

CLIENT MEMORANDUM

CFTC Proposes Cross-Border Margin Rule For Uncleared Swaps

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AUTHORS

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The Commodity Futures Trading Commission recently proposed a rule that would govern the application of margin requirements for uncleared swaps in cross-border transactions.¹ The proposed rule would apply to any CFTC registered swap dealer or major swap participant that is not subject to the margin requirements of a prudential regulator (a “covered swap entity” or “CSE”).² Comments on the proposed rule are due by September 14, 2015.

Background

The Dodd-Frank Act directs the CFTC to adopt rules establishing minimum initial and variation margin requirements on all uncleared swaps for covered swap entities. In an October 2014 advance notice of proposed rulemaking, the CFTC sought comment on alternative approaches to the application of its margin requirements in the context of cross-border

¹ [Proposed Rule on the Cross-Border Application of the Margin Requirements](#), 80 Fed. Reg. 41376 (July 14, 2015).

² The “prudential regulators” include the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency.

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transactions.³ The CFTC stated that, in considering the new proposal, it took into account the global and interconnected nature of the swaps market which can transmit risks to the U.S. financial system while also recognizing that conflicting and duplicative rules could result in market inefficiencies and competitive disparities that could disadvantage the U.S.

Margin for Cross-Border Swaps

Under the proposed rule, a CSE must generally either comply with the CFTC's margin requirements or qualify for a limited exclusion. Alternatively, certain covered swap entities may comply with a foreign jurisdiction's comparable margin requirements for certain transactions in lieu of the CFTC's margin requirements ("substituted compliance"), but only if the CFTC has issued a comparability determination for such jurisdiction's margin requirements.

Although the proposed rule covers a number of situations, its key aspects are as follows:

- CFTC's margin requirements generally apply when:
 - A U.S. CSE⁴ enters into a swap with a U.S. person or a non-U.S. person (including a non-U.S. CSE, foreign consolidated subsidiary⁵ or a U.S. branch of a non-U.S. CSE) whose obligations under the relevant swap are guaranteed by a U.S. person (a "Guaranteed Non-U.S. Person"); or
 - A non-U.S. CSE (including a U.S. branch or a foreign consolidated subsidiary) whose obligations under the swap are guaranteed by a U.S. person (a "Guaranteed Non-U.S. CSE") enters into a swap with a U.S. person or Guaranteed Non-U.S. Person.

- Substituted Compliance Eligibility

The CFTC proposes to establish a standard of review to apply to its determinations regarding whether a foreign jurisdiction's margin requirements are comparable to the CFTC's corresponding rules. Factors proposed to be considered include the types of transactions and entities subject to the relevant requirements, calculation methodologies, timing of collection, custody and other risk management issues.

³ The Dodd-Frank Act also requires that the prudential regulators adopt a joint margin rule. In September 2014, the prudential regulators published proposed rules to implement initial and variation margin requirements for swap dealers and major swap participants that have a prudential regulator. For more information on the prudential regulators' proposal, please see our client memorandum entitled "Prudential Regulators Propose Margin Requirements For Non-Cleared Swaps," dated October 21, 2014.

⁴ Under the proposed rule, a "U.S. CSE" is a CSE that is a U.S. person. The term U.S. CSE includes a foreign branch of a U.S. CSE. A "non-U.S. CSE" is any CSE that is not a U.S. person.

⁵ A foreign consolidated subsidiary is, generally, any non-U.S. CSE in which an ultimate parent entity that is a U.S. person has a controlling financial interest such that the non-U.S. CSE's operating results and other financial information is consolidated in the parent entity's financial statements.

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- Initial Margin Only
 - The initial margin posted (but not collected) by a U.S. CSE or Guaranteed Non-U.S. CSE would generally be eligible for substituted compliance when the counterparty to the swap is a non-U.S. person (including a non-U.S. CSE, foreign consolidated subsidiary or U.S. branch) whose obligations under the relevant swap are not guaranteed by a U.S. person (a “Non-Guaranteed Non-U.S. Person”).
- Initial and Variation Margin
 - The initial and variation margin posted and collected by a foreign consolidated subsidiary or a U.S. branch, in each case whose obligations under the swap are not guaranteed by a U.S. person, are proposed to be eligible for substituted compliance when the counterparty to the swap is:
 - A U.S. person that is not a CSE;
 - A Guaranteed Non-U.S. Person that is not a CSE, U.S. branch or foreign consolidated subsidiary; or
 - A Non-Guaranteed Non-U.S. Person.
 - The initial and variation margin posted and collected by a non-U.S. CSE (i) whose obligations under the swap are not guaranteed by a U.S. person and (ii) that is not a foreign consolidated subsidiary or a U.S. branch, are proposed to be eligible for substituted compliance when the counterparty to the swap is:
 - A U.S. person that is not a CSE;
 - A Guaranteed Non-U.S. Person that is not a CSE, U.S. branch or foreign consolidated subsidiary; or
 - A U.S. branch or foreign consolidated subsidiary, in each case whose obligations under the swap agreement are not guaranteed by a U.S. person.
- Exclusion

Under the proposal, a swap between a non-U.S. CSE and a Non-U.S. Person (including a non-U.S. CSE) would be excluded from the margin requirements, provided that:

- Their obligations under the swap are not guaranteed by a U.S. person; and
- Neither is a foreign consolidated subsidiary or a U.S. branch.

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U.S. Person Definition

Under the proposed rule, the definition of U.S. person is substantially similar to the definition of U.S. person in the CFTC's prior swap guidance (the "Guidance") with a notable difference.⁶ The Guidance defines U.S. person generally to include any fund or other collective investment vehicle that is majority-owned by U.S. persons. Under the proposed rule, however, such ownership would not in and of itself render an investment fund a U.S. person, unless such owners that are U.S. persons also bore unlimited responsibility for the obligations and liabilities of the legal entity.

If you have questions concerning the foregoing or would like additional information, please contact Rita M. Molesworth (212-728-8727, rmolesworth@willkie.com), Deborah A. Tuchman (212-728-8491, dtuchman@willkie.com), Jack I. Habert (212-728-8952, jhabert@willkie.com), James E. Lippert (212-728-8945, jlippert@willkie.com) or the Willkie attorney with whom you regularly work.

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⁶ Interpretative Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45292 (July 26, 2013). For more information on the Guidance, please see our client memorandum entitled CFTC Issues Guidance and Temporary Exemptive Relief Regarding Cross-Border Swap Regulations, dated July 22, 2013.