared swap or non-cleared security-based swap that has a positive or negative value to a covered swap entity on the date it is entered into, such positive or negative value plus any cumulative mark-to-market change in value to the covered swap entity of a non-cleared swap or non-cleared security-based swap after such date), less the value of all variation margin previously collected, plus the value of all variation margin previously posted with respect to such non-cleared swap or non-cleared security-based swap.

§ __.3 *Initial margin.*

(a) *Collection of margin.* A covered swap entity shall collect initial margin with respect to any non-cleared swap or non-cleared security-based swap from a counterparty that is a financial end user with material swaps exposure or that is a swap entity in an amount that is no less than the greater of—

(1) Zero; or

(2) The initial margin collection amount for such non-cleared swap or non-cleared security-based swap *less* the initial margin threshold amount (not including any portion of the initial margin threshold amount already applied by the covered swap entity or its affiliates to other non-cleared swaps or non-cleared security-based swaps with the counterparty or its affiliates), as applicable.

(b) *Posting of margin.* A covered swap entity shall post initial margin with respect to any non-cleared swap or non-cleared security-based swap to a counterparty that is a financial end user with material swaps exposure. Such initial margin shall be in an amount at least as large as the covered swap entity would be required to collect under paragraph (a) of this section if it were in the place of the counterparty.

(c) *Timing.* A covered swap entity shall comply with the initial margin requirements described in paragraphs (a) and (b) of this section on each business day, for a period beginning on or before the business day following the day of execution and ending on the date the non-cleared swap or non-cleared security-based swap terminates or expires.

(d) *Other counterparties*. A covered swap entity is not required to collect or post initial margin with respect to any non-cleared swap or non-cleared security-based swap described in §__1(d). For any other non-cleared swap or non-cleared security-based swap between a covered swap entity and a counterparty that is neither a financial end user with a material swaps exposure nor a swap entity, the covered swap entity shall collect initial margin at such times and in such forms and such amounts (if any), that the covered swap entity determines appropriately addresses the credit risk posed by the counterparty and the risks of such non-cleared swap or non-cleared security-based swap.

§ __.4 *Variation margin.*

(a) *General.* After the date on which a covered swap entity enters into a non-cleared swap or non-cleared security-based swap with a swap entity or financial end user, the covered swap entity shall collect variation margin equal to the variation margin amount from the counterparty to such non-cleared swap or non-cleared security-based swap when the amount is positive and post variation margin equal to the variation margin amount to the counterparty to such non-cleared swap or non-cleared security-based swap when the amount is negative.

(b) *Timing.* A covered swap entity shall comply with the variation margin requirements described in paragraph (a) of this section on each business day, for a period beginning on or before the business day following the day of execution and ending on the date the non-cleared swap or non-cleared security based swap terminates or expires.

(c) *Other counterparties*. A covered swap entity is not required to collect or post variation margin with respect to any non-cleared swap or non-cleared security-based swap described in §__1(d). For any other non-cleared swap or non-cleared security-based swap between a covered swap entity and a counterparty that is neither a financial end user nor a swap entity, the covered swap entity shall collect variation margin at such times and in such forms and such amounts (if any), that the covered swap entity determines appropriately addresses the credit risk posed by the counterparty and the risks of such non-cleared swap or non-cleared security-based swap.

§ __.5 *Netting arrangements, minimum transfer amount, and satisfaction of collecting and posting requirements.*

(a) *Netting arrangements*. (1) For purposes of calculating and complying with the initial margin requirements of § ___.3 using an initial margin model as described in § ___.8, or with the variation margin requirements of § ___.4, a covered swap entity may net non-cleared swaps or non-cleared security-based swaps in accordance with this subsection.

(2) To the extent that one or more non-cleared swaps or non-cleared security-based swaps are executed pursuant to an eligible master netting agreement between a covered swap entity and its counterparty that is a swap entity or financial end user, a covered swap entity may calculate and comply with the applicable requirements of this [sub]part on an aggregate net basis with respect to all non-cleared swaps and non-cleared security-based swaps governed by such agreement, subject to paragraph (a)(3) of this section.

(3)(i) Except as permitted in paragraph (3)(ii) of this section, if an eligible master netting agreement covers non-cleared swaps and non-cleared security-based swaps entered into on or after the applicable compliance date set forth in §§ ___.1(e) or ___.1(g), all the non-cleared swaps and non-cleared security-based swaps covered by that agreement are subject to the requirements of this [part] and included in the aggregate netting portfolio for the purposes of calculating and complying with the margin requirements of this [part].

(ii) An eligible master netting agreement may identify one or more separate netting portfolios that independently meet the requirements in paragraph (1) of the definition of eligible master netting agreement in §__.2 and to which collection and posting of margin applies on an aggregate net basis separate from and exclusive of any other non-cleared swaps or non-cleared security-based swaps covered by the eligible master netting agreement. Any such netting portfolio that contains any non-cleared swap or non-cleared security-based swap entered into on or after the applicable compliance date set forth in §§ ___.1(e) or ___.1(g) is subject to the requirements of this [part]. Any such netting portfolio that contains only non-cleared swaps or non-cleared security-based swaps entered into before the applicable compliance date is not subject to the requirements of this [part].

(4) If a covered swap entity cannot conclude after sufficient legal review with a well-founded basis that the netting agreement described in this section meets the definition of eligible master netting agreement set forth in §__.2 , the covered swap entity must treat the non-cleared swaps and non-cleared security based swaps covered by the agreement on a gross basis for the purposes of calculating and complying with the requirements of this [part] to collect margin, but the covered swap entity may net those non-cleared swaps and non-cleared security-based swaps in accordance with paragraphs (a)(1) – (3) of this section for the purposes of calculating and complying with the requirements of this [part] to post margin.

(b) *Minimum transfer amount.* Notwithstanding §§ ___.3 or ___. 4, a covered swap entity is not required to collect or post margin pursuant to this [part] with respect to a particular counterparty unless and until the combined amount of initial margin and variation margin that is required pursuant to this [part] to be collected or posted and that has not yet been collected or posted with respect to the counterparty is greater than $500,000.

(c) *Satisfaction of Collecting and Posting Requirements.* A covered swap entity shall not be deemed to have violated its obligation to collect or post margin from or to a counterparty under §§§__.3, __.4 or __.6(e) if—

(1) The counterparty has refused or otherwise failed to provide or accept the required margin to or from the covered swap entity; and

(2) The covered swap entity has—

(i) Made the necessary efforts to collect or post the required margin, including the timely initiation and continued pursuit of formal dispute resolution mechanisms, or has otherwise demonstrated upon request to the satisfaction of [Agency] that it has made appropriate efforts to collect or post the required margin; or

(ii) Commenced termination of the non-cleared swap or non-cleared security-based swap with the counterparty promptly following the applicable cure period and notification requirements.

§ __.6 *Eligible collateral.*

(a) *Non-cleared swaps and non-cleared security-based swaps with a swap entity.* For a non-cleared swap or non-cleared security-based swap with a swap entity, a covered swap entity shall collect initial margin and variation margin required pursuant to this [part] solely in the form of the following types of collateral—

(1) Immediately available cash funds that are denominated in—

(i) U.S. dollars or another major currency; or

(ii) The currency of settlement for the non-cleared swap or non-cleared security-based swap;

(2) With respect to initial margin only---

(i) A security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury;

(ii) A security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, a U.S. government agency (other than the U.S. Department of Treasury) whose obligations are fully guaranteed by the full faith and credit of the United States government;

(iii) A security that is issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to the covered swap entity as set forth in § __.12 of this [part];

(iv) A publicly traded debt security issued by, or an asset-backed security fully guaranteed as to the payment of principal and interest by, a U.S. Government-sponsored enterprise that is operating with capital support or another form of direct financial assistance received from the U.S. government that enables the repayments of the U.S. Government-sponsored enterprise's eligible securities;

(v) A publicly traded debt security that meets the terms of [RESERVED] and is issued by a U.S. Government-sponsored enterprise not operating with capital support or another form of direct financial assistance from the U.S. government, and is not an asset-backed security;

(vi) A security that is issued by, or fully guaranteed as to the payment of principal and interest by, the Bank for International Settlements, the International Monetary Fund, or a multilateral development bank;

(vii) A security solely in the form of:

(A) Publicly traded debt not otherwise described in paragraph (a)(2) of this section that meets the terms of [RESERVED] and is not an asset-backed security;

(B) Publicly traded common equity that is included in:

(1) The Standard & Poor's Composite 1500 Index or any other similar index of liquid and readily marketable equity securities as determined by [Agency]; or

(2) An index that a covered swap entity's supervisor in a foreign jurisdiction recognizes for purposes of including publicly traded common equity as initial margin under applicable regulatory policy, if held in that foreign jurisdiction;

(viii) Securities in the form of redeemable securities in a pooled investment fund representing the security-holder's proportional interest in the fund's net assets and that are issued and redeemed only on the basis of the market value of the fund's net assets prepared each business day after the security-holder makes its investment commitment or redemption request to the fund, if (A) the fund's investments are limited to the following:

(1) Securities that are issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury, and immediately-available cash funds denominated in U.S. dollars; or

(2) Securities denominated in a common currency and issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to the covered swap entity as set forth in § __.12 of this [part], and immediately-available cash funds denominated in the same currency; and

(B) Assets of the fund may not be transferred through securities lending, securities borrowing, repurchase agreements, reverse repurchase agreements, or other means that involve the fund having rights to acquire the same or similar assets from the transferee; or

(ix) Gold.

(b) *Non-cleared swaps and non-cleared security-based swaps with a financial end user.* For a non-cleared swap or non-cleared security-based swap with a financial end user, a covered swap entity shall collect and post initial margin and variation margin required pursuant to this [part] solely in the form of the following types of collateral—

(1) Immediately available cash funds that are denominated in—

(i) U.S. dollars or another major currency; or

(ii) The currency of settlement for the non-cleared swap or non-cleared security-based swap;

(2) A security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury;

(3) A security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, a U.S. government agency (other than the U.S. Department of Treasury) whose obligations are fully guaranteed by the full faith and credit of the United States government;

(4) A security that is issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to the covered swap entity as set forth in § __.12 of this [part];

(5) A publicly traded debt security issued by, or an asset-backed security fully guaranteed as to the payment of principal and interest by, a U.S. Government-sponsored enterprise that is operating with capital support or another form of direct financial assistance received from the U.S. government that enables the repayments of the U.S. Government-sponsored enterprise's eligible securities;

(6) A publicly traded debt security that meets the terms of [RESERVED] and is issued by a U.S. Government-sponsored enterprise not operating with capital support or another form of direct financial assistance from the U.S. government, and is not an asset-backed security;

(7) A security that is issued by, or fully guaranteed as to the payment of principal and interest by, the Bank for International Settlements, the International Monetary Fund, or a multilateral development bank;

(8) A security solely in the form of:

(i) Publicly traded debt not otherwise described in this subsection (b) that meets the terms of [RESERVED] and is not an asset-backed security;

(ii) Publicly traded common equity that is included in:

(A) The Standard & Poor's Composite 1500 Index or any other similar index of liquid and readily marketable equity securities as determined by [Agency]; or

(B) An index that a covered swap entity's supervisor in a foreign jurisdiction recognizes for purposes of including publicly traded common equity as initial margin under applicable regulatory policy, if held in that foreign jurisdiction;

(9) Securities in the form of redeemable securities in a pooled investment fund representing the security-holder's proportional interest in the fund's net assets and that are issued and redeemed only on the basis of the market value of the fund's net assets prepared each

business day after the security-holder makes its investment commitment or redemption request to the fund, if (i) the fund's investments are limited to the following:

(A) Securities that are issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury, and immediately-available cash funds denominated in U.S. dollars; or

(B) Securities denominated in a common currency and issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to the covered swap entity as set forth in § __.12 of this [part], and immediately-available cash funds denominated in the same currency; and

(ii) Assets of the fund may not be transferred through securities lending, securities borrowing, repurchase agreements, reverse repurchase agreements, or other means that involve the fund having rights to acquire the same or similar assets from the transferee; or

(10) Gold.

(c)(1) The value of any eligible collateral collected or posted to satisfy margin requirements pursuant to this [part] is subject to the sum of the following discounts, as applicable:

(i) An 8 percent discount for variation margin collateral denominated in a currency that is not the currency of settlement for the non-cleared swap or non-cleared security-based swap, except for immediately available cash funds denominated in U.S. dollars or another major currency;

(ii) An 8 percent discount for initial margin collateral denominated in a currency that is not the currency of settlement for the non-cleared swap or non-cleared security-based swap, except for eligible types of collateral denominated in a single termination currency designated as payable to the non-posting counterparty as part of the eligible master netting agreement; and

(iii) For variation and initial margin non-cash collateral, the discounts described in Appendix B of this [part].

(2) The value of variation margin or initial margin collateral is computed as the product of the cash or market value of the eligible collateral asset times one minus the applicable discounts pursuant to paragraph (c)(1) of this section expressed in percentage terms. The total value of all variation margin or initial margin collateral is calculated as the sum of those values for each eligible collateral asset.

(d) Notwithstanding paragraphs (a) and (b) of this section, eligible collateral for initial margin and variation margin required by this [part] does not include a security issued by—

(1) The party or an affiliate of the party pledging such collateral;

(2) A bank holding company, a savings and loan holding company, a U.S. intermediate holding company established or designated for purposes of compliance with 12 CFR 252.153, a foreign bank, a depository institution, a market intermediary, a company that would be any of the foregoing if it were organized under the laws of the United States or any State, or an affiliate of any of the foregoing institutions; or

(3) A nonbank financial institution supervised by the Board of Governors of the Federal Reserve System under Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5323).

(e) A covered swap entity shall monitor the market value and eligibility of all collateral collected and posted to satisfy the minimum initial margin and minimum variation margin requirements of this [part]. To the extent that the market value of such collateral has declined, the covered swap entity shall promptly collect or post such additional eligible collateral as is necessary to maintain compliance with the margin requirements of this [part]. To the extent that the collateral is no longer eligible, the covered swap entity shall promptly collect or post sufficient eligible replacement collateral to comply with the margin requirements of this [part].

(f) A covered swap entity may collect or post initial margin and variation margin that is required by §§ __.3(d) or __.4(c) or that is not required pursuant to this [part] in any form of collateral.

§ __.7 *Segregation of collateral.*

(a) A covered swap entity that posts any collateral other than for variation margin with respect to a non-cleared swap or a non-cleared security-based swap shall require that all funds or other property other than variation margin provided by the covered swap entity be held by one or more custodians that are not the covered swap entity or counterparty and not affiliates of the covered swap entity or the counterparty.

(b) A covered swap entity that collects initial margin required by § __.3(a) with respect to a non-cleared swap or a non-cleared security-based swap shall require that such initial margin be held by one or more custodians that are not the covered swap entity or counterparty and not affiliates of the covered swap entity or the counterparty.

(c) For purposes of paragraphs (a) and (b) of this section, the custodian must act pursuant to a custody agreement that:

(1) Prohibits the custodian from rehypothecating, repledging, reusing, or otherwise transferring (through securities lending, securities borrowing, repurchase agreement, reverse repurchase agreement or other means) the collateral held by the custodian, except that cash collateral may be held in a general deposit account with the custodian if the funds in the account

are used to purchase an asset described in § __.6(a)(2) or §__.6(b), such asset is held in compliance with this § __.7, and such purchase takes place within a time period reasonably necessary to consummate such purchase after the cash collateral is posted as initial margin; and

(2) Is a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding.

(d) Notwithstanding paragraph (c)(1) of this section, a custody agreement may permit the posting party to substitute or direct any reinvestment of posted collateral held by the custodian, provided that, with respect to collateral collected by a covered swap entity pursuant to § __.3(a) or posted by a covered swap entity pursuant to § __.3(b), the agreement requires the posting party to:

(1) Substitute only funds or other property that would qualify as eligible collateral under § __.6, and for which the amount net of applicable discounts described in Appendix B would be sufficient to meet the requirements of § __.3; and

(2) Direct reinvestment of funds only in assets that would qualify as eligible collateral under § __.6, and for which the amount net of applicable discounts described in Appendix B would be sufficient to meet the requirements of § __.3.

§ __.8 *Initial margin models and standardized amounts.*

(a) *Standardized amounts.* Unless a covered swap entity's initial margin model conforms to the requirements of this section, the covered swap entity shall calculate the amount of initial margin required to be collected or posted for one or more non-cleared swaps or non-cleared security-based swaps with a given counterparty pursuant to § __.3 on a daily basis pursuant to Appendix A of this [part].

(b) *Use of initial margin models.* A covered swap entity may calculate the amount of initial margin required to be collected or posted for one or more non-cleared swaps or non-cleared security-based swaps with a given counterparty pursuant to § __.3 on a daily basis using an initial margin model only if the initial margin model meets the requirements of this section.

(c) *Requirements for initial margin model.*

(1) A covered swap entity must obtain the prior written approval of [Agency] before using any initial margin model to calculate the initial margin required in this [part].

(2) A covered swap entity must demonstrate that the initial margin model satisfies all of the requirements of this section on an ongoing basis.

(3) A covered swap entity must notify [Agency] in writing 60 days prior to:

(i) Extending the use of an initial margin model that [Agency] has approved under this section to an additional product type;

(ii) Making any change to any initial margin model approved by [Agency] under this section that would result in a material change in the covered swap entity's assessment of initial margin requirements; or

(iii) Making any material change to modeling assumptions used by the initial margin model.

(4) [Agency] may rescind its approval of the use of any initial margin model, in whole or in part, or may impose additional conditions or requirements if [Agency] determines, in its sole discretion, that the initial margin model no longer complies with this section.

(d) *Quantitative requirements.*

(1) The covered swap entity’s initial margin model must calculate an amount of initial margin that is equal to the potential future exposure of the non-cleared swap, non-cleared

security-based swap or netting portfolio of non-cleared swaps or non-cleared security-based swaps covered by an eligible master netting agreement. Potential future exposure is an estimate of the one-tailed 99 percent confidence interval for an increase in the value of the non-cleared swap, non-cleared security-based swap or netting portfolio of non-cleared swaps or non-cleared security-based swaps due to an instantaneous price shock that is equivalent to a movement in all material underlying risk factors, including prices, rates, and spreads, over a holding period equal to the shorter of ten business days or the maturity of the non-cleared swap, non-cleared security-based swap or netting portfolio.

(2) All data used to calibrate the initial margin model must be based on an equally weighted historical observation period of at least one year and not more than five years and must incorporate a period of significant financial stress for each broad asset class that is appropriate to the non-cleared swaps and non-cleared security-based swaps to which the initial margin model is applied.

(3) The covered swap entity's initial margin model must use risk factors sufficient to measure all material price risks inherent in the transactions for which initial margin is being calculated. The risk categories must include, but should not be limited to, foreign exchange or interest rate risk, credit risk, equity risk, and commodity risk, as appropriate. For material exposures in significant currencies and markets, modeling techniques must capture spread and basis risk and must incorporate a sufficient number of segments of the yield curve to capture differences in volatility and imperfect correlation of rates along the yield curve.

(4) In the case of a non-cleared cross-currency swap, the covered swap entity's initial margin model need not recognize any risks or risk factors associated with the fixed, physically-settled foreign exchange transaction associated with the exchange of principal embedded in the

non-cleared cross-currency swap. The initial margin model must recognize all material risks and risk factors associated with all other payments and cash flows that occur during the life of the non-cleared cross-currency swap.

(5) The initial margin model may calculate initial margin for a non-cleared swap or non-cleared security-based swap or a netting portfolio of non-cleared swaps or non-cleared security-based swaps covered by an eligible master netting agreement. It may reflect offsetting exposures, diversification, and other hedging benefits for non-cleared swaps and non-cleared security-based swaps that are governed by the same eligible master netting agreement by incorporating empirical correlations within the following broad risk categories, provided the covered swap entity validates and demonstrates the reasonableness of its process for modeling and measuring hedging benefits: commodity, credit, equity, and foreign exchange or interest rate. Empirical correlations under an eligible master netting agreement may be recognized by the initial margin model within each broad risk category, but not across broad risk categories.

(6) If the initial margin model does not explicitly reflect offsetting exposures, diversification, and hedging benefits between subsets of non-cleared swaps or non-cleared security-based swaps within a broad risk category, the covered swap entity must calculate an amount of initial margin separately for each subset within which such relationships are explicitly recognized by the initial margin model. The sum of the initial margin amounts calculated for each subset of non-cleared swaps and non-cleared security-based swaps within a broad risk category will be used to determine the aggregate initial margin due from the counterparty for the portfolio of non-cleared swaps and non-cleared security-based swaps within the broad risk category.

(7) The sum of the initial margin amounts calculated for each broad risk category will be used to determine the aggregate initial margin due from the counterparty.

(8) The initial margin model may not permit the calculation of any initial margin collection amount to be offset by, or otherwise take into account, any initial margin that may be owed or otherwise payable by the covered swap entity to the counterparty.

(9) The initial margin model must include all material risks arising from the nonlinear price characteristics of option positions or positions with embedded optionality and the sensitivity of the market value of the positions to changes in the volatility of the underlying rates, prices, or other material risk factors.

(10) The covered swap entity may not omit any risk factor from the calculation of its initial margin that the covered swap entity uses in its initial margin model unless it has first demonstrated to the satisfaction of [Agency] that such omission is appropriate.

(11) The covered swap entity may not incorporate any proxy or approximation used to capture the risks of the covered swap entity's non-cleared swaps or non-cleared security-based swaps unless it has first demonstrated to the satisfaction of [Agency] that such proxy or approximation is appropriate.

(12) The covered swap entity must have a rigorous and well-defined process for re-estimating, re-evaluating, and updating its internal margin model to ensure continued applicability and relevance.

(13) The covered swap entity must review and, as necessary, revise the data used to calibrate the initial margin model at least annually, and more frequently as market conditions warrant, to ensure that the data incorporate a period of significant financial stress appropriate to

the non-cleared swaps and non-cleared security-based swaps to which the initial margin model is applied.

(14) The level of sophistication of the initial margin model must be commensurate with the complexity of the non-cleared swaps and non-cleared security-based swaps to which it is applied. In calculating an initial margin collection amount, the initial margin model may make use of any of the generally accepted approaches for modeling the risk of a single instrument or portfolio of instruments.

(15) [Agency] may in its sole discretion require a covered swap entity using an initial margin model to collect a greater amount of initial margin than that determined by the covered swap entity's initial margin model if [Agency] determines that the additional collateral is appropriate due to the nature, structure, or characteristics of the covered swap entity's transaction(s), or is commensurate with the risks associated with the transaction(s).

(e) *Periodic review.* A covered swap entity must periodically, but no less frequently than annually, review its initial margin model in light of developments in financial markets and modeling technologies, and enhance the initial margin model as appropriate to ensure that the initial margin model continues to meet the requirements for approval in this section.

(f) *Control, oversight, and validation mechanisms.*

(1) The covered swap entity must maintain a risk control unit that reports directly to senior management and is independent from the business trading units.

(2) The covered swap entity's risk control unit must validate its initial margin model prior to implementation and on an ongoing basis. The covered swap entity's validation process must be independent of the development, implementation, and operation of the initial margin

model, or the validation process must be subject to an independent review of its adequacy and effectiveness. The validation process must include:

(i) An evaluation of the conceptual soundness of (including developmental evidence supporting) the initial margin model;

(ii) An ongoing monitoring process that includes verification of processes and benchmarking by comparing the covered swap entity's initial margin model outputs (estimation of initial margin) with relevant alternative internal and external data sources or estimation techniques. The benchmark(s) must address the chosen model's limitations. When applicable, the covered swap entity should consider benchmarks that allow for non-normal distributions such as historical and Monte Carlo simulations. When applicable, validation shall include benchmarking against observable margin standards to ensure that the initial margin required is not less than what a derivatives clearing organization or a clearing agency would require for similar cleared transactions; and

(iii) An outcomes analysis process that includes backtesting the initial margin model. This analysis must recognize and compensate for the challenges inherent in back-testing over periods that do not contain significant financial stress.

(3) If the validation process reveals any material problems with the initial margin model, the covered swap entity must promptly notify [Agency] of the problems, describe to [Agency] any remedial actions being taken, and adjust the initial margin model to ensure an appropriately conservative amount of required initial margin is being calculated.

(4) The covered swap entity must have an internal audit function independent of business-line management and the risk control unit that at least annually assesses the effectiveness of the controls supporting the covered swap entity's initial margin model

measurement systems, including the activities of the business trading units and risk control unit, compliance with policies and procedures, and calculation of the covered swap entity's initial margin requirements under this [part]. At least annually, the internal audit function must report its findings to the covered swap entity's board of directors or a committee thereof.

(g) *Documentation.* The covered swap entity must adequately document all material aspects of its initial margin model, including the management and valuation of the non-cleared swaps and non-cleared security-based swaps to which it applies, the control, oversight, and validation of the initial margin model, any review processes and the results of such processes.

(h) *Escalation procedures.* The covered swap entity must adequately document internal authorization procedures, including escalation procedures, that require review and approval of any change to the initial margin calculation under the initial margin model, demonstrable analysis that any basis for any such change is consistent with the requirements of this section, and independent review of such demonstrable analysis and approval.

§ __.9 *Cross-border application of margin requirements.*

(a) *Transactions to which this rule does not apply.* The requirements of §§ __.3 through __.8 and §§__.10 through __.12 shall not apply to any foreign non-cleared swap or foreign non-cleared security-based swap of a foreign covered swap entity.

(b) For purposes of this section, a *foreign non-cleared swap or foreign non-cleared security-based swap* is any non-cleared swap or non-cleared security-based swap with respect to which neither the counterparty to the foreign covered swap entity nor any party that provides a guarantee of either party's obligations under the non-cleared swap or non-cleared security-based swap is–

(1) An entity organized under the laws of the United States or any State (including a U.S. branch, agency, or subsidiary of a foreign bank) or a natural person who is a resident of the United States;

(2) A branch or office of an entity organized under the laws of the United States or any State; or

(3) A swap entity that is a subsidiary of an entity that is organized under the laws of the United States or any State.

(c) For purposes of this section, a *foreign covered swap entity* is any covered swap entity that is not–

(1) An entity organized under the laws of the United States or any State, including a U.S. branch, agency, or subsidiary of a foreign bank;

(2) A branch or office of an entity organized under the laws of the United States or any State; or

(3) An entity that is a subsidiary of an entity that is organized under the laws of the United States or any State.

(d) *Transactions for which substituted compliance determination may apply.*

(1) *Determinations and reliance.* For non-cleared swaps and non-cleared security-based swaps entered into by covered swap entities described in paragraph (d)(3) of this section, a covered swap entity may satisfy the provisions of this [part] by complying with the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps that the prudential regulators jointly, conditionally or unconditionally, determine by public order satisfy the corresponding requirements of §§ __.3 through §§__.8 and __.10 through __.12.

(2) *Standard.* In determining whether to make a determination under paragraph (d)(1) of this section, the prudential regulators will consider whether the requirements of such foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps applicable to such covered swap entities are comparable to the otherwise applicable requirements of this [part] and appropriate for the safe and sound operation of the covered swap entity, taking into account the risks associated with non-cleared swaps and non-cleared security-based swaps.

(3) *Covered swap entities eligible for substituted compliance.* A covered swap entity may rely on a determination under paragraph (d)(1) of this section only if:

(i) The covered swap entity's obligations under the non-cleared swap or non-cleared security-based swap do not have a guarantee from:

(A) An entity organized under the laws of the United States or any State (other than a U.S. branch or agency of a foreign bank) or a natural person who is a resident of the United States; or

(B) A branch or office of an entity organized under the laws of the United States or any State; and

(ii) The covered swap entity is—

(A) A foreign covered swap entity;

(B) A U.S. branch or agency of a foreign bank; or

(C) An entity that is not organized under the laws of the United States or any State and is a subsidiary of a depository institution, Edge corporation, or agreement corporation.

(4) *Compliance with foreign margin collection requirement.* A covered swap entity satisfies its requirement to post initial margin under § __.3(b) of this [part] by posting to its counterparty initial margin in the form and amount, and at such times, that its counterparty is

required to collect pursuant to a foreign regulatory framework, provided that the counterparty is subject to the foreign regulatory framework and the prudential regulators have made a determination under paragraph (d)(1) of this section, unless otherwise stated in that determination, and the counterparty's obligations under the non-cleared swap or non-cleared security-based swap do not have a guarantee from:

(i) An entity organized under the laws of the United States or any State (including a U.S. branch, agency, or subsidiary of a foreign bank) or a natural person who is a resident of the United States; or

(ii) A branch or office of an entity organized under the laws of the United States or any State.

(e) *Requests for determinations.*

(1) A covered swap entity described in paragraph (d)(3) of this section may request that the prudential regulators make a determination pursuant to this section. A request for a determination must include a description of:

(i) The scope and objectives of the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps;

(ii) The specific provisions of the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps that govern:

(A) The scope of transactions covered;

(B) The determination of the amount of initial margin and variation margin required and how that amount is calculated;

(C) The timing of margin requirements;

(D) Any documentation requirements;

(E) The forms of eligible collateral;

(F) Any segregation and rehypothecation requirements; and

(G) The approval process and standards for models used in calculating initial margin and variation margin;

(iii) The supervisory compliance program and enforcement authority exercised by a foreign financial regulatory authority or authorities in such system to support its oversight of the application of the non-cleared swap or non-cleared security-based swap regulatory framework and how that framework applies to the non-cleared swaps or non-cleared security-based swaps of the covered swap entity; and

(iv) Any other descriptions and documentation that the prudential regulators determine are appropriate.

(2) A covered swap entity described in paragraph (d)(3) of this section may make a request under this section only if the non-cleared swap or non-cleared security-based swap activities of the covered swap entity are directly supervised by the authorities administering the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps.

(f) *Segregation unavailable.* Sections __.3(b) and __.7 of this [part] do not apply to a non-cleared swap or non-cleared security-based swap entered into by (i) a foreign branch of a covered swap entity that is a depository institution; or (ii) a covered swap entity that is not organized under the laws of the United States or any State and is a subsidiary of a depository institution, Edge corporation, or agreement corporation, if—

(1) Inherent limitations in the legal or operational infrastructure in the foreign jurisdiction make it impracticable for the covered swap entity and the counterparty to post any

form of eligible initial margin collateral recognized pursuant to § __.6(b) of this [part] in compliance with the segregation requirements of §__.7 of this [part];

(2) The covered swap entity is subject to foreign regulatory restrictions that require the covered swap entity to transact in the non-cleared swap or non-cleared security-based swap with the counterparty through an establishment within the foreign jurisdiction and do not accommodate the posting of collateral for the non-cleared swap or non-cleared security-based swap outside the jurisdiction;

(3) The counterparty to the non-cleared swap or non-cleared security-based swap is not, and the counterparty's obligations under the non-cleared swap or non-cleared security-based swap do not have a guarantee from:

(i) An entity organized under the laws of the United States or any State (including a U.S. branch, agency, or subsidiary of a foreign bank) or a natural person who is a resident of the United States; or

(ii) A branch or office of an entity organized under the laws of the United States or any State;

(4) The covered swap entity collects initial margin for the non-cleared swap or non-cleared security-based swap in accordance with §__.3(a) in the form of cash pursuant to §__.6(b)(1), and posts and collects variation margin in accordance with §__.4(a) in the form of cash pursuant to §__.6(b)(1); and

(5) The [Agency] provides the covered swap entity with prior written approval for the covered swap entity's reliance on this paragraph (f) for the foreign jurisdiction.

(g) *Guarantee* means an arrangement pursuant to which one party to a non-cleared swap or non-cleared security-based swap has rights of recourse against a third-party guarantor, with respect to its counterparty's obligations under the non-cleared swap or non-cleared security-based swap. For these purposes, a party to a non-cleared swap or non-cleared security-based 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 non-cleared swap or non-cleared security-based swap. In addition, 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 third party guarantor with respect to the counterparty's obligations under the non-cleared swap or non-cleared security-based swap, such arrangement will be deemed a guarantee of the counterparty's obligations under the non-cleared swap or non-cleared security-based swap by the other guarantor.

§ __.10 *Documentation of margin matters.*

(a) A covered swap entity shall execute trading documentation with each counterparty that is either a swap entity or financial end user regarding credit support arrangements that—

(1) Provides the covered swap entity and its counterparty with the contractual right to collect and post initial margin and variation margin in such amounts, in such form, and under such circumstances as are required by this [part]; and

(2) Specifies—

(i) The methods, procedures, rules, and inputs for determining the value of each non-cleared swap or non-cleared security-based swap for purposes of calculating variation margin requirements; and

(ii) The procedures by which any disputes concerning the valuation of non-cleared swaps or non-cleared security-based swaps, or the valuation of assets collected or posted as initial margin or variation margin, may be resolved; and

(3) Describes the methods, procedures, rules, and inputs used to calculate initial margin for non-cleared swaps and non-cleared security based swaps entered into between the covered swap entity and the counterparty.

§ __.11 *Special Rules for Affiliates*.

(a) *Affiliates.* This [part] applies to a non-cleared swap or non-cleared security-based swap of a covered swap entity with its affiliate, unless the swap or security-based swap is excluded from coverage under §__.1(d) or as otherwise provided in this section. To the extent of any inconsistency between this section and any other provision of this [part], this section will apply.

(b) *Initial margin.*

(1) *Posting of Initial margin.* The requirement for a covered swap entity to post initial margin under § __.3(b) does not apply with respect to any non-cleared swap or non-cleared security-based swap with a counterparty that is an affiliate. A covered swap entity shall calculate the amount of initial margin that would be required to be posted to an affiliate that is a financial end user with material swaps exposure pursuant to § __.3(b) and provide documentation of such amount to each affiliate on a daily basis.

(2) *Initial Margin Threshold Amount.* For purposes of calculating the amount of initial margin to be collected from an affiliate counterparty in accordance with § __.3(a) or calculating the amount of initial margin that would have been posted to an affiliate counterparty in accordance with paragraph (b)(1) of this section, the initial margin threshold amount is an aggregate credit exposure of $20 million resulting from all non-cleared swaps and non-cleared

security-based swaps between the covered swap entity and that affiliate. For purposes of this calculation, an entity shall not count a non-cleared swap or non-cleared security-based swap that is exempt pursuant to § __.1(d).

(c) *Variation margin*. A covered swap entity shall collect and post variation margin with respect to a non-cleared swap or non-cleared security-based swap with any counterparty that is an affiliate as provided in § __.4.

(d) *Custodian for Non-Cash Collateral*. To the extent that a covered swap entity collects initial margin required by § __.3(a) from an affiliate with respect to any non-cleared swap or non-cleared security-based swap in the form of collateral other than cash collateral, the custodian for such collateral may be the covered swap entity or an affiliate of the covered swap entity.

(e) *Model holding period and netting.*

(1) *Model holding period.* For any non-cleared swap or non-cleared security-based swap (or netting portfolio) between a covered swap entity and an affiliate that would be subject to the clearing requirements of section 2(h)(1)(A) of the Commodity Exchange Act of 1936 or section 3C(a)(1) of the Securities Exchange Act of 1934 but for an exemption under section 2(h)(7)(C)(iii) or (D) or section 4(c)(1) of the Commodity Exchange Act of 1936 or regulations of the Commodity Futures Trading Commission or section 3C(g)(4) of the Securities Exchange Act of 1934 or regulations of the U.S. Securities and Exchange Commission, the covered swap entity's initial margin model calculation as described in § ___.8(d)(1) may use a holding period equal to the shorter of five business days or the maturity of the non-cleared swap or non-cleared security-based swap (or netting portfolio).

(2) *Netting arrangements*. Any netting portfolio that contains any non-cleared swap or non-cleared security-based swap with a model holding period equal to the shorter of five business days or the maturity of the non-cleared swap or non-cleared security-based swap pursuant to paragraph (e)(1) of this section must be identified and separate from any other netting portfolio for purposes of calculating and complying with the initial margin requirements of this [part].

(f) *Standardized amounts.* If a covered swap entity's initial margin model does not conform to the requirements of § ___.8, the covered swap entity shall calculate the amount of initial margin required to be collected for one or more non-cleared swaps or non-cleared security-based swaps with a given affiliate counterparty pursuant to section § ___.3 on a daily basis pursuant to Appendix A with the gross initial margin multiplied by 0.7.

§ __.12 *Capital.*

[Reserved]

Appendix A to [Part] -- Standardized Minimum Initial Margin Requirements for Non-cleared Swaps and Non-cleared Security-based Swaps.

Table A: Standardized Minimum Gross Initial Margin Requirements for Non-cleared Swaps and Non-cleared Security-Based Swaps[1]

Asset Class	Gross Initial Margin (% of Notional Exposure)
Credit: 0-2 year duration	2
Credit: 2-5 year duration	5
Credit: 5+ year duration	10
Commodity	15
Equity	15
Foreign Exchange/Currency	6
Cross Currency Swaps: 0-2 year duration	1
Cross-Currency Swaps: 2-5 year duration	2
Cross-Currency Swaps: 5+ year duration	4
Interest Rate: 0-2 year duration	1
Interest Rate: 2-5 year duration	2
Interest Rate: 5+ year duration	4
Other	15

[1] The initial margin amount applicable to multiple non-cleared swaps or non-cleared security-based swaps subject to an eligible master netting agreement that is calculated according to Appendix A will be computed as follows:

Initial Margin=0.4xGross Initial Margin +0.6x NGRxGross Initial Margin

where;

Gross Initial Margin = the sum of the product of each non-cleared swap's or non-cleared security-based swap's effective notional amount and the gross initial margin requirement for all non-cleared swaps and non-cleared security-based swaps subject to the eligible master netting agreement;

and

NGR = the net-to-gross ratio (that is, the ratio of the net current replacement cost to the gross current replacement cost). In calculating NGR, the gross current replacement cost equals the sum of the replacement cost for each non-cleared swap and non-cleared security-based swap subject to the eligible master netting agreement for which the cost is positive. The net current replacement cost equals the total replacement cost for all non-cleared swaps and non-cleared security-based swaps subject to the eligible master netting agreement. In cases where the gross replacement cost is zero, the NGR should be set to 1.0.

Appendix B to [Part] -- Margin Values for Eligible Noncash Margin Collateral.

Table B: Margin Values for Eligible Noncash Margin Collateral

Asset Class[1]	Discount (%)
Eligible government and related (e.g., central bank, multilateral development bank, GSE securities identified in §_.6(a)(2)(iv) or §_.6(b)(5) debt: residual maturity less than one-year	0.5
Eligible government and related (e.g., central bank, multilateral development bank, GSE securities identified in §_.6(a)(2)(iv) or §_.6(5) debt: residual maturity between one and five years	2.0
Eligible government and related (e.g., central bank, multilateral development bank, GSE securities identified in §_.6(a)(2)(iv) or §_.6(b)(5) debt: residual maturity greater than five years	4.0
Eligible GSE debt securities not identified in §_.6(a)(2)(iv) or §_.6(b)(5): residual maturity less than one-year	1.0
Eligible GSE debt securities not identified in §_.6(a)(2)(iv) or §_.6(b)(5): residual maturity between one and five years:	4.0
Eligible GSE debt securities not identified in §_.6(a)(2)(iv) or §_.6(b)(6)(i): residual maturity greater than five years:	8.0
Other eligible publicly traded debt: residual maturity less than one-year	1.0
Other eligible publicly traded debt: residual maturity between one and five years	4.0
Other eligible publicly traded debt: residual maturity greater than five years	8.0
Equities included in S&P 500 or related index	15.0
Equities included in S&P 1500 Composite or related index but not S&P 500 or related index	25.0
Gold	15.0

[1] The discount to be applied to an eligible investment fund is the weighted average discount on all assets within the eligible investment fund at the end of the prior month. The weights to be applied in the weighted average should be calculated as a fraction of the fund's total market value that is invested in each asset with a given discount amount. As an example, an eligible investment fund that is comprised solely of $100 of 91 day Treasury bills and $100 of 3 year US Treasury bonds would receive a discount of (100/200)*0.5+(100/200)*2.0=(0.5)*0.5+(0.5)*2.0=1.25 percent.

[END OF COMMON TEXT]

Adoption of the Common Rule Text

List of Subjects

12 CFR Part 45

Administrative practice and procedure, Capital, Margin requirements, National Banks, Federal Savings Associations, Reporting and recordkeeping requirements, Risk.

Adoption of the Common Rule Text

The proposed adoption of the common rules by the agencies, as modified by agency-specific text, is set forth below:

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and issuance

For the reasons stated in the Common Preamble and under the authority of 12 U.S.C. 93a and 5412(b)(2)(B), the Office of the Comptroller of the Currency amends chapter I of Title 12, Code of Federal Regulations, as follows:

PART 45—MARGIN AND CAPITAL REQUIREMENTS FOR COVERED SWAP ENTITIES

1. Part 45 is added as set forth at the end of the Common Preamble.

2. The authority citation for part 45 is added to read as follows:

Authority: 7 U.S.C. 6s(e), 12 U.S.C. 1 et seq., 12 U.S.C. 93a, 161, 481, 1818, 3907, 3909, 5412(b)(2)(B), and 15 U.S.C. 78o-10(e).

3. Part 45 is amended by:

a. Removing "[Agency]" wherever it appears and adding in its place "the OCC";

b. Removing "[The Agency]" wherever it appears and adding in its place "The OCC";

c. Removing "[part]" wherever it appears and adding in its place "part 45"; and

4. Paragraphs (a), (b), and (c) of section 45.1 are revised to read as follows:

§ 45.1 Authority, purpose, scope, and compliance dates.

(a) Authority. This part 45 is issued under the authority of 7 U.S.C. 6s(e), 12 U.S.C. 1 et seq., 93a, 161, 481, 1818, 3907, 3909, 5412(b)(2)(B), and 15 U.S.C. 78o-10(e).

(b) Purpose. Section 4s of the Commodity Exchange Act of 1936 (7 U.S.C. 6s) and section 15F of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10) require the OCC to establish capital and margin requirements for any for any national bank or subsidiary thereof, Federal savings association or subsidiary thereof, or Federal branch or agency of a foreign bank that is registered as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant with respect to all non-cleared swaps and non-cleared security-based swaps. This regulation implements section 4s of the Commodity Exchange Act of 1936 and section 15F of the Securities Exchange Act of 1934 by defining terms used in the statute and related terms, establishing capital and margin requirements, and explaining the statutes' requirements.

(c) Scope. This part establishes minimum capital and margin requirements for each covered swap entity subject to this part with respect to all non-cleared swaps and non-cleared security-based swaps. This part applies to any non-cleared swap or non-cleared security-based swap entered into by a covered swap entity on or after the relevant compliance date set forth in § 45.1(e) of this section. Nothing in this part is intended to prevent a covered swap entity from collecting margin in amounts greater than are required under this part.

* * * * *

5. Section 45.2 is amended by adding a definition of "covered swap entity" in alphabetical order to read as follows:

§ 45.2 Definitions.

* * * * *

Covered swap entity means any national bank or subsidiary thereof, Federal savings association or subsidiary thereof, or Federal branch or agency of a foreign bank that is a swap entity, or any other entity that the OCC determines.

* * * * *

§ 45.6 – [Amended]

6. Section 45.6 is amended by removing "[RESERVED]" and adding in its place "12 CFR Part 1";

7. Section 45.12 is added to read as follows:

§ 45.12 Capital.

A covered swap entity shall comply with:

(a) In the case of a covered swap entity that is a national bank or Federal savings association, the minimum capital requirements as generally provided 12 CFR Part 3.

(b) In the case of a covered swap entity that is a Federal branch or agency of a foreign bank, the capital adequacy guidelines applicable as generally provided under 12 CFR 28.14.