COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 23

RIN ____ - ____

Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants

AGENCY: Commodity Futures Trading Commission

ACTION: Proposed rule on the cross-border application of the margin requirements

SUMMARY: On October 3, 2014, the Commission published proposed regulations to implement section 4s(e) of the Commodity Exchange Act ("CEA"), as added by section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). This provision requires the Commission to adopt initial and variation margin requirements for swap dealers ("SDs") and major swap participants ("MSPs") that do not have a Prudential Regulator (collectively, "CSEs" or "Covered Swap Entities"). In the October 3, 2014 proposing release, the Commission also issued an Advance Notice of Proposed Rulemaking ("ANPR") requesting public comment on the cross-border application of such margin requirements. In this release, the Commission is proposing a rule for the application of the Commission's margin requirements to cross-border transactions ("Proposed Rule").

DATES: Comments must be received on or before [INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by RIN [____ - ____], and Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants by any of the following methods:

- Agency Web site, via its Comments Online process at http://comments.cftc.gov. Follow the instructions for submitting comments through the web site.
- Mail: Send to Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.
- Hand Delivery/Courier: Same as mail above.
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

Please submit your comments using only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to http://www.cftc.gov. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that may be exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the established procedures in § 145.9 of the Commission's regulation, 17 CFR § 145.9.

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from www.cftc.gov that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted, or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

FOR FURTHER INFORMATION CONTACT: Laura B. Badian, Assistant General Counsel, (202) 418-5969, lbadian@cftc.gov, or Paul Schlichting, Assistant General Counsel, (202) 418-5884, pschlichting@cftc.gov, Office of the General Counsel, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

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4. General Request for Comment

I. Background

A. Dodd-Frank Act and the Scope of This Rulemaking

In the fall of 2008, as massive losses spread throughout the financial system and many major financial institutions failed or narrowly escaped failure with government intervention, confidence in the financial system was replaced by panic, credit markets seized up, and trading in many markets grounded to a halt. The financial crisis revealed the vulnerability of the U.S. financial system to widespread systemic risk resulting from, among other things, excessive leverage, poor risk management practices at financial firms, and the lack of integrated supervisory oversight of financial institutions and financial markets.[1] The financial crisis also highlighted the contagion risks of under-collateralized counterparty exposures in a highly interconnected financial system.[2]

In the wake of the financial crisis, Congress enacted the provisions of the Commodity Exchange Act ("CEA") relating to swaps in Title VII of the Dodd-Frank Act,[3] which establishes a comprehensive new regulatory framework for swaps. One of

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[1] See Financial Crisis Inquiry Commission, "The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States," Jan. 2011, at xviii-xxv, 307-8, 363-5, 386, available at http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

[2] Id. at xxiv-xxv, 49-51.

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

the cornerstones of this regulatory framework is the reduction of systemic risk to the U.S. financial system through the establishment of margin requirements for uncleared swaps.[4]

Section 731 of the Dodd-Frank Act added a new section 4s, which directs the Commission to adopt rules establishing minimum initial and variation margin requirements for SDs and MSPs on all swaps that are not cleared by a registered derivatives clearing organization. Section 4s(e) further provides that the margin requirements must: (i) help ensure the safety and soundness of the SD or MSP; and (ii) be appropriate for the risk associated with the uncleared swaps held as a SD or MSP.[5]

The Dodd-Frank Act also requires that the Prudential Regulators,[6] in consultation with the Commission and the Securities and Exchange Commission ("SEC"), adopt a joint margin rule. Accordingly, each SD and MSP for which there is a Prudential Regulator must meet margin requirements established by the applicable Prudential Regulator, and each SD and MSP for which there is no Prudential Regulator must comply with the Commission's margin requirements. Further, the Dodd-Frank Act requires that the Commission, the Prudential Regulators and the SEC, to the maximum extent practicable, establish and maintain comparable minimum capital and minimum initial and

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[4] The Financial Crisis Inquiry Commission stated in its report that the failure of American International Group, Inc. ("AIG") was possible because the sweeping deregulation of over-the-counter derivatives (including credit default swaps) effectively eliminated federal and state regulation of these products, including capital and margin requirements that would have reduced the likelihood of AIG's failure. Id. at 352.

[5] Section 4s(e)(3)(A)(i) of the CEA, 7 U.S.C. 6s(e)(3)(A)(i).

[6] The term "Prudential Regulator" is defined in section 1a(39) of the CEA, as amended by section 721 of the Dodd-Frank Act. This definition includes the Board of Governors of the Federal Reserve System ("FRB"); the Office of the Comptroller of the Currency ("OCC"); the Federal Deposit Insurance Corporation ("FDIC"); the Farm Credit Administration; and the Federal Housing Finance Agency.

variation margin requirements, including the use of noncash collateral, for SDs and MSPs.[7]

In determining whether, and the extent to which, section 4s(e) should apply to a CSE's swap activities outside the United States, the Commission focused on the text and objectives of that provision together with the language of section 2(i) of the CEA.[8] As discussed further below, the primary reason for the margin requirement is to protect CSEs in the event of a counterparty default. That is, in the event of a default by a counterparty, margin protects the CSE by allowing it to absorb the losses using collateral provided by the defaulting entity and to continue to meet all of its obligations. In addition, margin functions as a risk management tool by limiting the amount of leverage that a CSE can incur. Specifically, by requiring a CSE to post margin to its counterparties, the margin requirements ensure that a CSE has adequate eligible collateral to enter into an uncleared swap.

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[7] See section 4s(e)(3)(D)(ii) of the CEA, 7 U.S.C. 6s(e)(3)(D)(ii), which was added by section 731 of the Dodd-Frank Act. The Prudential Regulators, the Commission, and the SEC are also required to consult periodically (but not less frequently than annually) on minimum capital requirements and minimum initial and variation margin requirements. See section 4s(e)(3)(D)(i) of the CEA, 7 U.S.C. 6s(e)(3)(D)(i).

[8] See 7 U.S.C. 2(i). Section 2(i) of the CEA states:

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

Risk arising from uncleared swaps can potentially have a substantial adverse effect on any CSE—irrespective of its domicile or the domicile of its counterparties—and therefore the stability of the U.S. financial system because each CSE has a sufficient nexus to the U.S. financial system to require registration as a CSE. In light of the role of margin in ensuring the safety and soundness of CSEs and preserving the stability of the U.S. financial system, and consistent with section 2(i), section 4s(e)'s margin requirements extend to all CSEs on a cross-border basis.

Pursuant to its new section 4s(e) authority, on October 3, 2014, the Commission published reproposed regulations to implement initial and variation margin requirements on uncleared swaps ("Proposed Margin Rules") for SDs and MSPs that do not have a Prudential Regulator (collectively, "CSEs" or "Covered Swap Entities").[9] In the same release, the Commission also published an Advance Notice of Proposed Rulemaking ("ANPR") requesting public comment on the cross-border application of such margin requirements. In this release, the Commission is proposing a rule for the application of the Commission's uncleared swap margin requirements to cross-border transactions (referred to herein as the "Proposed Rule").

[9] The Commission's Proposed Margin Rules are set forth in proposed rules 150 through 159 of part 23 of the Commission's regulations, proposed as17 CFR § 23.150 through § 23.159. See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 FR 59898 (Oct. 3, 2014). In September 2014, the Prudential Regulators published proposed regulations to implement initial and variation margin requirements for SDs and MSPs that have a Prudential Regulator. See Margin and Capital Requirements for Covered Swap Entities, 79 FR 53748 (Sept. 24, 2014), available at http://www.gpo.gov/fdsys/pkg/FR-2014-09-24/pdf/2014-22001.pdf. The Commission originally proposed margin rules for public comment in 2011. See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 FR 23732 (April 28, 2011).

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

The swaps market is global in nature. Swaps are routinely entered into between counterparties located in different jurisdictions. Dealers and other market participants conduct their swaps business through subsidiaries, affiliates, and branches dispersed across geographical boundaries. The global and highly interconnected nature of the swaps market heightens the potential that risks assumed by a firm overseas can be transmitted across national borders to cause or contribute to substantial losses to U.S. persons and threaten the stability of the entire U.S. financial system. Therefore, it is important that margin requirements for uncleared swaps apply on a cross-border basis in a manner that effectively addresses risks to U.S. persons and the U.S. financial system.

The Commission recognizes that non-U.S. CSEs and non-U.S. counterparties may be subject to comparable or different rules in their home jurisdictions. Conflicting and duplicative requirements between U.S. and foreign margin regimes could potentially lead to market inefficiencies and regulatory arbitrage, as well as competitive disparities that undermine the relative position of U.S. CSEs and their counterparties. Therefore, it is essential that a cross-border margin framework takes into account the global nature of the swaps market and the supervisory interests of foreign regulators with respect to entities and transactions covered by the Commission's margin regime.[10]

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[10] In developing the proposed cross-border framework, the Commission is guided by principles of international comity, which counsels due regard for the important interests of foreign sovereigns. See Restatement (Third) of Foreign Relations Law of the United States (the "Restatement"). The Restatement provides that even where a country has a basis for jurisdiction, it should not prescribe law with respect to a person or activity in another country when the exercise of such jurisdiction is unreasonable. See Restatement § 403(1). The reasonableness of such an exercise of jurisdiction, in turn, is to be determined by evaluating all relevant factors, including certain specifically enumerated factors where appropriate:

In granting the Commission new authorities under the Dodd-Frank Act, Congress also reaffirmed and called for coordination and cooperation among domestic and foreign regulators. Section 752(a) of the Dodd-Frank Act requires the Commission, the Prudential Regulators, and the SEC to consult and coordinate with foreign regulatory authorities on the "establishment of consistent international standards" with respect to the regulation of swaps.[11] In this regard, the Commission recognizes that efforts are underway by other domestic and foreign regulators to implement margin reform and that

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(a) the link of the activity to the territory of the regulating state, i.e., the extent to which the activity takes place within the territory, or has substantial, direct, and foreseeable effect upon or in the territory;

(b) the connections, such as nationality, residence, or economic activity, between the regulating state and the persons principally responsible for the activity to be regulated, or between that state and those whom the regulation is designed to protect;

(c) the character of the activity to be regulated, the importance of regulation to the regulating state, the extent to which other states regulate such activities, and the degree to which the desirability of such regulation is generally accepted;

(d) the existence of justified expectations that might be protected or hurt by the regulation;

(e) the importance of the regulation to the international political, legal, or economic system;

(f) the extent to which the regulation is consistent with the traditions of the international system;

(g) the extent to which another state may have an interest in regulating the activity; and

(h) the likelihood of conflict with regulation by another state.

See Restatement § 403(2).

Notably, the Restatement does not preclude concurrent regulation by multiple jurisdictions. However, where concurrent jurisdiction by two or more jurisdictions creates conflict, the Restatement recommends that each country evaluate its own interests in exercising jurisdiction and those of the other jurisdiction, and where possible, to consult with each other.

[11] 15 U.S.C. 8325(a) (added by section 752 of the Dodd-Frank Act). Also, before commencing any rulemaking or issuing an order regarding swaps, the Commission must consult and coordinate to the extent possible with the SEC and the Prudential Regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible. See 15 U.S.C. 8302(a)(1) (added by section 712(a)(1) of the Dodd-Frank Act).

regulatory harmonization and coordination are indispensable to achieving a workable cross-border framework.

In developing a cross-border framework for margin regulations, the Commission aims to strike the proper balance among these sometimes competing considerations. To that end, the Commission has consulted and coordinated with the Prudential Regulators and foreign regulatory authorities. Commission staff worked closely with the staff of the Prudential Regulators, and the Proposed Rule is closely aligned with the cross-border proposal that was published by the Prudential Regulators in September 2014. In addition, Commission staff has participated in numerous bilateral and multilateral discussions with foreign regulatory authorities addressing national efforts to implement margin reform and the possibility of conflicts and overlaps between U.S. and foreign regulatory regimes. Recognizing that systemic risks arising from global and interconnected swaps market must be addressed through coordinated regulatory requirements for margin across international jurisdictions, the Commission has played an active role in encouraging international harmonization and coordination of margin requirements for uncleared swaps.

The Commission notes that its collaboration with the Basel Committee on Banking Supervision ("BCBS") and the Board of the International Organization of Securities Commissions ("IOSCO") as a member of the Working Group on Margining Requirements ("WGMR") resulted in the issuance of a final margin policy framework for non-cleared, bilateral derivatives in September 2013 (referred to herein as the "BCBS-

IOSCO framework").[12] Individual regulatory authorities across major jurisdictions (including the EU, Japan, and the United States) have since started to develop their own margin rules.[13] The Proposed Rule is consistent with the standards in the final BCBS-IOSCO framework, and we have been in continuous communication with regulators in the EU and Japan as we developed our cross-border margin proposal. Although at this time foreign jurisdictions do not yet have their margin regimes in place, the Commission has participated in ongoing, collaborative discussions with regulatory authorities in the EU and Japan regarding their cross-border approaches to the margin rules, including the anticipated scope of application of margin requirements in their jurisdiction to cross-border swaps, their plans for recognizing foreign margin regimes, and their anticipated timelines.

The Commission believes that its ongoing bilateral and multilateral discussions with foreign regulatory authorities in major jurisdictions (including the EU and Japan) are critical to fostering international cooperation and harmonization and in reducing conflicting and duplicative regulatory requirements. The Commission expects that these discussions will continue as it finalizes and then implements its framework for the

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[12] See Margin Requirements for Non-centrally Cleared Derivatives (Sept. 2013), available at http://www.bis.org/publ/bcbs261.pdf.

[13] See European Banking Authority, European Securities and Markets Authority, and European Insurance and Occupational Pensions Authority, Consultation Paper on draft regulatory technical standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012 (for the European Market Infrastructure Regulation) (April 14, 2014), available at https://www.eba.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf; Financial Services Agency of Japan, draft amendments to the "Cabinet Office Ordinance on Financial Instruments Business" and "Comprehensive Guidelines for Supervision" with regard to margin requirements for non-centrally cleared derivatives (July 3, 2014). Available in Japanese at http://www.fsa.go.jp/news/26/syouken/20140703-3.html.

application of margin requirements to cross-border transactions, and as other jurisdictions develop their own respective approaches.

C. Advance Notice of Proposed Rulemaking

The ANPR sought public comment on three potential alternative approaches to the cross-border application of its margin requirements: (1) a transaction-level approach that is consistent with the Commission's cross-border guidance ("Guidance Approach");[14] (2) an approach that is consistent with the approach proposed by the Prudential Regulators (the "Prudential Regulators' Approach");[15] and (3) an entity-level approach described in the ANPR ("Entity-Level Approach"). To provide context for the discussion of the Proposed Rule, the three alternative approaches discussed in the ANPR are summarized below.

1. Guidance Approach

Under the first alternative discussed in the ANPR, the Commission's margin requirements would be applied on a transaction-level basis, consistent with its cross-border Guidance.[16] The Commission stated in the Guidance that it would generally treat its margin requirements for uncleared swaps as a transaction-level requirement. Consistent with the rationale stated in the Guidance, under this transaction-level

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[14] Interpretative Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 FR 45292 (July 26, 2013) ("Guidance"). The Commission addressed, among other things, how the swap provisions in the Dodd-Frank Act (including the margin requirement for uncleared swaps) generally would apply on a cross-border basis. In this regard, the Commission stated that as a general policy matter it expected to apply the margin requirement as a transaction-level requirement.

[15] See Margin and Capital Requirements for Covered Swap Entities, 79 FR 53748 (Sept. 24, 2014), available at http://www.gpo.gov/fdsys/pkg/FR-2014-09-24/pdf/2014-22001.pdf.

[16] See Interpretative Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 FR 45292 (July 26, 2013).

approach, the Commission's Proposed Margin Rules would apply to a U.S. SD/MSP (other than a foreign branch of a U.S. bank that is a SD/MSP) for all of its uncleared swaps, regardless of whether its counterparty is a U.S. person,[17] without substituted compliance.

However, under this approach the margin requirements would apply to a non-U.S. SD/MSP (whether or not it is a "guaranteed affiliate"[18] or an "affiliate conduit"[19]) only with respect to its uncleared swaps with a U.S. person counterparty and a non-U.S. counterparty that is a guaranteed affiliate or an affiliate conduit; the margin requirements would not apply to uncleared swaps with a non-U.S. person counterparty that is not a guaranteed affiliate or an affiliate conduit. Where the non-U.S. counterparty is a guaranteed affiliate or an affiliate conduit, the Commission would allow substituted compliance (i.e., the non-U.S. SD/MSP would be permitted to comply with the margin

[17] The scope of the term "U.S. person" as used in the Cross-Border Guidance Approach and the Entity-Level Approach would be the same as under the Guidance. See Guidance at 45316-45317 for a summary of the Commission's interpretation of the term "U.S. person."

[18] Under the Guidance, id. at 45318, the term "guaranteed affiliate" refers to a non-U.S. person that is an affiliate of a U.S. person and that is guaranteed by a U.S. person. The scope of the term "guarantee" under the Guidance Approach and the Entity-Level Approach would be the same as under note 267 of the Guidance and accompanying text.

[19] Under the approach discussed in the Guidance, id. at 45359, the factors that are relevant to the consideration of whether a person is an "affiliate conduit" include whether: (i) the non-U.S. person is majority-owned, directly or indirectly, by a U.S. person; (ii) the non-U.S. person controls, is controlled by, or is under common control with the U.S. person; (iii) the non-U.S. person, in the regular course of business, engages in swaps with non-U.S. third party(ies) for the purpose of hedging or mitigating risks faced by, or to take positions on behalf of, its U.S. affiliate(s), and enters into offsetting swaps or other arrangements with such U.S. affiliate(s) in order to transfer the risks and benefits of such swaps with third-party(ies) to its U.S. affiliates; and (iv) the financial results of the non-U.S. person are included in the consolidated financial statements of the U.S. person. Other facts and circumstances also may be relevant.

requirements of its home country's regulator if the Commission determines that such requirements are comparable to the Commission's margin requirements).[20]

2. Prudential Regulators' Approach

The second alternative discussed in the ANPR was the Prudential Regulators' Approach to cross-border application of the margin requirements.[21] Under the Prudential Regulators' proposal issued in September 2014 (the "September proposal"), the Prudential Regulators would apply the margin requirements to all uncleared swaps of CSEs under their supervision with a limited exception.[22] Specifically, the Prudential Regulators would not apply their margin requirements to any foreign non-cleared swap of a foreign covered swap entity.[23] This exclusion would only be available where neither the non-U.S. SD/MSP's nor the non-U.S. counterparty's obligations under the relevant

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[20] Where the uncleared swap is between a non-U.S. SD/MSP (whether or not it is a guaranteed affiliate or an affiliate conduit) and a foreign branch of a U.S. bank that is a SD/MSP, substituted compliance would be available if certain conditions are met.

[21] See section 9 of the proposed rule on Margin and Capital Requirements for Covered Swap Entities, 12 CFR part 237 (Sept. 24, 2014) for a complete description of the proposed cross-border application of margin requirements to swaps by the Prudential Regulators, available at http://www.gpo.gov/fdsys/pkg/FR-2014-09-24/pdf/2014-22001.pdf.

[22] A summary of the Prudential Regulators' Approach to the cross-border application of their proposed margin requirements is included in the ANPR. See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 FR at 59917(Oct. 3, 2014). For further information on the Prudential Regulators' Approach generally, see Margin and Capital Requirements for Covered Swap Entities, 79 FR 53748 (Sept. 24, 2014), available at http://www.gpo.gov/fdsys/pkg/FR-2014-09-24/pdf/2014-22001.pdf.

[23] The Prudential Regulators define a "foreign covered swap entity" as 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 controlled by an entity organized under U.S. or State law. Under the Prudential Regulators' proposal, a "foreign non-cleared swap" would include 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; (ii) a branch or office of an entity organized under U.S. or State law; or (iii) a covered swap entity controlled by an entity organized under U.S. or State law.

swap are guaranteed by a U.S. person and neither party is "controlled" by a U.S. person. Under the "control" test used in the September proposal, the term "control" of another company means: (1) 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; (2) ownership or control of 25 percent or more of the total equity of the company, directly or indirectly or acting through one or more other persons; or (3) control in any manner of the election of a majority of the directors or trustees of the company.

3. Entity-Level Approach

Under the third alternative discussed in the ANPR, margin requirements would be treated as an entity-level requirement. Under this Entity-Level Approach, the Commission would apply its proposed cross-border rules on margin on a firm-wide level—that is, to all uncleared swaps activities of a SD/MSP registered with the Commission, irrespective of whether the counterparty is a U.S. person, and with no possibility of exclusion. This approach takes into account that a non-U.S. SD/MSP entering into uncleared swaps faces counterparty credit risk regardless of where the swap is executed or whether the counterparty is a U.S. person.[24] That risk, if it leads to a default by the non-U.S. SD/MSP, could cause adverse consequences to its U.S. counterparties and the U.S. financial system. At the same time, in recognition of

[24] A summary of the Entity-Level Approach to the cross-border application of the Proposed Margin Rules is included in the ANPR. See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 FR at 59917(Oct. 3, 2014).

international comity, under this approach the Commission would consider, where appropriate, allowing CSEs to avail themselves of substituted compliance.

4. Comments on the Alternative Approaches Discussed in the ANPR

After publishing the ANPR, the Commission received comments that responded to the three alternative approaches.[25] There was no consensus among commenters on a preferable approach.

Several commenters supported the Guidance Approach, with modifications, on the basis that margin rules should not apply to swaps between a foreign swap dealer and a foreign, non-guaranteed counterparty.[26] Some of these commenters suggested modifications to the availability of substituted compliance in the approach described in the Guidance.[27] For example, one commenter suggested that the Commission should treat non-U.S. margin requirements that conform to the BCBS-IOSCO framework as "essentially identical" to the Commission's regime and therefore accessible to all SDs as a means of complying with the Commission's margin requirements.[28] Another commenter suggested that the Commission modify its approach to substituted compliance outlined in the Guidance to allow substituted compliance for trades between U.S. persons and non-U.S. persons at such parties' mutual agreement.[29] In addition, some commenters

[25] Comment letters received in response to the ANPR may be found on the Commission's web site at http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1528.

[26] See International Swaps and Derivatives Association, Inc. (Nov. 24, 2014) ("ISDA"), Managed Funds Association ("MFA") (Dec. 2, 2014), and INTL FCStone Inc. (Dec. 3, 2014).

[27] See ISDA (Nov. 24, 2014) and MFA (Dec. 2, 2014).

[28] See ISDA (Nov. 24, 2014).

[29] See MFA (Dec. 2, 2014).

that supported the Guidance Approach expressed the view that it should include an emerging markets exception.[30] Still another commenter argued that the Commission's Guidance correctly classified margin as a transaction-level rather than an entity-level requirement because, as with the clearing requirement, it is practicable to separate out transactions which are subject to the margin requirements and transactions which are not. This commenter stated that it would be an odd result if the Commission were to determine that the reach of the clearing requirement was not as great as that of the margin requirement, given that both requirements are intended to address counterparty credit risk.[31]

In contrast, some commenters argued against adopting the Guidance Approach. One commenter argued that the Guidance Approach has become a significant driver of conflict between U.S. and European regulatory requirements, and is undermining the goal of a globally coordinated regulatory framework.[32] Another commenter argued that this approach provides an excessively broad exemption for "non-guaranteed" foreign affiliates of U.S. banks, and that it is completely inappropriate to apply such an exemption to a crucial prudential requirement such as derivatives margin, which could pose major risks to the financial system by encouraging a race to the bottom among jurisdictions concerning margin requirements.[33]

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[30] See ISDA (Nov. 24, 2014) and American Bankers Association (Nov. 25, 2014).

[31] See INTL FCStone Inc. (Dec. 3, 2014).

[32] See Alternative Investment Management Association ("AIMA") (Dec. 2, 2014).

[33] See Americans for Financial Reform ("AFR") (Dec. 2, 2014).

Other commenters generally supported the Entity-Level Approach, with modifications, on the basis that it captures all registrants' uncleared trades, regardless of the domicile of the registrant or the counterparty. These commenters generally favored this approach because, rather than exempting foreign to foreign transactions, it makes substituted compliance available for these transactions. One commenter stated that the Entity-Level Approach is the most appropriate choice because it provides market participants with more certainty in determining which jurisdiction's margin requirements apply. Further, this commenter stated that the Entity-Level Approach is consistent with how collateral is currently handled under a single master agreement and would mitigate legal uncertainty and operational errors that can arise if trades are subject to different margin requirements under the same master agreement.[34] Another commenter favored the Entity-Level Approach because it imposes prudential rules on all swaps activities of U.S.-headquartered firms, regardless of where the swap transaction is booked. This commenter stated that both the Prudential Regulators' Approach and the Guidance Approach provide a means for U.S. firms to escape U.S. oversight.[35]

Another commenter supported a cross-border approach that combines the Guidance Approach with certain enhancements found in the Entity-Level Approach. This commenter suggested that the Entity-Level Approach correctly subjects certain non-U.S. SDs and MSPs to U.S. regulations—at least with respect to variation margin and the collection of initial margin—where the Guidance Approach would permit substituted

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[34] See Securities Industry and Financial Markets Association, Asset Management Group (Nov. 24, 2014).

[35] See Public Citizen (Dec. 2, 2014).

compliance to both parties in all respects. However, this commenter stated that the Entity-Level Approach also contains provisions that are significantly weaker than the Guidance Approach, such as making substituted compliance available to certain non-U.S. counterparties of U.S. SDs or MSPs. This commenter also expressed the view that the Guidance Approach correctly requires both counterparties to fully comply with U.S. rules in all transactions involving a U.S. SD or MSP.[36]

Commenters generally did not support the Prudential Regulators' Approach as their first choice, but two commenters thought it might be workable with modifications. The first commenter stated that if the Commission elects not to adopt the "Entity-Level" Approach, the Prudential Regulators' Approach might be workable, although this commenter had reservations about situations where different jurisdictions' regimes apply to the same transaction.[37] The other commenter argued that if its first choice, the Entity-Level Approach, is not adopted, the Prudential Regulators' Approach is greatly superior to the Guidance Approach, as it would apply margin requirements to foreign affiliates of U.S. banks that are classified as SDs or MSPs, regardless of whether such affiliates are nominally guaranteed. However, this commenter argued that the Prudential Regulators' Approach is flawed in that, like the Guidance Approach, it would exempt controlled foreign subsidiaries of U.S. banks that are not registered with the Commission as swaps entities.[38]

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[36] See Better Markets, Inc. (Dec. 2, 2014).

[37] See AIMA (Dec. 2, 2014).

[38] See AFR (Dec. 2, 2014).

Two commenters specifically argued against the Prudential Regulators' Approach. One commenter contended that the Prudential Regulators' Approach provides limited clarity on how the "control" test should be applied, which means that foreign bank subsidiaries of U.S. banks cannot be certain whether they are subject to U.S. rules or foreign rules, and provides limited guidance as to how foreign covered swaps entities can determine whether a financial end-user counterparty is a U.S. entity or a foreign entity, in comparison to the clear "U.S. person" standard in the Guidance.[39] The other commenter is concerned with the Prudential Regulators' Approach as it relates to funds. This commenter stated that the Prudential Regulators' definition of "foreign non-cleared swap" effectively classifies funds organized outside of the United States, but with a U.S. principal place of business (e.g., funds with a U.S.-based manager), as foreign entities. This commenter stated that if funds with a U.S.-based manager are not considered "U.S. persons" subject to U.S. derivatives regulation, even though they have a substantial U.S. nexus, they would likely be required to margin their covered swaps in accordance with the foreign margin rules to which their non-U.S. CSE counterparty is subject, which would give too much deference to the foreign regulatory regime.[40]

One commenter asserted that both the Prudential Regulators' Approach and the Guidance Approach would appropriately exclude swaps between foreign-headquartered swap entities that are not controlled or guaranteed by a U.S. person and a non-U.S. person that is not guaranteed by a U.S. person from the scope of the margin rules, noting

[39] See Committee on Capital Markets Regulation (Nov. 24, 2014).

[40] See MFA (Dec. 2, 2014).

that if U.S. rules require the foreign-headquartered swap entity to post margin, this would create the potential for conflicts or inconsistencies with its home country margin requirements.[41]

One commenter did not explicitly support any of the three approaches, noting that all of the proposals diverge in potentially significant ways from the final framework developed by BCBS and IOSCO and the OTC margin framework proposed in April 2014 by European supervisory agencies, and that none of the proposals embrace substituted compliance in a comprehensive manner that would address cross-border conflicts or inconsistencies that could arise. This commenter suggested that the Commission should use an outcomes-based approach that looks to whether giving full recognition to an equivalent foreign OTC margin framework as a whole would ensure an acceptable reduction of aggregate unmargined risk.[42]

II. The Proposed Rule

A. Overview

Based on, among other things, consideration of the comments to the ANPR and after close consultation with the Prudential Regulators, the Commission is proposing a rule for the application of the Commission's Proposed Margin Rules to cross-border transactions (as noted above, the proposed cross-border margin rule is referred to herein as the "Proposed Rule"). As discussed above, a cross-border framework for margin

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[41] See Institute of International Bankers (Nov. 24, 2014). This commenter also stated that these foreign swaps would have little effect on the U.S. financial system in the event of a default; further, under the Dodd-Frank Act, the risk to the United States of a default by the foreign-headquartered swap entity on its swaps with U.S. counterparties would already be mitigated by capital and margin collection requirements.

[42] See Securities Industry and Financial Markets Association ("SIFMA") (Nov. 24, 2014).

necessarily involves consideration of significant, and sometimes competing, legal and policy considerations, including the impact on market efficiency and competition.[43] The Commission, in developing the Proposed Rule, aims to balance these considerations to effectively address the risk posed to the safety and soundness of CSEs, while creating a workable framework that reduces the potential for undue market disruptions and promotes global harmonization. The Commission also recognizes that there are other possible approaches to applying the margin rules in the cross-border context. Accordingly, the Commission invites public comment regarding all aspects of the Proposed Rule.

1. Use of Hybrid, Firm-Wide Approach

The Proposed Rule is a combination of the entity- and transaction-level approaches and is closely aligned with the Prudential Regulators' Approach. In general, under the Proposed Rule, margin requirements are designed to address the risks to a CSE, as an entity, associated with its uncleared swaps (entity-level); nevertheless, certain uncleared swaps would be eligible for substituted compliance or excluded from the Commission's margin rules based on the counterparties' nexus to the United States relative to other jurisdictions (transaction-level).

Although margin is calculated for individual transactions or positions, and therefore, could be applied on a transaction-level basis, the Commission believes that as a general matter margin requirements should apply on a firm-wide basis, irrespective of the domicile of the counterparties or where the trade is executed. The primary reason for

[43] The Commission's consideration of the costs and benefits associated with the Proposed Rule is discussed in section III.C. below.

collecting margin from counterparties is to protect an entity in the event of a counterparty default. That is, in the event of a default by a counterparty, margin protects the non-defaulting counterparty by allowing it to absorb the losses using collateral provided by the defaulting entity and to continue to meet all of its obligations. In addition, margin functions as a risk management tool by limiting the amount of leverage that a CSE can incur. Specifically, by requiring a CSE to post margin to its counterparties, the margin requirements ensure that a CSE has adequate eligible collateral to enter into an uncleared swap. In this way, margin serves as a first line of defense to protect a CSE as a whole from risk arising from uncleared swaps.

The source of counterparty credit risk to a CSE, however, is not confined to its uncleared swaps with U.S. counterparties. Risk arising from uncleared swaps involving non-U.S. counterparties can potentially have a substantial adverse effect on a CSE—including a non-U.S. CSE—and therefore the stability of the U.S. financial system because CSEs have a sufficient nexus to the U.S. financial system to require registration as a CSE. Given the function of margin, the Commission believes that margin should be treated as an entity-level requirement in the cross-border context, and thus not take into account the domicile of CSE counterparties or where the trade is executed.

The Commission also believes that treating margin as an entity-level requirement is consistent with the role of margin in a CSE's overall risk management program. Margin, by design, is complementary to capital.[44] That is, margin and capital requirements serve different but equally important risk mitigation functions that are best

[44] See BCBS and IOSCO, Margin requirements for non-centrally cleared derivatives (Sept. 2013) at 3, available at http://www.bis.org/publ/bcbs261.pdf.

implemented at the entity-level. Unlike margin, capital is difficult to rapidly adjust in response to changing risk exposures; thus, capital can be viewed as a backstop, in the event that the margin is not enough to cover all of the losses that resulted from the counterparty default. Standing alone, either capital or margin may not be enough to prevent a CSE from failing, but together, they are designed to reduce the probability of default by the CSE and limit the amount of leverage that can be undertaken by CSEs (and other market participants), which ultimately mitigates the possibility of a systemic event.[45]

At the same time, the Commission recognizes that a CSE's uncleared swaps with a particular counterparty may implicate the supervisory interests of foreign regulators and it is important to calibrate the cross-border application of the margin requirements to mitigate, to the extent possible and consistent with the Commission's regulatory interests, the potential for conflicts or duplication with other jurisdictions. Therefore, the Proposed Rule, while applying margin requirements to a CSE as a whole, also permits a U.S. CSE or non-U.S. CSE to avail itself of substituted compliance (to the extent applicable under the Proposed Rule) by complying with the margin requirements of the relevant foreign jurisdiction in lieu of compliance with the Commission's margin requirements, provided that the Commission finds that such jurisdiction's margin requirements are comparable to the Commission's margin requirements, as further discussed in section II.D. below.

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[45] Section 4s(e) of the CEA, 7 U.S.C. 6s(e), directs the Commission to adopt capital requirements for SDs and MSPs. The Commission proposed capital rules in 2011. See Capital Requirements for Swap Dealers and Major Swap Participants, Notice of proposed rulemaking, 76 FR 27802 (May 12, 2011).

In addition, the Proposed Rule provides for a limited exclusion of uncleared swaps between non-U.S. CSEs and non-U.S. counterparties (the "Exclusion") in certain circumstances. The Commission recognizes that the supervisory interest of foreign regulators in certain uncleared swaps between non-U.S. CSEs and their non-U.S. counterparties may equal or exceed the supervisory interest of the United States. The Proposed Rule takes into account the interests of other jurisdictions and balances those interests with the supervisory interests of the United States in order to calibrate the application of margin rules to non-U.S. CSEs' swaps with non-U.S. counterparties. Accordingly, the Commission believes that it would be appropriate to not apply the Commission's margin rules to uncleared swaps meeting the criteria for the Exclusion, which is described in section II.C.3. below.

B. Key Definitions

The Proposed Rule uses certain key definitions to establish a proposed framework for the application of margin requirements in a cross-border context. Specifically, the Proposed Rule defines the terms "U.S. person," "guarantee," and "Foreign Consolidated Subsidiary" in order to identify those persons or transactions that, because of their substantial connection or impact on the U.S. market, raise or implicate greater supervisory interest relative to other CSEs, counterparties, and uncleared swaps that are subject to the Commission's margin rules. These definitions are discussed below.

1. <u>U.S. person</u>

Generally speaking, the term "U.S. person" would be defined to include those individuals or entities whose activities have a significant nexus to the U.S. market by virtue of their organization or domicile in the United States or the depth of their connection to the U.S. market, even if domiciled or organized outside the United States. The proposed definition generally follows the traditional, territorial approach to defining a U.S. person, and the Commission believes that this definition provides an objective and clear basis for determining those individuals or entities that should be identified as a U.S. person.[46]

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[46]In addition, the Commission notes that the proposed definition of "U.S. person" is similar to the definition of "U.S. person" used by the SEC in the context of cross-border security-based swaps. In the SEC's August 2014 release adopting rules and providing guidance regarding the application of Title VII of the Dodd-Frank Act to cross-border security-based swap activities and persons engaged in those activities, the SEC defined the term "U.S. person" in Rule 240.3a71-3(a)(4) under the Securities Exchange Act of 1934 as follows:

> (i) Except as provided in paragraph (a)(4)(iii) of this section, *U.S. person* means any person that is:
>
> (A) A natural person resident in the United States;
>
> (B) A partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States or having its principal place of business in the United States;
>
> (C) An account (whether discretionary or non-discretionary) of a U.S. person; or
>
> (D) An estate of a decedent who was a resident of the United States at the time of death.
>
> (ii) For purposes of this section, *principal place of business* means the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person. With respect to an externally managed investment vehicle, this location is the office from which the manager of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle.
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> (iii) The term *U.S. person* does not include the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, and their agencies and pension plans, and any other similar international organizations, their agencies and pension plans.
>
> (iv) A person shall not be required to consider its counterparty to a security-based swap to be a U.S. person if such person receives a representation from the counterparty that the counterparty does not satisfy the criteria set forth in paragraph (a)(4)(i) of this section, unless such person knows or has reason to know that the representation is not accurate; for the purposes of this final rule a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate.

The Proposed Rule would define a "U.S. person" for purposes of the cross-border application of the margin rules to mean:

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

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

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

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

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

(vi) Any legal entity (other than a limited liability company, limited liability partnership or similar entity where all of the owners of the entity have limited liability) owned by one or more persons described in subparagraph (i), (ii), (iii), (iv) or

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See Application of "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" Definitions to Cross-Border Security-Based Swap Activities; Final rule; interpretation (Republication), 79 FR at 47371 (Aug. 12, 2014).

(v) of this paragraph who bear(s) unlimited responsibility for the obligations and liabilities of the legal entity, including any branch of the legal entity; and

(vii) Any individual account or joint account (discretionary or not) where the beneficial owner (or one of the beneficial owners in the case of a joint account) is a person described in subparagraph (i), (ii), (iii), (iv), (v) or (vi).[47]

A non-U.S. person is defined to be any person that is not a U.S. person.[48]

The proposed definition is generally consistent with the definition of this term set forth in the Guidance, with certain exceptions discussed below.

Prongs (i), (ii), (iii), (iv), (v), and (vii) identify certain persons as a "U.S. person" by virtue of their domicile or organization within the United States. The Commission has traditionally looked to where a legal entity is organized or incorporated (or in the case of a natural person, where he or she resides) to determine whether it is a U.S. person.[49] In the Commission's view, these persons—by virtue of their decision to organize or locate in the United States and because they are likely to have significant financial and legal relationships in the United States—are appropriately included within the definition of "U.S. person" for purposes of the proposed cross-border margin framework.

Under prong (iii), consistent with its traditional approach, the Commission proposes to define "U.S. person" also to include persons that are organized or incorporated outside the United States, but have their principal place of business in the

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[47] See § 23.160(a)(10) of the Proposed Rule.

[48] See § 23.160(a)(5) of the Proposed Rule.

[49] See, e.g., 17 C.F.R. 4.7(a)(1)(iv) (defining "Non-United States person" for purposes of part 4 of the Commission regulations relating to commodity pool operators).

United States. For purposes of this prong, the Commission proposes to interpret "principal place of business" to mean the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person. This interpretation is consistent with the Supreme Court's decision in Hertz Corp. v. Friend, which described a corporation's principal place of business, for purposes of diversity jurisdiction, as the "place where the corporation's high level officers direct, control, and coordinate the corporation's activities."[50]

The Commission is of the view that the application of the principal place of business concept to a fund may require consideration of additional factors beyond those applicable to operating companies. In the case of a fund, the Commission notes that the senior personnel that direct, control, and coordinate a fund's activities are generally not the persons who are named as directors or officers of the fund, but rather are persons who work for the fund's investment adviser or the fund's promoter. Therefore, consistent with the Guidance, the Commission generally would consider the principal place of business of a fund to be in the United States if the senior personnel responsible for either (1) the formation and promotion of the fund or (2) the implementation of the fund's investment strategy are located in the United States, depending on the facts and circumstances that are relevant to determining the center of direction, control and coordination of the fund.[51]

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[50] See Hertz Corp. v. Friend, 559 U.S. 77, 80 (2010).

[51] See the Guidance, 78 FR at 45309-45312, for guidance on application of the principal place of business test to funds and other collective investment vehicles in the context of cross-border swaps, including examples of how the Commission's approach could apply to a consideration of whether the "principal place of business" of a fund is in the United States in particular hypothetical situations. However, because of variations in the structure of collective investment vehicles as well as the factors that are relevant to the

Prong (vi) of the proposed definition of "U.S. person" would include certain legal entities owned by one or more U.S. person(s) and for which such person(s) bear unlimited responsibility for the obligations and liabilities of the legal entity. As noted above, the Guidance included a similar concept in the definition of the term "U.S. person"; however the definition contained in the Guidance would generally characterize a legal entity as a U.S. person if the entity were "directly or indirectly majority-owned" by one or more persons falling within the term "U.S. person" and such U.S. person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity. Where a U.S. person serves as a financial backstop for all of a legal entity's obligations and liabilities, creditors and counterparties look to the U.S. person when assessing the risk in dealing with the entity, regardless of the amount of equity owned by the U.S. person. Under such circumstances, because the U.S. person has unlimited responsibility for all of the legal entity's obligations, the Commission believes that the legal entity should be deemed to be a U.S. person.

The Proposed Rule would not include the U.S. majority-ownership prong that was included in the Guidance (50% U.S. person ownership of a fund or other collective investment vehicle).[52] Some commenters have argued that a majority ownership test for funds should not be included on the basis that ownership alone is not indicative of whether the activities of a non-U.S. fund with a non-U.S.-based manager has a direct and

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consideration of whether a collective investment vehicle has its principal place of business in the United States under the Guidance, these examples were included in the Guidance for illustrative purposes only.

[52] The Commission's definition of the term "U.S. person" as used in the Guidance included a prong (iv) which covered "any commodity pool, pooled account, or collective investment vehicle (whether or not it is organized or incorporated in the United States) of which a majority ownership is held, directly or indirectly, by a U.S. person(s)."

significant effect on the U.S. financial system, and that it is difficult to determine the identity of the beneficial owner of a fund in certain fund structures (e.g., fund-of-funds or master-feeder). Alternatively, an argument for retaining the majority-ownership test would be that many of these funds have large U.S. investors, who can be adversely impacted in the event of a counterparty default. On balance, the Commission believes the majority-ownership test should not be included in the definition of U.S. person for purposes of the margin rules. Non-U.S. funds with U.S. majority-ownership, even if treated as a non-U.S. person, would be excluded from the Commission's margin rules only in limited circumstances (namely, when these funds trade with a non-U.S. CSE that is not a consolidated subsidiary of a U.S. entity or a U.S. branch of a non-U.S. CSE). This, coupled with the implementation issues raised by commenters, persuades the Commission not to propose to define those funds that are majority-owned by U.S. persons (and that would otherwise not fall within the definition of a "U.S. person"), as U.S. persons.

The proposed definition of "U.S. person" determines a legal person's status at the entity level and thus includes any foreign operations that are part of the U.S. legal person, regardless of their location. Consistent with this approach, the definition of "U.S. person" under the Proposed Rule would include a foreign branch of a U.S. person.

Under the proposed definition, the status of a legal person as a U.S. person would not affect whether a separately incorporated or organized legal person in the affiliated corporate group is a U.S. person. Therefore, an affiliate or a subsidiary of a U.S. person that is organized or incorporated in a non-U.S. jurisdiction would not be deemed a "U.S. person" solely by virtue of its relationship with a U.S. person.

The proposed "U.S. person" definition does not include the prefatory phrase "includes, but is not limited to" that was included in the Guidance. The Commission believes that this prefatory phrase should not be included in order to provide legal certainty regarding the application of U.S. margin requirements to cross-border swaps.

The Commission understands that the information necessary for a swap counterparty to accurately assess the status of its counterparties as U.S. persons may not be available, or may be available only through overly burdensome due diligence. For this reason, the Commission believes that a swap counterparty generally should be permitted to reasonably rely on its counterparty's written representation in determining whether the counterparty is within the definition of the term "U.S. person." In this context, the Commission's policy is to interpret the "reasonable" standard to be satisfied when a party to a swap conducts reasonable due diligence on its counterparties, with what is reasonable in a particular situation to depend on the relevant facts and circumstances.[53]

Under the Proposed Rule, a "non-U.S. person" is any person that is not a "U.S. person" (as defined in the Proposed Rule).[54] References in this preamble to a "U.S. counterparty" are to a swap counterparty that is a "U.S. person" under the Proposed Rule,

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[53] The Commission notes that under the External Business Conduct Rules, a SD or MSP generally meets its due diligence obligations if it reasonably relies on counterparty representations, absent indications to the contrary. As in the case of the External Business Rules, the Commission believes that allowing for reasonable reliance on counterparty representations encourages objectivity and avoids subjective evaluations, which in turn facilitates a more consistent and foreseeable determination of whether a person is within the Commission's interpretation of the term "U.S. person."

[54] See § 23.160(a)(5) of the Proposed Rule.

and references to a "non-U.S. counterparty" are to a swap counterparty that is a "non-U.S. person" under the Proposed Rule.[55]

<u>Request for Comment</u>. The Commission requests comment on all aspects of the proposed definition of "U.S. person," including the following:

1. Does the proposed definition of "U.S. person" appropriately identify all individuals or entities that should be designated as U.S. persons? Is the proposed definition too narrow or broad? Why?

2. Should the definition of "U.S. person" include the U.S. majority-ownership prong for funds and other collective investment vehicles, as set forth in the Guidance? Please explain.

3. Should the definition of "U.S. person" include certain legal entities owned by one or more persons described in prongs (i), (ii), (iii), (iv), or (v) of the proposed U.S. person definition who bear(s) unlimited responsibility for the obligations and liabilities of the legal entity? Please explain.

4. Should the definition of "U.S. person" be identical to the definition of "U.S. person" that the SEC adopted in its August 2014 rulemaking? For example:

    a. Should the definition of "U.S. person" exclude certain designated (and any similar) international organizations, their agencies and pension plans, with headquarters in the United States?

    b. Should the Commission define the term "principal place of business" as the location from which the officers, partners, or managers of a

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[55] 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.

legal person primarily direct, control, and coordinate the activities of the legal person, and specify that in the case of an externally managed investment vehicle, this location is the office from which the manager of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle?

c. Should the Commission delete prong (vi) of the proposed definition of "U.S. person" which includes certain legal entities owned by one or more U.S. person(s) and for which such person(s) bear unlimited responsibility for the obligations and liabilities of the legal entity and instead treat such arrangements as recourse guarantees?

d. Should any other changes be made to the proposed definition of "U.S. person" to conform it to the definition adopted by the SEC?

2. Guarantees

Under the Proposed Rule, uncleared swaps of non-U.S. CSEs, where the non-U.S. CSE's obligations under the uncleared swap are guaranteed by a U.S. person, would be treated the same as uncleared swaps of a U.S. CSE. The Commission believes that this treatment is appropriate because the swap of a non-U.S. CSE whose obligations under the swap are guaranteed by a U.S. person is identical, in relevant respects, to a swap entered directly by a U.S. person. That is, by virtue of the guarantee, the U.S. guarantor is responsible for the swap it guarantees in a manner similar to a direct counterparty to the swap. The U.S. person guarantor effectively acts jointly with the non-U.S. person whose swap it guarantees to engage in swaps transactions. The counterparty, pursuant to the recourse guarantee, looks to both the direct non-U.S. counterparty and its U.S. guarantor in entering into the swap.

The Proposed Rule would define the term "guarantee" as an arrangement pursuant to which one party to a swap transaction with a non-U.S. counterparty has rights of recourse against a U.S. person guarantor (whether such guarantor is affiliated with the non-U.S. counterparty or is an unaffiliated third party) with respect to the non-U.S. counterparty's obligations under the relevant swap transaction. Under the Commission's proposal, a party to a swap transaction has rights of recourse against the U.S. person guarantor if the party has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the non-U.S. person's obligations under the swap.[56] Accordingly, the term "guarantee" would apply whenever a party to the swap has a legally enforceable right of recourse against the U.S. guarantor of a non-U.S. counterparty's obligations under the relevant swap, regardless of whether such right of recourse is conditioned upon the non-U.S. counterparty's insolvency or failure to meet its obligations under the relevant swap, and regardless of whether the counterparty seeking to enforce the guarantee is required to make a demand for payment or performance from the non-U.S. counterparty before proceeding against the U.S. guarantor.

Under the Proposed Rule, the terms of the guarantee need not necessarily be included within the swap documentation or even otherwise reduced to writing (so long as legally enforceable rights are created under the laws of the relevant jurisdiction),

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[56] See § 23.160(a)(2) of the Proposed Rule.

provided that a swap counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the non-U.S. person's obligations under the swap.[57]

Further, the Commission's proposed definition of guarantee would not be affected by whether the U.S. guarantor is an affiliate of the non-U.S. CSE because, in each case, the swap counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the non-U.S. person's obligations under the swap.

The Commission notes that the definition of "guarantee" in the Proposed Rule is narrower in scope than the one used in the Guidance.[58] In proposing this definition, the Commission is cognizant that many other types of financial arrangements or support, other than a guarantee as defined in the Proposed Rule, may be provided by a U.S. person to a non-U.S. CSE (e.g., keepwells and liquidity puts, certain types of indemnity agreements, master trust agreements, liability or loss transfer or sharing agreements). The Commission understands that these other financial arrangements or support transfer risk directly back to the U.S. financial system, with possible significant adverse effects, in a manner similar to a guarantee with a direct recourse to a U.S. person. The Commission, however, believes that application of a narrower definition of guarantee for

[57] Further, the definition of "guarantee" is intended to encompass any swap of a non-U.S. person where the counterparty to the swap has rights of recourse, regardless of the form of the arrangement, against at least one U.S. person (either individually or jointly or severally with others) for the non-U.S. person's obligations under the swap.

[58] In the Guidance, the Commission interpreted the term "guarantee" generally to include not only traditional guarantees of payment or performance of the related swaps, but also other formal arrangements that, in view of all the facts and circumstances, support the non-U.S. person's ability to pay or perform its swap obligations with respect to its swaps.

purposes of identifying those uncleared swaps that should be treated like uncleared swaps of a U.S. CSEs would reduce the potential for conflict with the non-U.S. CSE's home regulator. Moreover, the Commission believes that a non-U.S. CSE that has been provided with financial arrangements or support from a U.S. person that do not fall within the term "guarantee" as defined in the Proposed Rule in many cases is likely to meet the definition of a "Foreign Consolidated Subsidiary" and therefore, as discussed in the next section, would be subject to the Commission's margin requirements, with substituted compliance (but not the Exclusion) available. Therefore, the Commission believes that a narrow definition of guarantee would achieve a more workable framework for non-U.S. CSEs, without undermining protection of U.S. persons and U.S. financial system.

The Commission is aware that some non-U.S. CSEs removed guarantees in order to fall outside the scope of certain Dodd-Frank requirements. The proposed coverage of foreign subsidiaries of a U.S. person as a "Foreign Consolidated Subsidiary," which is discussed in the next section, and whose swaps would not be eligible for the Exclusion under any circumstances (as discussed in section II.C.3. below), would address the concern that even without a guarantee, as defined under the Guidance or in the Proposed Rule, foreign subsidiaries of a U.S. person with a substantial nexus to the U.S. financial system are adequately covered by the margin requirements.

Request for Comment. The Commission seeks comment on all aspects of the proposed definition of "guarantee," including the following:

1. Should the broader use of the term "guarantee" in the Guidance be used instead of the proposed definition, and if so, why? Would an alternative definition be more effective in light of the purpose of the margin requirements, and if so, why?

2. Is the Commission's assumption that a non-U.S. CSE is likely to meet the definition of a "Foreign Consolidated Subsidiary" when it has been provided with financial arrangements or support from a U.S. person that do not fall within the term "guarantee" (as defined in the Proposed Rule) correct? If not, why not?

3. Is it appropriate to distinguish, for purposes of the Proposed Rule, between those arrangements under which a party to the swap has a legally enforceable right of recourse against the U.S. guarantor and those arrangements where there is not direct recourse against a U.S. guarantor?

3. Foreign Consolidated Subsidiaries

The Proposed Rule uses the term "Foreign Consolidated Subsidiary" in order to identify swaps of those non-U.S. CSEs whose obligations under the relevant uncleared swap are not guaranteed by a U.S. person but that raise substantial supervisory concern in the United States, as a result of the possible negative impact on their U.S. parent entities and the U.S. financial system. Consolidated financial statements report the financial position, results of operations and statement of cash flows of a parent entity together with subsidiaries in which the parent entity has a controlling financial interest (which are required to be consolidated under U.S. GAAP). In the Commission's view, the fact that an entity is included in the consolidated financial statements of another is an indication of potential risk to the other entity that offers a clear and objective standard for the application of margin requirements.

Specifically, the Proposed Rule defines the term "Foreign Consolidated Subsidiary" as a non-U.S. CSE in which an ultimate parent entity[59] that is a U.S. person has a controlling interest, in accordance with U.S. GAAP, such that the U.S. ultimate parent entity includes the non-U.S. CSE's operating results, financial position and statement of cash flows in the U.S. ultimate parent entity's consolidated financial statements, in accordance with U.S. GAAP.

In the case of Foreign Consolidated Subsidiaries whose obligations under the relevant swap are not guaranteed by a U.S. person, substituted compliance would be broadly available under the Proposed Rule to the same extent as other non-U.S. CSEs whose obligations under the relevant swap are not guaranteed by a U.S. person, even though the financial position, operating results, and statement of cash flows of the Foreign Consolidated Subsidiary have a direct impact on the financial position, risk profile and market value of the consolidated group (which includes a U.S. parent entity); however, the Exclusion would not be available for swaps with a Foreign Consolidated Subsidiary because their swap activities have a direct impact on the financial position, risk profile, and market value of a U.S. parent entity that consolidates the Foreign Consolidated Subsidiary's financial statements and a potential spill-over effect on the U.S. financial system.[60]

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[59] Under the Proposed Rule, the term "ultimate parent entity" means the parent entity in a consolidated group in which none of the other entities in the consolidated group has a controlling interest, in accordance with U.S. generally accepted accounting principles ("GAAP").

[60] The Exclusion under the Proposed Rule is discussed in section II.C.3. below.

The Commission believes that not extending the Exclusion to Foreign Consolidated Subsidiaries under the Proposed Rule would be appropriate because the U.S. parent entity that consolidates the Foreign Consolidated Subsidiary's financial statements may have an incentive to provide support to a Foreign Consolidated Subsidiary, or the Foreign Consolidated Subsidiary may pose financial risk to the U.S. parent entity. In addition, market participants (including counterparties) may have the expectation that the parent entity will provide support to the Foreign Consolidated Subsidiary although, whether the U.S. parent entity actually steps in to fulfill the obligations of the Foreign Consolidated Subsidiary would depend on a business judgment rather than a legal obligation.[61] Notably, although consolidation has a direct impact on the U.S. parent entity, the U.S. parent entity stands in a different legal position than a U.S. guarantor because, in the absence of a direct recourse guarantee, the U.S. parent entity has no legal obligation to pay or perform under the relevant swap if the Foreign Consolidated Subsidiary defaults on its swap obligations. Therefore, the Commission believes that, in the absence of a direct recourse guarantee from a U.S. person, uncleared swaps with a Foreign Consolidated Subsidiary should not be treated the same as swaps

[61] For example, when General Electric announced on April 10, 2015 that it would guarantee repayment of approximately $210 billion of debt from GE Capital, the prices of some GE Capital bonds reportedly went up as much as 1.5% even though previously the parent company had provided other support but not an unconditional guarantee. According to an article in the Wall Street Journal, Russell Solomon, an analyst at Moody's Investors Service, stated: "We've always assumed that GE would support GE Capital almost no matter what…But now this says they'll support it no matter what." Similarly, the article reports that Standard & Poor's Rating Services stated that General Electric's decision to back GE Capital debt "strengthens our view of GE's support, by buttressing the parent's proven willingness and ability to support its subsidiary with a contractual obligation to do so." See Mike Cherney and Katy Burne, WSJ, Apr. 10, 2015, available at http://www.wsj.com/articles/ges-move-alters-the-bond-market-1428707800.

with a U.S. CSE or a non-U.S. CSE whose obligations under the relevant swap are guaranteed by a U.S. person.

The Commission considered proposing a “control” test similar to that proposed by the Prudential Regulators. The “control test” in the Prudential Regulators’ proposal is based solely on an entity’s ownership level and control of the election of the board, [62] which may or may not clearly identify, depending on the facts and circumstances, those non-U.S. CSEs that are likely to raise greater supervisory concerns than other non-U.S. CSEs (in each case whose obligations under the relevant swap are not guaranteed by a U.S. person). Therefore, the Commission is using a “consolidation test” rather than a “control test” in the proposed definition of a “Foreign Consolidated Subsidiary” in order to provide a clear, bright-line test for identifying those non-U.S. CSEs whose uncleared swaps are likely to raise greater supervisory concerns.

Request for Comment. The Commission seeks comment on all aspects of the Proposed Rule’s definition of “Foreign Consolidated Subsidiary,” including:

1. Does the proposed definition of a “Foreign Consolidated Subsidiary” appropriately capture those non-U.S. CSEs that should not be eligible for the Exclusion? If not, please explain and provide an alternative(s).

2. The consolidation test in the definition of a “Foreign Consolidated Subsidiary” is intended to provide a clear, bright-line test for identifying those non-U.S.

[62] Under the Prudential Regulators’ proposal, the term “control” of another company means: (1) 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; (2) ownership or control of 25 percent or more of the total equity of the company, directly or indirectly or acting through one or more other persons; or (3) control in any manner of the election of a majority of the directors or trustees of the company.

CSEs whose uncleared swaps are likely to raise greater supervisory concerns relative to other non-guaranteed non-U.S. CSEs. Should the proposed consolidation test be used in lieu of the control test proposed by the Prudential Regulators? Why or why not? Should the Commission use both a consolidation test and a control test? If so, please explain. Would any other tests or criteria be more appropriate? If so, please explain what tests or criteria should be used and why they are more appropriate.

3. Under the definition of Foreign Consolidated Subsidiary, the Commission is using U.S. GAAP as the standard for purposes of determining whether an entity consolidates another entity. In reviewing registration data of CSEs, the Commission believes that this definition balances the goals of the statute and the burdens placed on the industry; however, should the Commission also consider including in the definition of Foreign Consolidated Subsidiary, non-U.S. CSEs whose U.S. ultimate parent entity uses a different standard than U.S. GAAP in determining whether a parent entity must consolidate an entity for financial reporting purposes? If so, please explain why.

4. Should the Commission also include in the definition of "Foreign Consolidated Subsidiary" those non-U.S. CSEs whose U.S. ultimate parent entity is not required to prepare consolidated financial statements under any accounting standard or for any other reason (e.g., the U.S. ultimate parent entity is not a public company under federal securities laws and is not required to prepare consolidated financial statements by private investors or debtholders as a condition to investing or financing), but which would consolidate the non-U.S. CSE if it were required to prepare consolidated financial statements in accordance with U.S. GAAP? If so, please explain why?

5. Under the definition of Foreign Consolidated Subsidiary, the Commission is only including non-U.S. CSEs whose financial statements are consolidated by an ultimate parent entity that is a U.S. person. Should the Commission also include immediate and intermediate parent entities of the non-U.S. CSE in the definition? If so, please explain why?

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

The following section describes the application of the Commission's margin rules to cross-border swaps between CSEs and various types of counterparties, as well as when the Exclusion from the Commission's margin requirements would be applicable. Appendix A includes a table illustrating how the Proposed Rule would apply to specific transactions between various types of counterparties, which should be read in conjunction with the rest of the preamble and the text of the Proposed Rule.

1. Uncleared swaps of U.S. CSEs or non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. Person

Under the Proposed Rule, the Commission's margin rules[63] would apply to all uncleared swaps of U.S. CSEs,[64] with no exclusions. By their nature, U.S. CSEs have a significant impact on the U.S. swaps market, and the Commission therefore has a strong interest in ensuring their viability. However, substituted compliance would be available with respect to initial margin posted to (but not collected from) any non-U.S.

[63] The Commission's Proposed Margin Rules are set forth in proposed rules 150 through 159 of part 23 of the Commission's regulations, proposed as17 CFR § 23.150 through § 23.159.

[64] Foreign branches of a U.S. CSE are treated as part of the related principal entity and hence an uncleared swap executed by or through a foreign branch would be treated as an uncleared swap of a U.S. CSE.

counterparty (including a non-U.S. CSE) whose obligations under the uncleared swap are not guaranteed by a U.S. person. The Commission proposes to provide substituted compliance in this situation (assuming that the non-U.S. counterparty is subject to comparable margin requirements in a foreign jurisdiction) because the swap counterparty is a non-U.S. person and where its swap obligations are not guaranteed by a U.S. person, the foreign regulator may have equal or greater interest in the collection of margin by the non-U.S. counterparty. However, substituted compliance would not apply to the collection of margin by the U.S. CSE from the non-U.S. counterparty, as the Commission has a significant regulatory interest in the collection of margin by the U.S. CSE, which protects the U.S. CSE and the U.S. financial system from counterparty credit risk.

The same treatment that applies to U.S. CSEs would also apply to a non-U.S. CSE whose obligations under the relevant swap are guaranteed by a U.S. person. The Commission believes that this result is appropriate because the economics of the transaction are no different from a trade entered directly by the U.S. guarantor, as discussed in section II.B.2. above. In addition, the Commission believes that treating uncleared swaps of these entities differently from those of U.S. CSEs would lead to unwarranted competitive distortions. That is, the non-U.S. CSE that enters into a swap with a direct recourse guarantee from a U.S. person would be positioned to benefit from more competitive pricing when dealing with non-U.S. counterparties (as compared to U.S. CSEs) to the extent that either substituted compliance or the Exclusion would be available.

The Commission believes that requiring U.S. CSEs and non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person to comply with its margin requirements, with only limited substituted compliance for margin posted to (but not collected from) any non-U.S. counterparty (including a non-U.S. CSE) whose obligations under the uncleared swap are not guaranteed by a U.S. person, would help ensure their safety and soundness and support the stability of the U.S. financial markets, reducing the likelihood of another financial crisis affecting the U.S. economy.

Request for Comment. The Commission requests comments on all aspects of the proposed treatment of uncleared swaps of U.S. CSEs and/or non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person, including:

1. Is the Proposed Rule's treatment of U.S. CSEs and non-U.S. CSEs whose obligations under the swap are guaranteed by a U.S. person appropriate? If not, please explain. If a different treatment should apply to U.S. CSEs or non-U.S. CSEs whose obligations under the swap are guaranteed by a U.S. person, please describe the alternative treatment that should apply and explain why.

2. What are the competitive implications of the proposed treatment of uncleared swaps of non-U.S. CSEs whose obligations under the swap are guaranteed by a U.S. person?

3. Does the proposed treatment of non-U.S. CSEs whose obligations under the swap are guaranteed by a U.S. person appropriately take into account the supervisory interest of a non-U.S. CSE's home jurisdiction?

2. Uncleared swaps of non-U.S. CSEs (including Foreign Consolidated Subsidiaries) whose obligations under the relevant swap are not guaranteed by a U.S. person

Under the Proposed Rule, non-U.S. CSEs (including Foreign Consolidated Subsidiaries) whose obligations under the relevant uncleared swap are not guaranteed by a U.S. person may avail themselves of substituted compliance to a greater extent than if their obligations under the swap were guaranteed by a U.S. person. The Commission believes that this approach is appropriate since a non-U.S. CSE whose swap obligations are not guaranteed by a U.S. person (including a Foreign Consolidated Subsidiary), on balance, may implicate equal or greater supervisory concerns on the part of a foreign regulator relative to the supervisory interest of the Commission (in comparison to U.S. CSEs or non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person, because the Commission has a significant regulatory interest in uncleared swaps of these CSEs). Under the Proposed Rule, where the obligations of a non-U.S. CSE (including a Foreign Consolidated Subsidiary) under the relevant swap are not guaranteed by a U.S. person, substituted compliance would be available with respect to its uncleared swaps with any counterparty, except where the counterparty is a U.S. CSE or a non-U.S. CSE whose obligations under the relevant swap are guaranteed by a U.S. person.[65]

Further, uncleared swaps entered into by Foreign Consolidated Subsidiaries would not be eligible for the Exclusion under the Proposed Rule. As described above, the financial position, operating results, and statement of cash flows of a Foreign Consolidated Subsidiary are incorporated into the financial statements of the U.S. ultimate parent entity and therefore, likely have a direct impact on the consolidated entity's financial position, risk profile, and market value. Under these circumstances, and given the importance of margin in mitigating counterparty credit risk, the Commission

[65] With respect to uncleared swaps with a U.S. CSE or a non-U.S. CSE whose obligations under the relevant swap are guaranteed by a U.S. person, substituted compliance would only be available for initial margin collected by the non-U.S. CSE whose obligations under the relevant swap are not guaranteed by a U.S. person, as discussed in section II.C.1.

has greater supervisory concerns with respect to the uncleared swaps of a Foreign Consolidated Subsidiary than other non-U.S. CSEs. Therefore, the Commission believes that extending the Exclusion to a Foreign Consolidated Subsidiary would not further the goal of ensuring the safety and soundness of a CSE and the stability of U.S. financial markets. The Commission is also concerned that extending the Exclusion to Foreign Consolidated Subsidiaries would encourage a U.S. entity to use their non-U.S. subsidiaries to conduct their swap activities with non-U.S. counterparties, possibly bifurcating the U.S. entity's U.S. and non-U.S.-facing businesses, and potentially resulting in separate pools of liquidity.

Request for Comment. The Commission requests comments on all aspects of the proposed treatment of uncleared swaps of non-U.S. CSEs (including Foreign Consolidated Subsidiaries) whose obligations under the relevant swap are not guaranteed by a U.S. person, including:

1. The Proposed Rule makes substituted compliance more broadly available to a Foreign Consolidated Subsidiary whose obligations under the relevant swap are not guaranteed by a U.S. person than a non-U.S. CSE (including a Foreign Consolidated Subsidiary) whose obligations under the relevant swap are guaranteed by a U.S. person. Should Foreign Consolidated Subsidiaries be treated the same as non-U.S. CSEs that are guaranteed by a U.S. person and if not, what treatment is appropriate?

2. What are the competitive implications of the proposed treatment of Foreign Consolidated Subsidiaries (relative to other non-U.S. CSEs)? Does the proposed treatment appropriately take into account the supervisory interest of a non-U.S. CSE's home jurisdiction?

3. Exclusion for uncleared swaps of non-U.S. CSEs where neither counterparty's obligations under the relevant swap are guaranteed by a U.S. person and neither counterparty is a Foreign Consolidated Subsidiary nor a U.S. branch of a non-U.S. CSE

Under the Proposed Rule, an uncleared swap entered into by a non-U.S. CSE with a non-U.S. person counterparty (including a non-U.S. CSE) would be excluded from the Commission's margin rules, provided that neither counterparty's obligations under the relevant swap are guaranteed by a U.S. person and neither counterparty is a Foreign Consolidated Subsidiary nor a U.S. branch of a non-U.S. CSE.[66]

As discussed above, the Commission believes that, given the importance of margin to the safety and soundness of a CSE, as a general matter, margin requirements should apply to the uncleared swaps of a CSE, without regard to the domicile of the counterparty or where the trade is executed. At the same time, the Commission believes that it is appropriate to make a limited exception to this principle of firm-wide application of margin requirements in the cross-border context, consistent with section 4s(e) of the CEA[67] and comity principles, so as to exclude a narrow class of uncleared swaps involving a non-U.S. CSE and a non-U.S. counterparty.

The Commission notes that a non-U.S. CSE that can avail itself of the Exclusion would still be subject to the Commission's margin rules with respect to all uncleared swaps not meeting the criteria for the Exclusion, albeit with the possibility of substituted compliance. The non-US CSE would also be subject to the Commission's capital

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[66] See § 23.160(b)(2)(ii) of the Proposed Rule.

[67] Section 4s(e)(3)(A) of the CEA, 7 U.S.C. 6s(e)(3)(A). The section calls for, among other things, that margin requirements "be appropriate for the risks associated with the non-cleared swaps held as a swap dealer or major market participant."

requirements, which, as proposed, would impose a capital charge for uncollateralized exposures.[68] Additionally, any excluded swaps would most likely be covered by the margin requirements of another jurisdiction that adheres to the BCBS-IOSCO framework.[69]

The Commission also recognizes that the supervisory interest of foreign regulators in the uncleared swaps of non-U.S. CSEs (and their non-U.S. counterparties) that are eligible for the Exclusion may equal or exceed the supervisory interest of the United States in such uncleared swaps. Both counterparties are domiciled outside the United States and likely would be subject to the supervision of a foreign regulator. As discussed above, the Commission believes that a workable cross-border framework must take into account the interests of other jurisdictions and balance those interests with the supervisory interests of the United States in order to calibrate the application of margin rules to non-U.S. CSEs' swaps with non-U.S. counterparties. Such an approach would help mitigate the potential for conflicts with other jurisdictions and ultimately promote global harmonization. For all of the foregoing reasons, the Commission believes that it would be appropriate to not apply the Commission's margin rules to uncleared swaps meeting the criteria for the Exclusion.

The Commission acknowledges that similar mitigating factors and comity considerations may apply to Foreign Consolidated Subsidiaries, but as discussed above, a

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[68] See Capital Requirements of Swap Dealers and Major Swap Participants, Notice of proposed rulemaking, 76 FR 27802 (May 12, 2011).

[69] The non-U.S. CSE that qualifies for the exclusion would be eligible for substituted compliance, with respect to all margin requirements, if its counterparty to the uncleared swap is a U.S. person that is not a CSE. If the uncleared swap is with a U.S. CSE, substituted compliance would only be available with respect to initial margin posed by the U.S. CSE counterparty.

Foreign Consolidated Subsidiary's financial position, operating results, and statement of cash flows are directly reflected in its U.S. Ultimate Parent entity's financial statements, which implicates greater supervisory concerns. Therefore, the Commission believes that it has a greater regulatory interest in Foreign Consolidated Subsidiaries than other non-U.S. CSEs (that are not guaranteed by a U.S. person), and that the uncleared swaps of Foreign Consolidated subsidiaries should not be excluded from the margin requirements.

Further, the Commission believes that the uncleared swaps of a U.S. branch of a non-U.S. CSE should not be excluded from the margin requirements for the reasons discussed in the next section.

Request for Comment. The Commission is requesting comments on all aspects of the proposed Exclusion, including:

1. In light of the mitigating factors cited above and the Commission's supervisory interest in the safety and soundness of all CSEs and the critical role that margin plays in helping ensure the safety and soundness of CSEs, is the proposed Exclusion appropriate, and if not, please explain why not? Is the scope of the Exclusion appropriate, or should it be broader or narrower, and if so, why?

2. Under the Proposed Rule, uncleared swaps with a Foreign Consolidated Subsidiary would not be eligible for the Exclusion from the Commission's margin requirements. Should Foreign Consolidated Subsidiaries be eligible for the Exclusion and if so, why?

4. U.S. Branches of Non-U.S. CSEs

The Proposed Rule treats uncleared swaps executed through or by a U.S. branch of a non-U.S. CSE the same as those swaps of a non-U.S. CSE, except that the Exclusion from the margin rules would not be available to a U.S. branch of a non-U.S. CSE.

Generally speaking, because the risks posed by uncleared swaps are borne by a CSE as a whole, it should not matter if the transaction is entered by or through a U.S. branch or office within the United States. Nevertheless, the Commission believes that extending the Exclusion (to the extent than the Exclusion might otherwise apply to the non-U.S. CSE, as discussed above) would not be appropriate in the case of uncleared swaps executed by or through a U.S. branch of a non-U.S. CSE.

The Commission notes that non-U.S. CSEs can conduct their swap dealing business within the United States utilizing a number of different legal structures, including a U.S. subsidiary or a U.S. branch or office. Excluding uncleared swaps conducted by or through U.S. branches of non-U.S. CSEs would give these non-U.S. CSEs an unfair advantage when dealing with non-U.S. clients relative to U.S. CSEs (including those CSEs that are subsidiaries of foreign entities). That is, a U.S. branch of a non-U.S. CSE that is permitted to operate outside of the Commission's margin requirements would be able to offer a more competitive price to non-U.S. clients than a U.S. CSE. The Commission believes that when a non-U.S. CSE is conducting its swap activities within the United States through a branch or office located in the United States, it should be subject to U.S. margin laws. However, the Commission also believes that, consistent with comity principles, substituted compliance should be available for uncleared swaps executed by or through a U.S. branch of a non-U.S. CSE whose obligations under the relevant swap are not guaranteed by a U.S. person with any counterparty (except where the counterparty is a U.S. CSE or a non-U.S. CSE whose obligations under the relevant swap are guaranteed by a U.S. person).[70]

Request for Comment. The Commission seeks comment on the Proposed Rule's treatment of uncleared swaps conducted by or through a "U.S. branch of a non-U.S. CSE." In particular, the Commission requests comment on the following questions:

1. How should the Commission determine whether a swap is executed through or by a U.S. branch of a non-U.S. CSE for purposes of applying the Commission's margin rules on a cross-border basis? Should the Commission base the determination of whether the swap activity is conducted at a U.S. branch of a non-U.S. CSE for purposes of applying the Commission's margin rules on a cross-border basis on the same analysis as is used in the Volcker rule?[71]

2. The Commission seeks comment on the proposed treatment of U.S. branches of non-U.S. CSEs, including whether these branches should be eligible for the Exclusion in light of the policy objectives outlined above. If the Exclusion should be available, please explain why. The Commission also seeks comment regarding whether

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[70] With respect to uncleared swaps with a U.S. CSE or a non-U.S. CSE whose obligations under the relevant swap are guaranteed by a U.S. person, substituted compliance would only be available for initial margin collected by the U.S. branch of a non-U.S. CSE whose obligations under the relevant swap are not guaranteed by a U.S. person. See section II.C.1.

[71] Under the Volcker rule, personnel that arrange, negotiate, or execute a purchase or sale conducted under the exemption for trading activity of a foreign banking entity must be located outside of the United States. See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds; Final Rule, 79 FR 5808 (Jan. 31, 2014). Thus, for example, personnel in the United States cannot solicit or sell to or arrange for trades conducted under this exemption. Personnel in the United States also cannot serve as decision makers in transactions conducted under this exemption. Personnel that engage in back-office functions, such as clearing and settlement of trades, would not be considered to arrange, negotiate, or execute a purchase or sale for purposes of this provision. Id. at 5927, n. 1526.

the scope of substituted compliance for U.S. branches of non-U.S. CSEs under the Proposed Rule is appropriate. If not, please explain why.

D. Substituted Compliance

As noted above, consistent with CEA section 2(i) and comity principles, the Commission would allow CSEs to comply with comparable margin requirements in a foreign jurisdiction under certain circumstances. In this release, we are proposing to establish a standard of review that will apply to Commission determinations regarding whether some or all of the relevant foreign jurisdiction's margin requirements are comparable to the Commission's corresponding margin requirements, as well as procedures for requests for comparability determinations, including eligibility requirements and submission requirements.

Specifically, the Commission would permit a U.S. CSE or a non-U.S. CSE, as applicable, to avail itself of substituted compliance (to the extent applicable under the Proposed Rule) by complying with the margin requirements of the relevant foreign jurisdiction in lieu of compliance with the Commission's margin requirements, provided that the Commission finds that such jurisdiction's margin requirements are comparable to the Commission's margin requirements. Failure to comply with the applicable foreign margin requirements could result in a violation of the Commission's margin requirements. Further, all CSEs, regardless of whether they rely on a comparability determination, would remain subject to the Commission's examination and enforcement authority.[72]

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[72] Under Commission regulations 23.203 and 23.606, all records required by the CEA and the Commission's regulations to be maintained by a registered swap dealer or MSP shall be maintained in

The Commission is proposing a comparability standard that is outcome-based with a focus on whether the margin requirements in the foreign jurisdiction achieve the same regulatory objectives as the CEA's margin requirements. Under this outcome-based approach, the Commission would not look to whether a foreign jurisdiction has implemented specific rules and regulations that are identical to rules and regulations adopted by the Commission. Rather, the Commission would evaluate whether a foreign jurisdiction has rules and regulations that achieve comparable outcomes. If it does, the Commission believes that a comparability determination may be appropriate, even if there may be differences in the specific elements of a particular regulatory provision.[73]

In evaluating whether a foreign jurisdiction's margin requirements are comparable to the Commission's margin requirements, the Commission would consider whether the foreign jurisdiction's margin rules are consistent with international standards.[74] That is, the Commission would determine, considering all relevant facts and

accordance with Commission regulation 1.31 and shall be open for inspection by representatives of the Commission, the United States Department of Justice, or any applicable prudential regulator. The Commission believes that, before a non-U.S. CSE should be permitted to rely on substituted compliance, it should assure the Commission that it can provide the Commission with prompt access to books and records and submit to onsite inspection and examination. The Commission further expects that access to books and records and the ability to inspect and examine a non-U.S. CSE will be a condition to any comparability determination.

[73] As noted below, because the Commission would make comparability determinations on an element-by-element basis, it is possible that a foreign jurisdiction's margin requirements would be comparable with respect to some, but not all, elements of the margin requirements.

[74] Under the Proposed Rule, the term "international standards" means the margin policy framework for non-cleared, bilateral derivatives issued by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions in September 2013, as subsequently updated, revised, or otherwise amended, or any other international standards, principles or guidance relating to margin requirements for non-cleared, bilateral derivatives that the Commission may in the future recognize, to the extent that they are consistent with United States law (including the margin requirements in the Commodity Exchange Act). See § 23.160(a)(3) of the Proposed Rule. For further information regarding the margin policy framework for non-cleared, bilateral derivatives issued by the Basel Committee on

circumstances, whether a foreign jurisdiction has adopted margin rules that adequately address the BCBS-IOSCO framework. The Commission believes that considering this factor is appropriate because BCBS and IOSCO established this framework to ensure globally harmonized margin rules for uncleared derivative transactions. Individual regulatory authorities across major jurisdictions (including the EU, Japan, and the United States) have started to develop their own margin rules consistent with the final BCBS-IOSCO framework for non-centrally cleared, bilateral derivatives.[75] If the foreign jurisdiction's margin rules are not consistent with international standards, then the Commission may not find the rules comparable. In providing information to the Commission for a determination, applicants should include, among other things, information describing any difference between the foreign jurisdiction's margin requirements and international standards.[76]

Under the proposal, once the Commission has determined that a foreign jurisdiction's margin requirements adhere to the BCBS-IOSCO framework, the Commission would evaluate the various elements of the foreign jurisdiction's margin requirements.[77] Because the Commission is not proposing to make a binary determination of comparability (i.e., all or nothing), but instead would make comparability determinations on an element-by-element basis, it is possible that a foreign

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Banking Supervision and the International Organization of Securities in September 2013, see note 12, supra.

[75] See note 13, supra.

[76] See § 23.160(c)(2)(iii) of the Proposed Rule.

[77] See §23.160(c)(2) of the Proposed Rule.

margin system would be comparable with respect to some, but not all, elements of the margin requirements. For instance, a foreign jurisdiction may impose variation margin requirements on a non-U.S. CSE's uncleared swaps with financial end-users that achieve outcomes comparable to the Commission's margin requirements, but the same foreign jurisdiction may not achieve comparable regulatory outcomes with respect to segregation and rehypothecation requirements. By assessing each of the relevant elements separately, the Commission would have the flexibility to determine, with respect to one element of the requirements, that the outcomes are comparable, but not another. The elements that the Commission would be analyzing, among others, would include, but not be limited to: (i) the transactions subject to the foreign jurisdiction's margin requirements; (ii) the entities subject to the foreign jurisdiction's margin requirements; (iii) the methodologies for calculating the amounts of initial and variation margin; (iv) the process and standards for approving models for calculating initial and variation margin models; (v) the timing and manner in which initial and variation margin must be collected and/or paid; (vi) any threshold levels or amounts; (vii) risk management controls for the calculation of initial and variation margin; (viii) eligible collateral for initial and variation margin; (ix) the requirements of custodial arrangements, including rehypothecation and the segregation of margin; (x) documentation requirements relating to margin; and (xi) the cross-border application of the foreign jurisdiction's margin regime.

Moreover, the Commission would expect that the applicant, at a minimum, describe how the foreign jurisdiction's margin requirements addresses each of the above-referenced elements, and identify the specific legal and regulatory provisions that correspond to each element (and, if necessary, whether the foreign jurisdiction's margin requirements do not address a particular element), and describe the objectives of the foreign jurisdiction's margin requirements. Further, the applicant would be required to furnish copies of the foreign jurisdiction's margin requirements (including an English translation of any foreign language document) and any other information or documentation that the Commission deems appropriate.

In addition, in section (c)(3) of the Proposed Rule,[78] the Commission sets out its standard of review that would take into consideration all other relevant factors, including but not limited to, the scope and objectives of the foreign jurisdiction's margin requirement(s) for uncleared swaps; how the foreign jurisdiction's margin requirements compare to international standards; whether the foreign jurisdiction's margin requirements achieve comparable outcomes to the Commission's corresponding margin requirements; the ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the foreign jurisdiction's margin requirements; and any other facts and circumstances the Commission deems relevant.[79]

The Proposed Rule provides that any CSE that is eligible for substituted compliance may apply, either individually or collectively. In addition, the Proposed Rule provides that a foreign regulatory authority that has direct supervisory authority over one or more covered swap entities and that is responsible for administering the relevant

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[78] See § 23.160(c)(3) of the Proposed Rule.

[79] The submission should include a description of the ability of the relevant foreign regulatory authority or authorities to supervise and enforce compliance with the foreign jurisdiction's margin requirements, including the powers of the foreign regulatory authority or authorities to supervise, investigate, and discipline entities for compliance with the margin requirements and the ongoing efforts of the regulatory authority or authorities to detect, deter, and ensure compliance with the margin requirements. See § 23.160(c)(2)(iv) of the Proposed Rule.

foreign jurisdiction's margin requirements may submit a request for a comparability determination with respect to some or all of the Commission's margin requirements. Persons requesting a comparability determination may want to coordinate their application with other market participants and their home regulators to simplify and streamline the process. Once a comparability determination is made for a jurisdiction, it will apply for all entities or transactions in that jurisdiction to the extent provided in the Proposed Rule and the determination, subject to any conditions specified by the Commission.

The Commission expects that the comparability determination process would require close consultation, cooperation, and coordination with other appropriate U.S. regulators and relevant foreign regulators. Further, the Commission expects that, in connection with a comparability determination, the foreign regulator(s) would enter into, or would have entered into, an appropriate memorandum of understanding ("MOU") or similar arrangement with the Commission.

In issuing a Comparability Determination, the Commission may impose any terms and conditions it deems appropriate.[80] Further, the Proposed Rule would provide that the Commission may, on its own initiative, further condition, modify, suspend, terminate, or otherwise restrict a comparability determination in the Commission's discretion. This could result, for example, from a situation where, after the Commission issues a comparability determination, the basis of that determination ceases to be true. In this regard, the Commission would require an applicant to notify the Commission of any

[80] The violation of such terms and conditions may constitute a violation of the Commission's margin requirements and/or result in the modification or revocation of the comparability determination.

material changes to information submitted in support of a comparability determination (including, but not limited to, changes in the relevant foreign jurisdiction's supervisory or regulatory regime) as the Commission's comparability determination may no longer be valid.[81]

Request for Comment. The Commission is seeking comments on all aspects of the proposed standard of review that will apply to Commission determinations regarding whether some or all of the relevant foreign jurisdiction's margin requirements are comparable to the Commission's corresponding margin requirements, as well as proposed procedures for requests for comparability determinations, including eligibility requirements and submission requirements. Among other things, commenters may wish to submit comments on the following questions:

1. Please provide comments on the appropriate standard of review for comparability determinations and the degree of comparability and comprehensiveness that should be applied to comparability determinations.

2. Are the proposed procedures, including eligibility requirements and submission requirements, for comparability determinations appropriate?

3. Many foreign jurisdictions are in the process of implementing margin reform. Should the Commission develop an interim process that takes into account a different implementation timeline? Please provide details and address competitive implications for U.S. CSEs and non-U.S. CSEs that are required to comply with the Commission's margin regulations.

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

4. In the Guidance, the Commission discussed "a de minimis" exemption with respect to transaction-level requirements for foreign branches of U.S. swap dealers located in "emerging markets" that, in the aggregate, constitute less than 5 percent of the firm's notional swaps.[82] The Proposed Rule does not contain an exemption for CSEs operating in "emerging markets." Should the Commission develop an exemption for emerging markets? If so, what should be the eligibility criteria or conditions? For example, should the Commission provide an exemption where a non-U.S. CSE is operating in a jurisdiction that does not permit the related collateral to be held outside that jurisdiction and/or that lacks legal or operational infrastructure relating to proper segregation of initial margin? Should the Commission require the CSE to collect initial and variation margin from its counterparty in eligible emerging market jurisdictions, but only require the CSE to post variation margin? Should the Commission limit the type of eligible collateral that could be used in eligible emerging market jurisdictions? Which jurisdictions, if any, should qualify as "emerging markets" for purposes of the exemption? What should be the process for determining that the qualifying criteria are met? Please provide quantitative data, to the extent practical.

5. As some emerging market jurisdictions' laws may not support legally enforceable netting arrangements, which would then, under the Proposed Margin Rules and under certain circumstances, require that a CSE and its counterparty post and collect gross margin, should the Commission, if it does not provide for an emerging markets exception, permit the CSE and its counterparty to collect/post variation margin on a net

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[82] See the Guidance, 78 FR at 45351.

basis? If so, what conditions, if any, should the Commission place on this requirement to ensure that CSEs and the U.S. financial system are adequately protected?

6. Is the scope of substituted compliance under the Proposed Rule appropriate? Should additional or fewer transactions be eligible for substituted compliance, and if so, how should the Proposed Rule be modified?

E. General Request for Comments

In addition to the specific requests for comments included above, the Commission seeks comment on all aspects of the Proposed Rule. Commenters are encouraged to address, among other things, the scope and application of the Proposed Rule, costs and benefits of the Proposed Rule, alternatives to the Proposed Rule, practical implications for CSEs and other market participants and the market generally related to the Proposed Rule, whether the Proposed Rule sufficiently supports the statutory goals of ensuring the safety and soundness of the CSE and protecting the financial system against the risks associated with uncleared swaps, and whether the Proposed Rule sufficiently takes into account principles of international comity. In particular, the Commission requests comment on the following:

1. Does the Proposed Rule's approach to the cross-border application of margin requirements satisfy the Commission's statutory requirements, including the requirement to help ensure the safety and soundness of CSEs, and the requirement that the Commission, the Prudential Regulators, and the SEC, to the maximum extent practicable, establish and maintain comparable minimum initial and variation margin requirements?

2. Would it be more appropriate to apply the margin requirements at the entity-level, without any exclusion? If yes, please explain.

3. Would it be more appropriate to apply the margin requirements at a transaction-level? If yes, please explain.

4. Is the scope of the Proposed Rule appropriate, or should it be changed, and if so, how?

5. Would an alternative approach to the Proposed Rule better achieve the Commission's statutory requirements or otherwise be preferable or more appropriate? If yes, please explain.

6. Does the Commission's Proposed Rule strike the right balance between the Commission's supervisory interest in offsetting the risk to CSEs and the financial system arising from the use of uncleared swaps and international comity principles? If not, please explain.

III. RELATED MATTERS

A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA") requires that agencies consider whether the regulations they propose will have a significant economic impact on a substantial number of small entities.[83] The Commission previously has established certain definitions of "small entities" to be used in evaluating the impact of its regulations on

[83] 5 U.S.C. 601 et seq.

small entities in accordance with the RFA.[84] The proposed regulation establishes a mechanism for CSEs[85] to satisfy margin requirements by complying with comparable margin requirements in the relevant foreign jurisdiction as described in paragraph (c) of the Proposed Rule,[86] but only to the extent that the Commission makes a determination that complying with the laws of such foreign jurisdiction is comparable to complying with the corresponding margin requirement(s) for which the determination is sought.

The Commission previously has determined that SDs and MSPs are not small entities for purposes of the RFA.[87] Thus, the Commission is of the view that there will not be any small entities directly impacted by this rule.

The Commission notes that under the Proposed Margin Rules, SDs and MSPs would only be required to collect and post margin on uncleared swaps when the counterparties to the uncleared swaps are either other SDs and MSPs or financial end users. As noted above, SDs and MSPs are not small entities for RFA purposes. Furthermore, any financial end users that may be indirectly[88] impacted by the Proposed Rule would be similar to ECPs, and, as such, they would not be small entities.[89] Further,

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[84] 47 FR 18618 (Apr. 30, 1982).

[85] Section 23.151 of the Proposed Margin Rules defines CSEs as a SD or MSP for which there is no prudential regulator.

[86] See § 23.160(c) of the Proposed Rule.

[87] See 77 FR 30596, 30701 (May 23, 2012).

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

[89] As noted in paragraph (1)(xii) of the definition of “financial end user” in section 23.151 of the Proposed Margin Rules, a financial end-user includes a person that would be a financial entity described in paragraphs (1)(i)–(xi) of that definition, if it were organized under the laws of the United States or any

to the extent that there are any foreign financial entities that would not be considered ECPs, the Commission expects that there would not be a substantial number of these entities significantly impacted by the Proposed Rule. As noted above, most foreign financial entities would likely be ECPs to the extent they would trade in uncleared swaps. The Commission expects that only a small number of foreign financial entities that are not ECPs, if any, would trade in uncleared swaps.

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

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 ("PRA") imposes certain requirements on Federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA. This proposed rulemaking would result in the collection of information requirements within the meaning of the PRA, as discussed below. The proposed rulemaking contains collections of information for which the Commission has not previously received control numbers from the Office of Management and Budget ("OMB"). If adopted, responses to this collection of information would be required to obtain or retain benefits. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information

State thereof. The Commission believes that this prong of the definition of financial end-user would capture the same type of U.S. financial end-users that are ECPs, but for them being foreign financial entities. Therefore, for purposes of the Commission's RFA analysis, these foreign financial end-users will be considered ECPs and therefore, like ECPs in the U.S., not small entities.

unless it displays a currently valid control number. The Commission has submitted to OMB an information collection request to obtain an OMB control number for the collections contained in this proposal.

Section 731 of the Dodd-Frank Act, amended the CEA,[90] to add, as section 4s(e) thereof, provisions concerning the setting of initial and variation margin requirements for SDs and MSPs. Each SD and MSP for which there is a Prudential Regulator, as defined in section 1a(39) of the CEA, must meet margin requirements established by the applicable Prudential Regulator, and each CSE must comply with the Commission's regulations governing margin. With regard to the cross-border application of the swap provisions enacted by Title VII of the Dodd-Frank Act, section 2(i) of the CEA provides the Commission with express authority over activities outside the United States relating to swaps when certain conditions are met. Section 2(i) of the CEA provides that the provisions of the CEA relating to swaps enacted by Title VII of the Dodd-Frank Act (including Commission rules and regulations promulgated thereunder) shall not apply to activities outside the United States unless those activities (1) have a direct and significant connection with activities in, or effect on, commerce of the United States or (2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of Title VII.[91] Because margin requirements are critical to ensuring the safety and soundness of a CSE and supporting the stability of the U.S. financial markets, the Commission believes that

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[90] 7 U.S.C. 1 et seq.

[91] 7 U.S.C. 2(i).

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

As noted above, the Proposed Rule would establish margin requirements for uncleared swaps of CSEs on a firm-wide, entity-level basis (with substituted compliance available in certain circumstances), except as to a narrow class of uncleared swaps between a non-U.S. CSE and a non-U.S. counterparty that fall within the Exclusion. The Proposed Rule would establish a procedural framework in which the Commission would consider permitting compliance with comparable margin requirements in a foreign jurisdiction to substitute for compliance with the Commission's margin requirements in certain circumstances. The Commission would consider whether the requirements of such foreign jurisdiction with respect to margin of uncleared swaps are comparable to the Commission's margin requirements.

Specifically, the Proposed Rule would provide that a CSE who is eligible for substituted compliance may submit a request, individually or collectively, for a comparability determination.[92] Persons requesting a comparability determination may coordinate their application with other market participants and their home regulators to simplify and streamline the process. Once a comparability determination is made for a jurisdiction, it would apply for all entities or transactions in that jurisdiction to the extent provided in the determination, as approved by the Commission. In providing information

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

to the Commission for a comparability determination, applicants must include, at a minimum, information describing any differences between the relevant foreign jurisdiction's margin requirements and international standards, [93] and the specific provisions of the foreign jurisdiction that govern: (i) the transactions subject to the foreign jurisdiction's margin requirements; (ii) the entities subject to the foreign jurisdiction's margin requirements; (iii) the methodologies for calculating the amounts of initial and variation margin; (iv) the process and standards for approving models for calculating initial and variation margin models; (v) the timing and manner in which initial and variation margin must be collected and/or paid; (vi) any threshold levels or amounts; (vii) risk management controls for the calculation of initial and variation margin; (viii) eligible collateral for initial and variation margin; (ix) the requirements of custodial arrangements, including rehypothecation and the segregation of margin; (x) documentation requirements relating to margin; and (xi) the cross-border application of the foreign jurisdiction's margin regime.[94]

In addition, the Commission would expect the applicant, at a minimum, to describe how the foreign jurisdiction's margin requirements addresses each of the above-referenced elements, and identify the specific legal and regulatory provisions that correspond to each element (and, if necessary, whether the relevant foreign jurisdiction's margin requirements do not address a particular element). Further, the applicant must describe the objectives of the foreign jurisdiction's margin requirements, the ability of the

[93] See note 74, supra, for a discussion of the definition of "international standards" under the Proposed Rule. See also § 23.160(a)(3) of the Proposed Rule.

[94] See § 23.160(c)(2) of the Proposed Rule for submission requirements.

relevant regulatory authority or authorities to supervise and enforce compliance with the foreign jurisdiction's margin requirements, including the powers of the foreign regulatory authority or authorities to supervise, investigate, and discipline entities for compliance with the margin requirements and the ongoing efforts of the regulatory authority or authorities to detect, deter, and ensure compliance with the margin requirements. Finally, the applicant must furnish copies of the foreign jurisdiction's margin requirements (including an English translation of any foreign language document) and any other information and documentation that the Commission deems appropriate.[95]

In issuing a Comparability Determination, the Commission may impose any terms and conditions it deems appropriate.[96] In addition, the Proposed Rule would provide that the Commission may, on its own initiative, further condition, modify, suspend, terminate, or otherwise restrict a comparability determination in the Commission's discretion. This could result, for example, from a situation where, after the Commission issues a comparability determination, the basis of that determination ceases to be true. In this regard, the Commission would require an applicant to notify the Commission of any material changes to information submitted in support of a comparability determination (including, but not limited to, changes in the foreign jurisdiction's supervisory or regulatory regime) as the Commission's comparability determination may no longer be valid.[97]

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[95] See §§ 23.160(c)(2)(v) and (vi) of the Proposed Rule.

[96] The violation of such terms and conditions may constitute a violation of the Commission's margin requirements and/or result in the modification or revocation of the comparability determination.

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

The collection of information that is proposed by this rulemaking is necessary to implement sections 4s(e) of the CEA, which mandates that the Commission adopt rules establishing minimum initial and variation margin requirements for CSEs on all swaps that are not cleared by a registered derivatives clearing organization, and section 2(i) of the CEA, which provides that the provisions of the CEA relating to swaps that were enacted by Title VII of the Dodd-Frank Act (including any rule prescribed or regulation promulgated thereunder) apply to activities outside the United States that have a direct and significant connection with activities in, or effect on, commerce of the United States.[98] The information collection would be necessary for the Commission to consider whether the requirements of the foreign rules are comparable to the applicable requirements of the Commission's rules.

As noted above, any CSE who is eligible for substituted compliance may make a request for a comparability determination. Currently, there are approximately 102 CSEs provisionally registered with the Commission. The Commission further estimates that of the approximately 102 CSEs, approximately 61 CSEs would be subject to the Commission's margin rules as they are not subject to a Prudential Regulator. However, the Commission notes that any foreign regulatory agency that has direct supervisory authority over one or more CSEs and that is responsible to administer the relevant foreign jurisdiction's margin requirements may apply for a comparability determination. Further,

[98] Section 2(i) of the CEA provides that the provisions of the CEA relating to swaps that were enacted by Title VII of the Dodd-Frank Act (including any rule prescribed or regulation promulgated thereunder), shall not apply to activities outside the United States unless those activities (1) have a direct and significant connection with activities in, or effect on, commerce of the United States or (2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of Title VII of the CEA.

once a comparability determination is made for a jurisdiction, it would apply for all entities or transactions in that jurisdiction to the extent provided in the determination, as approved by the Commission. The Commission estimates that it will receive requests for a comparability determination from 17 jurisdictions, consisting of the 16 jurisdictions within the G20, plus Switzerland, [99] and that each request would impose an average of 10 burden hours.

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

Number of respondents: 17

Frequency of collection: Once.

Estimated annual responses per registrant: 1.

Estimated aggregate number of annual responses: 17.

Estimated annual hour burden per registrant: 10 hours.

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

3. Information Collection Comments

The Commission invites the public and other Federal agencies to comment on any aspect of the reporting burdens discussed above. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (1) evaluate whether the proposed

[99] Because the Commission's proposed margin requirements are based on the BCBS-IOSCO framework and one of the factors that the Commission will consider in making its determination is the comparability to these international standards, the Commission estimates that in all likelihood, it will receive applications from all 16 jurisdictions within the G20, plus Switzerland.

collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (2) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Comments may be submitted directly to the Office of Information and Regulatory Affairs, by fax at (202) 395-6566 or by e-mail at OIRAsubmissions@omb.eop.gov. Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rule preamble. Refer to the **ADDRESSES** section of this notice of proposed rulemaking for comment submission instructions to the Commission. A copy of the supporting statements for the collections of information discussed above may be obtained by visiting RegInfo.gov. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment is best assured of having its full effect if OMB receives it within 30 days of publication.

C. Cost-Benefit Considerations

1. Introduction

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.[100] Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors.

In promulgating the Proposed Margin Rules,[101] the Commission considered the costs and benefits associated with its choices regarding the scope and extent to which it would apply its proposed margin requirements to uncleared swaps of a CSE, including those related to the setting of the material swap exposure for financial entities, and related substantive requirements, such as the determination of eligible collateral and acceptable custodial arrangements. In addition, in light of the fact that section 4s(e), by its terms, applies to uncleared swaps of all CSEs, regardless of the domicile of the CSE (or its counterparties), the costs and benefits discussed in the Proposed Margin Rules' Federal Register release relate both to the domestic and cross-border application of the margin rule. [102] The cost and benefit considerations ("CBC") set out in this proposal are intended to augment the CBC set forth in the Proposed Margin Rules' Federal Register release and address cost and benefit considerations related to the Commission's choices regarding the

[100] 7 U.S.C. 19(a).

[101] The Commission's Proposed Margin Rules are set forth in proposed rules 150 through 159 of part 23 of the Commission's regulations, proposed as17 CFR § 23.150 through § 23.159. See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 FR 59898 (Oct. 3, 2014).

[102] See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 FR at 59920-59926 (Oct. 3, 2014).

extent to which it would recognize compliance with comparable foreign requirements as an alternative means of compliance with the Commission's margin rules ("substituted compliance") and the extent to which it would exclude uncleared swaps from the Commission's margin rules. Further, in considering the relevant costs and benefits of the Proposed Margin Rules, the Commission used as its baseline the swaps market as it existed at the time of the Proposed Margin Rules' Federal Register release; because this Proposed Rule addresses the cross-border application of the Proposed Margin Rules, the Commission is using as its baseline the swaps market as it would operate once the Proposed Margin Rules were fully implemented.

As discussed in section I.B. above, in developing the proposed cross-border framework in the Proposed Rule, the Commission is mindful of the global and highly interconnected nature of the swaps market—and that risk exposures overseas can quickly manifest in the United States and pose substantial threat to the U.S. financial system. At the same time, the Commission also recognizes that competitive distortions and market inefficiencies can result—and the benefits of the BCBS-IOSCO framework lost—if due consideration is not given to comity principles. The Commission has also carefully considered the impact of its choices in determining whether (and, if so, under what circumstances) substituted compliance would be available or whether (and, if so, under what circumstances) swaps would be deemed excluded, including the effect of its choices on efficiency, competition, market integrity and transparency.

The Commission is aware of the potentially significant trade-offs inherent in its policy decisions. For instance, the Commission's choice not to exclude from its margin requirements certain foreign-facing swaps involving U.S. CSEs and non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person may make it more costly for such firms to conduct their swaps business, particularly in foreign jurisdictions, and put them at a competitive disadvantage relative to non-U.S. CSEs whose obligations under the relevant swap are not guaranteed by a U.S. person. It could also make foreign counterparties less willing to deal with U.S. CSEs and non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person. On the other hand, full application of the margin requirements to these CSEs may enhance the safety and soundness of these CSEs and consequently, the U.S. financial system. In addition, the extent, if any, to which either of the aforementioned disadvantages would arise depends on whether competitors of such CSEs must comply with comparable margin requirements. In developing the proposed cross-border framework in the Proposed Rule, the Commission has attempted to appropriately consider competing concerns in seeking to effectively address the risk posed to the safety and soundness of CSEs, while creating a workable framework that mitigates the potential for undue market distortions and that promotes global harmonization.

The Commission's consideration of the costs and benefits associated with the proposed framework is complicated by the fact that other jurisdictions may adopt requirements with different scope or on different timelines. Currently, no foreign jurisdiction has finalized rules for margin of uncleared swaps. However, the EU[103] and

[103] See European Banking Authority, European Securities and Markets Authority, and European Insurance and Occupational Pensions Authority, Consultation Paper on draft regulatory technical standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012 (for the European Market Infrastructure Regulation) (April 14, 2014), available at https://www.eba.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf.

Japan[104] have proposed such rules, each of which are based on the BCBS-IOSCO framework.[105] The extent to which, if at all, foreign jurisdictions will follow the BCBS-IOSCO framework and the differences between the requirements implemented overseas and the Commission's margin requirements will affect the costs and benefits related to the Proposed Rule. Thus, for example, if a margin rule in a particular foreign jurisdiction is less rigorous than the Commission's margin rule, those CSEs (U.S. and non-U.S. CSEs) that are subject to the Commission's margin rule may be competitively disadvantaged relative to those dealers that are eligible for Exclusion from the Commission's margin rule for certain swaps or are outside the Commission's jurisdiction.[106]

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[104] See Financial Services Agency of Japan, draft amendments to the "Cabinet Office Ordinance on Financial Instruments Business" and "Comprehensive Guidelines for Supervision" with regard to margin requirements for non-centrally cleared derivatives (July 3, 2014). Available in Japanese at http://www.fsa.go.jp/news/26/syouken/20140703-3.html.

[105] See Margin Requirements for Non-centrally Cleared Derivatives, Sept. 2013, available at http://www.bis.org/publ/bcbs261.pdf. The Commission is not incorporating the details of the EU and Japanese proposals in this CBC, because they have not been adopted and would be subject to change upon adoption.

[106] As discussed in section I.B. above, in the interest of promoting global harmonization, the Commission has consulted and coordinated with the Prudential Regulators and foreign regulatory authorities. In addition, the Commission staff has participated in numerous bilateral and multilateral discussions with foreign regulatory authorities discussing national efforts to implement margin reform and the possibility of conflicts and overlaps between U.S. and foreign regulatory regimes. Although at this time foreign jurisdictions do not yet have their margin regimes in place, the Commission has participated in ongoing, collaborative discussions with regulatory authorities in the EU and Japan regarding their cross-border approaches to the margin rules, including the anticipated scope of application of margin requirements in their jurisdiction to cross-border swaps, their plans for recognizing foreign margin regimes, and their anticipated timelines. The Commission expects that these discussions will continue as it finalizes and then implements its margin rules, and as other jurisdictions develop their own margin rules and approaches to cross-border applications.

In sum, given that foreign jurisdictions do not yet have in place their margin rules, it is not possible to fully evaluate the costs and benefits associated with the Proposed Rule, and in particular, the implications for the safety and soundness of CSEs and competition. However, to the extent that a foreign regime's margin requirements are comparable, any differences between the Commission's margin requirements and foreign margin requirements would be insignificant and, therefore, mitigate the potential for undue risk to the CSE and competitive distortions. However, if a foreign regime's margin requirements are not deemed comparable, this may put a CSE at a competitive disadvantage when competing with non-U.S. firms that are not registered with the Commission because these non-CFTC registered dealers would have a cost advantage that could affect their pricing terms to clients.

In the sections that follow, the Commission considers: (i) costs and benefits associated with the proposed definition of U.S. person; (ii) the proposed framework for substituted compliance; (iii) the proposed exclusion from the margin rule; (iv) the submission of requests for a comparability determination; and (v) alternatives considered and the cost and benefit of such alternatives. Wherever reasonably feasible, the Commission has endeavored to quantify the costs and benefits of this proposed rulemaking. In a number of instances, the Commission currently lacks the data and information required to precisely estimate costs and benefits. Where it was not feasible to quantify (e.g., because of the lack of accurate data or appropriate metrics), the Commission has endeavored to consider the costs and benefits of these rules in qualitative terms.

2. <u>Proposed Rule</u>

The Proposed Rule sets forth a definition of "U.S. person," describing the circumstances under which substituted compliance or the exclusion would be available, and would establish a process for the submission of requests for a comparability determination. In addition to issues related to financial integrity of markets, competition and market distortions noted above, the U.S. person definition and comparability determination process entail monetary costs for CSEs and market participants because a market participant may have to expend resources to determine whether it (or its counterparty) is a U.S. person. A CSE seeking to rely on substituted compliance could incur costs in connection with the submission of a request for a comparability determination, although this would not be the case in circumstances where the relevant jurisdiction has itself attained a comparability finding from the Commission. In this section, we describe the most significant considerations that we have taken into account in formulating the Proposed Rule.

a. <u>U.S. Person</u>

Under the Proposed Rule, the term "U.S. person" would be defined so as to identify activities having a substantial nexus to the U.S. market because they are undertaken by individuals or entities organized or domiciled in the United States or because of other connections to the U.S. market. The definition is intended to identify those individuals and entities whose swap activities have a substantial nexus to U.S. markets even when they transact in swaps with a non-U.S. CSE. As noted in section II.B.1. above, this proposed definition generally follows the traditional, territorial approach to defining a U.S. person. The chief benefit of this territorial approach is that it is objective and clear—and the Commission believes that the industry has largely followed a similar definition of "U.S. person" included in the Guidance.

The Commission considered including the U.S. majority-ownership prong that was included in the Guidance (50% U.S. person ownership of a fund or other collective investment vehicle), but has determined not to propose it.[107] The Commission understands that unlike other corporate structures, certain types of funds, specifically fund-of-funds and master-feeder structures, would require an adviser or administrator to look through to other fund entities in the fund structure, in ascertaining whether a beneficial owner of the fund is a U.S. person. The Commission further understands that this may be difficult to determine in some cases. In addition, the Commission believes that other elements of the U.S. person definition would in many circumstances cover these funds as a "U.S. person."

Even if a non-U.S. fund with U.S. majority-ownership is treated as a non-U.S. person, such fund would be excluded from the Commission's margin rules only in limited circumstances (namely, when the fund trades with a non-U.S. CSE that is not a consolidated subsidiary of a U.S. entity or a U.S. branch of a non-U.S. CSE). Additionally, any excluded swaps would most likely be covered by another jurisdiction that adheres to the BCBS-IOSCO standards. The Commission anticipates that non-U.S. CSEs will generally be required, in their home jurisdiction, to collect margin from these

[107] The Commission's definition of the term "U.S. person" as used in the Guidance included a prong (iv) which covered "any commodity pool, pooled account, or collective investment vehicle (whether or not it is organized or incorporated in the United States) of which a majority ownership is held, directly or indirectly, by a U.S.person(s)."

non-U.S. funds.[108] Therefore, non-U.S. CSEs would generally be protected in the event of a default by a non-U.S. fund even if the uncleared swap with the non-U.S. fund falls within the Exclusion.[109] Accordingly, the Commission believes that treatment of non-U.S. funds with U.S. majority-ownership as non-U.S. persons will not have a substantial impact on the safety and soundness of CSEs or the stability of the U.S. financial system; at the same time, the Commission believes that excluding the majority-ownership prong would alleviate any burden associated with determining whether a fund qualifies as a U.S. person under this criterion.

As noted in section II.B.1. above, prong (vi) of the proposed "U.S. person" definition would capture certain legal entities owned by one or more U.S. person(s) and for which such person(s) bear unlimited responsibility for the obligations and liabilities of the legal entity. In the case of the Guidance, the "U.S. person" definition would generally characterize a legal entity as a U.S. person if the entity were "directly or indirectly majority-owned" by one or more persons falling within the term "U.S. person" and such U.S. person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity. Because this prong of the proposed definition of "U.S. person" is broader in scope, the Commission believes that this may result in more legal entities

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[108] At this time, we do not have information as to what portion of the funds that would have been covered by the U.S. majority-ownership prong are hedge funds.

[109] Further, as noted earlier, a non-U.S. CSE that can avail itself of the Exclusion would still be subject to the Commission's margin rules with respect to all uncleared swaps not meeting the criteria for the Exclusion, albeit with the possibility of substituted compliance. The Commission further believes that the possibility of a cascading event affecting U.S. counterparties and the U.S. market more broadly as a result of a default by the non-U.S. CSE would also be mitigated because the non-U.S. CSE would be subject to U.S. margin requirements (with the possibility of substituted compliance to the extent applicable) when entering into a swap with U.S. counterparties.

meeting the U.S. person definition. In addition, to the extent that this prong of the proposed definition of "U.S. person" expands the number of market participants that would be deemed to be a "U.S. person," the Commission believes that the benefits that would have been provided to otherwise non-U.S. CSEs from being able to avail themselves of substituted compliance and the Exclusion would not be realized.

The proposed "U.S. person" definition does not include the prefatory phrase "includes, but is not limited to" that was included in the Guidance. The Commission believes that this prefatory phrase should not be included in the Proposed Rule in order to provide legal certainty regarding the application of U.S. margin requirements to cross-border swaps.

Finally, the Commission believes that the definition of "U.S. person" provides a clear and objective basis upon which to identify a U.S. person, and that identifying whether a counterparty is a "U.S. person" should be relatively straightforward because, as noted above, the Commission believes that a swap counterparty generally should be permitted to reasonably rely on its counterparty's written representation in determining whether the counterparty is within the definition of the term "U.S. person."

b. Availability of Substituted Compliance and Exclusion

i. Uncleared swaps of U.S. CSEs or of non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person

As set out in Appendix A, under the Proposed Rule, the Commission's margin rules would generally apply to all uncleared swaps of U.S. CSEs. For U.S. CSEs, substituted compliance would only be available with respect to the requirement to post initial margin and only if the counterparty is a non-U.S. person (including a non-U.S. CSE) whose obligations under the uncleared swap are not guaranteed by a U.S. person. Uncleared swaps with U.S. CSEs would never qualify for the Exclusion. Under the Proposed Rule, non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person would receive the same treatment as U.S. CSEs.[110] The Commission believes that this result is appropriate because a swap of an entity guaranteed by that U.S. person will have economic and financial implications that are likely to be very similar to the economic and financial implications of a swap entered into directly by the U.S. guarantor, as discussed in section II.B.2. above.

The Commission understands that the Proposed Rule may place U.S. CSEs and non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person at a disadvantage when competing with either non-U.S. CSEs that are able to rely on the Exclusion or with non-CFTC registered dealers for foreign clients, though whether such a disadvantage exists would depend on whether these competitors are subject to comparable margin rules in other jurisdictions. For example, the ability of a non-U.S. CSE that is not guaranteed by a U.S. person (and that is not a Foreign Consolidated Subsidiary or a U.S. branch of a non-U.S. CSE) to rely on the Exclusion could allow it to

[110] As discussed in section II.B.2, under the Proposed Rule the Commission is defining a guarantee narrower than in the Guidance, and in doing so, the Commission has broadened the availability of substituted compliance and the Exclusion to certain non-U.S. CSEs that would not have the ability to avail themselves of these if the broader definition of guarantee used in the Guidance were used in the Proposed Rule instead of the narrower definition. However, the Commission believes that as a result of its decision to define certain non-U.S. CSEs as Foreign Consolidated Subsidiaries, some of these same non-U.S. CSEs that would have been able to avail themselves of substituted compliance and the Exclusion, as a result of the narrow definition of a guarantee, would not be eligible for the Exclusion (but would benefit from the full application of substituted compliance instead of a limited application). The costs and benefits related to substituted compliance and the Exclusion are set out in this section and below.

gain a cost advantage over a U.S. CSE or a non-U.S. CSE that is guaranteed by a U.S. person and thus offer better pricing terms to foreign clients, unless it is subject to another jurisdiction's margin rules that are comparable. U.S. CSEs and non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person may also be at a disadvantage when competing for clients with non-U.S. CSEs that are able to rely on substituted compliance more broadly if the clients believe complying with the foreign jurisdiction's margin requirements would be less burdensome or costly than when transacting with a U.S. CSE under the Proposed Rule, as the amount posted by the non-U.S. counterparty would need to comply with U.S. margin requirements. However, the Commission believes that the requirement that the relevant foreign jurisdiction's margin requirements have comparable outcomes should operate to narrow any competitive disadvantage, thereby diminishing opportunities for regulatory arbitrage.[111]

In addition, because the Proposed Rule provides for limited substituted compliance for U.S. CSEs and non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person (relative to other CSEs), those CSEs may be subject to conflicting or duplicative regulations, and consequently, would incur costs associated with developing multiple sets of policies and procedures and operational infrastructures. The Commission recognizes that such costs would vary for firms depending on the nature and scope of the individual firm's business, and costs relative to other competitors would

[111] The Commission notes that of the approximately 61 CSEs that would be subject to the Commission's margin rules, 21 are non-U.S. CSEs. Of those 21 non-U.S. CSEs, 20 are domiciled in jurisdictions that participated in the development of the BCBS-IOSCO framework. Although harmonization among these jurisdictions may mitigate some competitive disadvantages, the associated costs and benefits cannot be reasonably determined as no jurisdictions have finalized their margin rules.

depend on whether the competitors are subject to other jurisdictions' margin rules. The Commission requests data from commenters to assist the Commission in considering the quantitative effect of the limited substituted compliance for U.S. CSEs and non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person.

On the other hand, the Commission believes that requiring U.S. CSEs and non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person to comply with its margin requirements would foster the stability of the U.S. financial markets. By their nature, U.S. CSEs and non-U.S. CSEs whose swap obligations are guaranteed by a U.S. person have a significant impact on the U.S. financial markets, and the Commission therefore has a strong interest in ensuring their viability. As discussed in section II.C.1. above, the Commission believes that requiring U.S. CSEs and non-U.S. CSEs whose swap obligations are guaranteed by a U.S. person to comply with the Commission's margin requirements, with only limited substituted compliance, is important to maintaining well-functioning U.S. financial markets and ensuring the sound risk management practices of key market participants in the U.S. swaps market.

ii. Uncleared swaps of non-U.S. CSEs whose obligations under the relevant swap are not guaranteed by a U.S. person

As set out in Appendix A, under the Proposed Rule, non-U.S. CSEs whose obligations under the relevant uncleared swap are not guaranteed by a U.S. person, including Foreign Consolidated Subsidiaries, are eligible for substituted compliance to a greater extent relative to U.S. CSEs or non-U.S. CSEs whose obligations under the relevant uncleared swap are guaranteed by a U.S. person. A subset of these non-U.S.

CSEs may qualify for the Exclusion, as described in section II.C.3. above. As noted in section II.C.2., the Commission believes that the proposed approach is appropriate since a non-U.S. CSE whose swap obligations are not guaranteed by a U.S. person (including a Foreign Consolidated Subsidiary), may implicate equal or greater supervisory concerns on the part of a foreign regulator relative to the Commission's supervisory interests (in comparison to U.S. CSEs or non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person, because the Commission has a significant regulatory interest in uncleared swaps of these CSEs).

Substituted compliance would benefit such non-U.S. CSEs by allowing them to avoid conflicting or duplicative regulations and choose the most appropriate set of rules when transacting with each other. Furthermore, eligible non-U.S. CSEs could further benefit from developing one enterprise-wide set of compliance and operational infrastructures.[112] And because substituted compliance is contingent on the Commission's determination that the relevant jurisdiction's margin rules are comparable, the potential for undue risk to the CSE and competitive distortions between those

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[112] The Commission notes that the costs of developing the margin infrastructure needed to comply with Commission margin requirements in the context of cross-border transactions, as well as the costs of complying with the Commission's margin requirements more generally in the context of cross-border transactions, could vary significantly for different CSEs based on factors specific to each firm (e.g., organizational structure, status as a U.S. CSE or non-U.S. CSE (including whether the firm is a Foreign Consolidated Subsidiary or a U.S. branch of a non-U.S. CSE), jurisdictions in which uncleared swaps activities are conducted, applicable margin requirements in the U.S. and other jurisdictions, the location and status of counterparties, existence of an appropriate MOU or similar arrangement with the relevant jurisdictions, existence of Comparability Determinations in the relevant jurisdictions and any conditions in such determinations, and firm policies and procedures for the posting and collection of margin). The Commission further notes that currently no foreign jurisdiction has finalized rules for margin of uncleared swaps. However, the EU and Japan have proposed such rules, each of which are based on the BCBS-IOSCO framework. Accordingly, the Commission lacks the data and information required to reasonably estimate costs related to developing the appropriate margin infrastructure or the costs of complying with the Commission's margin requirements generally in the context of cross-border transactions.

registrants that are eligible for substituted compliance and those that are not would be mitigated. However, if the foreign jurisdiction's margin requirements are not deemed comparable, these CSEs will be at a disadvantage to non-CFTC registered dealers when competing for client business.

iii. Exclusion for uncleared swaps of non-U.S. CSEs where neither counterparty's obligations under the relevant swap are guaranteed by a U.S. person and neither counterparty is a Foreign Consolidated Subsidiary nor a U.S. branch of a non-U.S. CSE

As discussed in section II.C.3., under the Proposed Rule, the Commission would exclude from its margin rules uncleared swaps entered into by a non-U.S. CSE with a non-U.S. person counterparty (including a non-U.S. CSE), provided that neither counterparty's obligations under the relevant swap are guaranteed by a U.S. person and neither counterparty is a Foreign Consolidated Subsidiary nor a U.S. branch of a non-U.S. CSE. As discussed in section II.C.3. above, the Commission believes that it would be appropriate to tailor the application of margin requirements in the cross-border context, consistent with section 4s(e) of the CEA[113] and comity principles, so as to exclude this narrow class of uncleared swaps involving a non-U.S. CSE and a non-U.S. counterparty.

[113] Section 4s(e)(3)(A) of the CEA, 7 U.S.C. 6s(e)(3)(A). The section provides, among other things, that margin requirements "be appropriate for the risks associated with the non-cleared swaps held as a swap dealer or major market participant."

The Commission believes that such non-U.S. CSEs may benefit from the Exclusion because it allows them to avoid conflicting or duplicative regulations where a transaction would be subject to more than one uncleared swap margin regime. On the other hand, to the extent a non-U.S. CSE would be able to rely on the margin requirements of a foreign jurisdiction, as opposed to the Commission's margin requirements, and such other margin requirements are not comparable, the Exclusion could result in a less rigorous margin regime for such CSE. This, in turn, could create competitive disparities between non-U.S. CSEs relying on the Exclusion and other CSEs that are not eligible for the Exclusion. That is, the Exclusion could allow these non-U.S. CSEs to offer better pricing to their non-U.S. clients, which would give them a competitive advantage relative to those CSEs that are not eligible for the Exclusion (e.g., U.S. CSEs, non-U.S. CSEs whose obligations under the relevant swap are not guaranteed by a U.S. person, or Foreign Consolidated Subsidiaries). However, whether these competitive effects occur will also depend on whether the relevant foreign jurisdiction has comparable margin rules. In addition, non-U.S. CSEs that are eligible for the Exclusion could be in a better position to compete with non-CFTC registered dealers in the relevant foreign jurisdiction for foreign clients.

As noted above, at this time, given that foreign jurisdictions do not yet have in place their margin regimes, it is not possible to fully evaluate the Proposed Rule's eventual implications for the safety and soundness of CSEs and competition. Assuming, however, for the sake of analysis that the relevant foreign jurisdiction does not have comparable margin requirements, the Commission preliminarily believes that the Exclusion would not result in a significant diminution in the safety and soundness of the non-U.S. CSE, as discussed in section II.C.3. above. This is based on several considerations. First, the potential adverse effect on a non-U.S. CSE would be substantially mitigated by the Commission's capital requirements.[114] Additionally, any excluded swaps would most likely be covered by another jurisdiction that adheres to the BCBS-IOSCO standards because the Commission believes that most swaps are currently undertaken in jurisdictions that already have agreed to adhere to the BCBS-IOSCO margin standards.

Further, a non-U.S. CSE that can avail itself of the Exclusion would still be subject to the Commission's margin rules with respect to all uncleared swaps not meeting the criteria for the Exclusion, albeit with the possibility of substituted compliance. The Commission further believes that the possibility of a cascading event affecting U.S. counterparties and the U.S. financial markets more broadly as a result of a default by the non-U.S. CSE would also be mitigated because the non-U.S. CSE would be subject to U.S. margin requirements (with the possibility of substituted compliance to the extent applicable) when entering into a swap with U.S. counterparties.

iv. Foreign Consolidated Subsidiaries

Under the Proposed Rule, substituted compliance is more broadly available to a Foreign Consolidated Subsidiary whose obligations under the relevant swap are not guaranteed by a U.S. person than a U.S. CSE or a non-U.S. CSE whose obligations under the relevant swap are guaranteed by a U.S. person. Further, a Foreign Consolidated Subsidiary would be able to avail itself of substituted compliance to the same extent as

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[114] See section II.A.1.

other non-U.S. CSEs, but would not be eligible for the Exclusion. A Foreign Consolidated Subsidiary's financial position, operating results, and statement of cash flows are directly reflected in its ultimate U.S. parent entity's financial statements. Given the nature of a Foreign Consolidated Subsidiary's direct relationship to a U.S. person, the Commission believes that the uncleared swaps of Foreign Consolidated Subsidiaries should not be excluded from the margin requirements, as discussed in section II.C.3. above.

The unavailability of the Exclusion could disadvantage Foreign Consolidated Subsidiaries relative to other non-U.S. CSEs that would be eligible for the Exclusion (i.e., non-U.S. CSEs where neither counterparty's obligations under the relevant swap are guaranteed by a U.S. person and neither counterparty is a Foreign Consolidated Subsidiary nor a U.S. branch of a non-U.S. CSE) or non-CFTC registered dealers within a foreign jurisdiction. Non-U.S. CSEs that rely on the Exclusion or non-CFTC registered dealers could realize a cost advantage over Foreign Consolidated Subsidiaries and thus have the potential to offer better pricing terms to foreign clients. The competitive disparity between non-U.S. CSEs that rely on the Exclusion and Foreign Consolidated Subsidiaries, however, may be somewhat mitigated to the extent that the relevant foreign jurisdiction implements the BCBS-IOSCO framework.

v. U.S. branch of a non-U.S. CSE

Under the Proposed Rule, the Exclusion from the margin rules would not be available to a U.S. branch of a non-U.S. CSE. The Commission believes that when a non-U.S. CSE conducts its swap activities within the United States through a branch or office located in the United States, it should be subject to U.S. margin requirements, but with the possibility of substituted compliance, consistent with comity principles. The Commission believes that the Proposed Rule's Exclusion should not be available in this case, because U.S. branches of non-U.S. CSEs are operating within the U.S. market and competing with U.S. CSEs for business, including from non-U.S. counterparties.

If a U.S. branch of a non-U.S. CSE were permitted to use the Exclusion it could be able to offer more competitive terms to non-U.S. clients than U.S. CSEs, and thereby gain an unwarranted advantage when dealing with non-U.S. clients relative to other CSEs operating within the United States (i.e., U.S. CSEs). On the other hand, for the same reason, the Proposed Rule could put non-U.S. CSEs that conduct swaps business through their U.S. branches at a disadvantage relative to either non-U.S. CSEs that are eligible for the Exclusion or non-CFTC registered dealers that conduct swaps business overseas. However, to the extent that the U.S. branch of a non-U.S. CSE is able to rely on substituted compliance, the competitive disparities relative to those non-U.S. CSEs that are eligible for the Exclusion should be reduced to the extent that the relevant foreign jurisdiction implements BCBS-IOSCO framework standards.[115]

The unavailability of the Exclusion could also result in the U.S. branch of a non-U.S. CSE being subject to conflicting or duplicative margin requirements. However, the Commission believes that overall any resulting costs may not be significant to the extent that the U.S. branch is able to avail itself of substituted compliance in that jurisdiction.

[115] Non-U.S. CSEs are also likely to conduct swaps business with U.S. clients from locations outside the United States; nevertheless, U.S. branches are likely to have greater U.S. client-orientation relative to such foreign operations.

c. Alternatives

The Commission believes that the Proposed Rule effectively addresses the risk posed to the safety and soundness of CSEs, while creating a workable framework that reduces the potential for undue market disruptions and promotes global harmonization by taking into account the interests of other jurisdictions and balancing those interests with the supervisory interests of the United States.

The Commission has determined not to propose the Guidance Approach because it believes that if the Guidance Approach were adopted, too many swaps would be excluded from the margin rules to ensure the safety and soundness of CSEs and the U.S. financial system. In particular, under the Guidance Approach, uncleared swaps between a non-U.S. CSE and a non-U.S. person whose uncleared swap obligations are not guaranteed by a U.S. person would be excluded from the Commission's margin rules without regard to whether the non-U.S CSE is guaranteed or its financial statements are consolidated with a U.S. parent entity under U.S. generally accepted accounting principles.

The Commission has also determined not to propose the Entity-Level Approach. On the one hand, the Entity-Level Approach (where the margin requirements would apply to all uncleared swaps of a CSE, with no possibility of any exclusion) is arguably appropriate because margin requirements are critical in ensuring the safety and soundness of a CSE and in supporting the stability of the U.S. financial markets. As a result of CSEs engaging in a level of uncleared swap activity that is significant enough to warrant U.S. registration, their uncleared swaps have a direct and significant nexus to the U.S. financial system, irrespective of whether their counterparty is a U.S. or non-U.S. entity.

However, the Commission believes that the Entity-Level Approach does not adequately consider the relative supervisory interests of U.S. and foreign regulators.

d. Comparability Determinations

As noted in section II.D. above, any CSE who is eligible for substituted compliance may make a request for a comparability determination. Currently, there are approximately 102 CSEs provisionally registered with the Commission. The Commission further estimates that of the 102 CSEs that are registered, approximately 61 CSEs would be subject to the Commission's margin rules, as they are not supervised by a Prudential Regulator. However, the Commission notes that any foreign regulatory agency that has direct supervisory authority to administer the foreign regulatory framework for margin of uncleared swaps in the requested foreign jurisdiction may apply for a comparability determination. Further, once a comparability determination is made for a jurisdiction, it would apply for all entities or transactions in that jurisdiction to the extent provided in the determination, as approved by the Commission.

The Commission assumes that a CSE or foreign regulatory agency will apply for a comparability determination only if the anticipated benefits warrant the costs attendant to submission of a request for a comparability determination. Although there is uncertainty regarding the number of requests that would be made under the Proposed Rule, the Commission estimates that it would receive applications for comparability determinations from 17 jurisdictions representing 61 separate registrants, and that each request would impose an average of 10 burden hours per registrant. [116]

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[116] See note 99, supra.

Based upon the above, the Commission estimates that the preparation and filing of submission requests for comparability determinations should take no more than 170 hours annually in the aggregate (17 registrants x 10 hours). The Commission further estimates that the total aggregate cost of preparing such submission requests would be $64,600, based on an estimated cost of $380 per hour for an in-house attorney.[117]

3. Section 15(a) Factors

As discussed above, the Proposed Rule is intended to apply the Proposed Margin Rules on a cross-border basis in a manner that effectively addresses risks to U.S. persons and the U.S. financial system, while mitigating the potential for conflicts and duplications that could lead to market distortions and undue competitive disparities. The discussion that follows supplements the related cost and benefit considerations addressed in the preceding section and addresses the overall effect of the Proposed Rule in terms of the factors set forth in section 15(a) of the CEA.

a. Protection of Market Participants and the Public

CEA section 15(a)(2)(A) requires the Commission to evaluate the costs and benefits of a proposed regulation in light of considerations of protection of market participants and the public. CEA section 4s(e)(2)(A) requires the Commission to develop rules designed to ensure the safety and soundness of CSEs and the U.S. financial system.

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

In developing the Proposed Rule, the Commission's primary focus was on the relationship or trade-offs between the benefits associated with applying the Commission's margin requirement and the costs associated with extending substituted compliance or the Exclusion. On the one hand, full application of the Commission's margin requirements would help to ensure the safety and soundness of CSEs and the U.S. financial system by reducing counterparty credit risk and the threat of contagion; on the other hand, extending substituted compliance or the Exclusion to CSEs would reduce the potential for conflicting or duplicative requirements, which would, in turn, reduce market distortions and promote global harmonization. Substituted compliance in particular should not reduce the safety and soundness benefit of the Proposed Rule because substituted compliance will not be available unless the Commission determines that foreign margin regulations are comparable to the Commission's margin regulations. Granting the Exclusion to certain CSEs should not significantly undermine these purposes, because other requirements and circumstances discussed above should mitigate the risk those CSEs pose to the U.S. financial system.

b. Efficiency, Competitiveness, and Financial Integrity

CEA section 15(a)(2)(B) requires the Commission to evaluate the costs and benefits of a proposed regulation in light of efficiency, competitiveness and financial integrity considerations.

i. Efficiency

The availability of substituted compliance to CSEs following comparable margin requirements in a foreign jurisdiction may incentivize global implementation of the BCBS-IOSCO framework. Greater harmonization across markets lessens the potential for conflicting or duplicative requirements, which, in turn, would promote greater operational efficiencies as a CSE would be able to avoid creating individualized compliance and operational infrastructures to account for the unique requirements of each jurisdiction in which it conducts swaps business. Also, to the extent that margin regimes across jurisdictions are comparable, substituted compliance should help to mitigate regulatory arbitrage.

ii. Competitiveness

Under the Proposed Rule, the availability of substituted compliance would turn primarily on the nature of the non-U.S. CSE's relationship to a U.S. person and the national status of the non-U.S. CSE's counterparty. For example, in the case of a non-U.S. CSE whose swap obligations are not guaranteed by a U.S. person, substituted compliance would be available for any swap with a counterparty that is not a U.S. CSE or a non-U.S. CSE whose swap obligations are guaranteed by a U.S. person. Further, under the Proposed Rule, an uncleared swap entered into by a non-U.S. CSE with a non-U.S. person counterparty (including a non-U.S. CSE) would be excluded from the Commission's margin rules, provided that neither counterparty's obligations under the relevant swap are guaranteed by a U.S. person and neither counterparty is a Foreign Consolidated Subsidiary nor a U.S. branch of a non-U.S. CSE.

The availability of substituted compliance and/or the Exclusion could create competitive disparities between those CSEs that are eligible for substituted compliance and/or the Exclusion relative to those that are not eligible. In addition, as the Exclusion is not provided to all CSEs, those that are not permitted to use the Exclusion may be at a competitive disadvantage when competing in foreign jurisdictions that do not have comparable margin rules to that of the Commission relative to non-CFTC registered dealers for foreign clients.[118] Because the Proposed Rule offers to U.S. CSEs (and non-U.S. CSEs with respect to swaps whose obligations are guaranteed by a U.S. person) only a minimal degree of substituted compliance and no Exclusion, these CSEs may be particularly impacted. As discussed in section II.C.1., however, the Commission believes that the Proposed Margin Rules should apply to the maximum degree to such CSEs in order to ensure the safety and soundness of U.S. CSEs (and U.S. guarantor) and the U.S. financial system. Furthermore, to the extent that that a relevant foreign jurisdiction's margin rules are comparable to that of the Commission's margin rules, such competitive disparities could be reduced.

iii. Financial integrity of markets

The safety and soundness of CSEs are critical to the financial integrity of markets. Further, as discussed in section II.A. above, margin serves as a first line of defense to protect a CSE as a whole in the event of a default by a counterparty. Together with capital, margin represents a key element in a CSE's overall risk management program, which ultimately mitigates the possibility of a systemic event.

At the same time, the Commission recognizes that a CSE's uncleared swaps with a particular counterparty may implicate the supervisory interests of foreign regulators, and it is important to calibrate the cross-border application of the margin requirements to mitigate, to the extent possible, consistent with the Commission's regulatory interests, the

[118] The Commission notes, however, that of the approximately 61 CSEs that would be subject to the Commission's margin rules, 21 are non-U.S. CSEs. Of those 21 non-U.S. CSEs, 20 are domiciled in jurisdictions that participated in the development of the BCBS-IOSCO framework, which may mitigate possible regulatory arbitrage between these dealers.

potential for conflict or duplication with other jurisdictions. Therefore, the Proposed Rule also allows for substituted compliance and an Exclusion in certain circumstances.

The Commission believes that the Proposed Rule strikes the right balance between the two competing considerations to ensure that substituted compliance and the Exclusion are not extended in a way that could pose substantial risk to the integrity of the U.S. financial system. Substituted compliance is predicated on the Commission's determination that the relevant foreign jurisdiction has comparable margin rules; if the Commission does not find a foreign jurisdiction's rules comparable, the CSE would then need to comply with the Commission's rules. Even in instances where the Exclusion would be available, the Commission has taken into account that the risk to the integrity of the financial markets would be mitigated by the Commission's expectation that: (1) the Proposed Margin Rules would cover many of the swaps of the non-U.S. CSEs (eligible for the Exclusion) with other counterparties, namely, all U.S. counterparties; (2) the Exclusion would be limited to a narrow set of swaps by non-U.S. CSEs; (3) the capital requirements would apply on an entity-level basis to all CSEs; and (4) the excluded swaps will most likely be covered by another foreign regulator's margin rules that are based on the BCBS-IOSCO framework.

iv. Price Discovery

CEA section 15(a)(2)(C) requires the Commission to evaluate the costs and benefits of a proposed regulation in light of price discovery considerations. The Commission generally believes that substituted compliance, by reducing the potential for conflicting or duplicative regulations, could reduce impediments to transact uncleared swaps on a cross-border basis. This, in turn, may enhance liquidity as more market participants would be willing to enter into uncleared swaps, thereby possibly improving price discovery – and ultimately reducing market fragmentation. Alternatively, if substituted compliance or the Exclusion were not made available, it would incentivize CSEs to consider setting up their swap operations outside the Commission's jurisdiction, and as a result, increase the potential for market fragmentation.

v. Sound Risk Management Practices

CEA section 15(a)(2)(D) requires the Commission to evaluate the costs and benefits of a proposed regulation in light of sound risk management practices. Margin is a critical element of a firm's sound risk management program that, among other things, can prevent the accumulation of counterparty credit risk. As international regulators and the Commission harmonize their margin regulations for uncleared swaps, market participants may be able to manage their risk more effectively on an enterprise-wide basis. On the other hand, to the extent that a CSE relies on the Exclusion for eligible swaps and the relevant foreign jurisdiction does not have comparable margin requirements, the Proposed Rule could lead to weaker risk management practices.

vi. Other Public Interest Considerations

CEA section 15(a)(2)(E) requires the Commission to evaluate the costs and benefits of a proposed regulation in light of other public interest considerations. The Commission has not identified any additional public interest considerations related to the costs and benefits of the Proposed Rule.

4. General Request for Comment

The Commission requests comment on all aspects of the costs and benefits relating to the cross-border application of the Proposed Rule, including the nature and extent of the costs and benefits discussed above and any other costs and benefits that could result from adoption of the Proposed Rule. Commenters are encouraged to discuss the costs and benefits to U.S. CSEs and non-U.S. CSEs covered by the Proposed Rule, as well as any costs and benefits to other market participants, the swap markets, or the general public, and to the extent such costs and benefits can be quantified, monetary and other estimates thereof. The Commission requests that commenters provide any data or other information that would be useful in estimating the quantifiable costs and benefits of this rulemaking. Among other things, commenters may wish to submit comments on the following questions:

1. Are the Commission's assumptions about the costs and benefits of the Proposed Rule accurate? If not, please explain and provide any data or other information that you have quantifying or qualifying the costs and benefits of the Proposed Rule.

2. Did the Commission consider all of the appropriate costs and benefits related to the Proposed Rule? If not, what additional costs and benefits should the Commission consider? Please explain why these additional costs and benefits should be considered and provide any data or other information that you have quantifying or qualifying the costs and benefits of these additional costs of the Proposed Rule.

3. Please provide any data or other information relating to costs associated with the definition of "U.S. person" in the Proposed Rule, and in particular, as the proposed definition relates to the definition of "U.S. person" that was included in the Guidance.

4. Will allowing substituted compliance or the Exclusion for swaps between certain categories of non-U.S. persons lead to fragmentation (e.g., creating separate or

multiple swap markets) of the liquidity in swaps markets for uncleared swaps to the detriment of price discovery? Is swap market fragmentation detrimental to various market participants when there is post-trade price transparency of swaps? Commenters are encouraged to quantify when practicable. Does the Proposed Rule have any significant effects on price discovery? Indeed, to what extent are the impacts on price discovery the result of other requirements, such as the margin for uncleared swaps or the trade execution mandate, and not the Proposed Rule per se?

List of Subjects

<u>17 CFR Part 23</u>

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

In consideration of the foregoing and pursuant to the authority contained in the Act, as indicated herein, the Commission hereby amends chapter I of title 17 of the Code of Federal Regulations as follows:

Part 23 – SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

1. The general authority citation for part 23 continues to read, and a sectional authority is added in numerical order, to read as follows:

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

* * * * *

Section 23.160 is also issued under Pub. L. 111-203, section 721(b), 124 Stat. 1641 (2010), and 7 U.S.C. 2(i).

2. Section 23.160 is added to Subpart E – Capital and Margin Requirements for Swap Dealers and Major Swap Participants and shall read as follows:

§ 23.160. Cross-border application

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

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

(2) **Guarantee** means an arrangement pursuant to which one party to a swap transaction with a non-U.S. person counterparty has rights of recourse against a U.S. person, with respect to the non-U.S. person counterparty's obligations under the swap transaction. For these purposes, a party to a swap transaction has rights of recourse against a U.S. person if the party has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from the U.S. person in connection with the non-U.S. person counterparty's obligations under the swap.

(3) **International standards** means the margin policy framework for non-cleared, bilateral derivatives issued by the Basel Committee on Banking Supervision and the International Organization of Securities in September 2013, as subsequently updated, revised, or otherwise amended, or any other

international standards, principles or guidance relating to margin requirements for non-cleared, bilateral derivatives that the Commission may in the future recognize, to the extent that they are consistent with United States law (including the margin requirements in the Commodity Exchange Act).

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

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

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

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

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

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

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

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

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

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

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

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

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

(vii) An individual account or joint account (discretionary or not) where the beneficial owner (or one of the beneficial owners in the case of a joint account) is a person described in subparagraph (i), (ii), (iii), (iv), (v) or (vi).

(b) **Applicability of margin requirements.**

(1) **Uncleared Swaps of U.S. CSEs or Non-U.S. CSEs whose obligations under the relevant swap are guaranteed by a U.S. person.**

(i) **Applicability of U.S. margin requirements; availability of substituted compliance for requirement to post initial margin.** With respect to each uncleared swap entered into by a U.S. CSE or a non-U.S. CSE whose obligations under the swap are guaranteed by a U.S. person, the U.S. CSE or non-U.S. CSE whose obligations under the swap are guaranteed by a U.S. person shall comply with the requirements of § 23.150 through § 23.159 of this part, provided that the U.S. CSE or non-U.S. CSE whose obligations under the swap are guaranteed by a U.S. person may satisfy its requirement to post initial margin to certain counterparties to the extent provided in paragraph (ii) of this section.

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

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

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

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

(2) **Uncleared Swaps of Non-U.S. CSEs whose obligations under the relevant swap are not guaranteed by a U.S. person.**

(i) **Applicability of U.S. Margin Requirements except where an Exclusion Applies; Availability of Substituted Compliance.** With respect to each uncleared swap entered into by a non-U.S. CSE whose obligations under the relevant swap are not guaranteed by a U.S. person, the non-U.S. CSE shall comply with the requirements of § 23.150 through § 23.159 of this part except to the extent that an exclusion is available under subparagraph (b)(2)(ii) of this section, provided that a non-U.S. CSE whose obligations under the relevant swap are not guaranteed by a U.S. person may satisfy its margin requirements under this part to the extent provided in subparagraphs (b)(2)(iii) and (b)(2)(iv) of this section.

(ii) **Exclusion**. A non-U.S. CSE shall not be required to comply with the requirements of § 23.150 through § 23.159 of this part with respect to each uncleared swap it enters into to the extent:

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

(B) The non-U.S. CSE is not a U.S. branch of a non-U.S. CSE; and

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

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

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

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

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

(c) **Comparability Determinations.**

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

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

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

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

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

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

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

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

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

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

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

(F) Any threshold levels or amounts;

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

(H) Eligible collateral for initial and variation margin;

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

(J) Documentation requirements relating to margin; and

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

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

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

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

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

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

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

(ii) How the relevant foreign jurisdiction's margin requirements compare to the International Standards;

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

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

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

(4) **Reliance.** Any covered swap entity that, in accordance with a Comparability Determination, complies with a foreign jurisdiction's margin requirements would be deemed to be in compliance with the Commission's corresponding margin requirements. Accordingly, the failure of such a covered swap entity to comply with the foreign jurisdiction's margin requirements may constitute a violation of the Commission's margin requirements. All covered swap entities, regardless of whether they rely on a Comparability Determination, remain subject to the Commission's examination and enforcement authority.

(5) **Conditions.** In issuing a Comparability Determination, the Commission may impose any terms and conditions it deems appropriate. The violation of such terms and conditions may constitute a violation of the Commission's

margin requirements and/or result in the modification or revocation of the Comparability Determination.

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

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

Note: The following Appendix will not appear in the Code of Federal Regulations.

Appendix A

APPLICATION OF THE PROPOSED RULE [1] [2] [3]

<table>
<tr><th>CSE</th><th>Counterparty</th><th>Proposed Approach</th></tr>
<tr><td rowspan="4">U.S. CSE

or

Non-U.S. CSE (including U.S. branch of a non-U.S. CSE and a Foreign Consolidated Subsidiary (“FCS”)) whose obligations under the relevant swap are guaranteed by a U.S. person</td><td>• U.S. person (including U.S. CSE)

• Non-U.S. person (including non-U.S. CSE, FCS, and U.S. branch of a non-U.S. CSE) whose obligations under the relevant swap are guaranteed by a U.S. person</td><td>U.S. (All)</td></tr>
<tr><td rowspan="3">• Non-U.S. person (including non-U.S. CSE, FCS and U.S. branch of a non-U.S. CSE) whose obligations under the relevant swap are not guaranteed by a U.S. person</td><td>U.S. (Initial Margin collected by CSE in column 1)</td></tr>
<tr><td>Substituted Compliance (Initial Margin posted by CSE in column 1)</td></tr>
<tr><td>U.S. (Variation Margin)</td></tr>
<tr><td rowspan="3">FCS whose obligations under the relevant swap are not guaranteed by a U.S. person

or

U.S. branch of a non-U.S. CSE whose obligations under the relevant swap</td><td rowspan="3">• U.S. CSE

• Non-U.S. CSE (including U.S. branch of a non-U.S. CSE and FCS) whose obligations under the relevant swap are guaranteed by a U.S. person</td><td>U.S. (Initial Margin posted by CSE in column 1)</td></tr>
<tr><td>Substituted Compliance (Initial Margin collected by CSE in column 1)</td></tr>
<tr><td>U.S. (Variation Margin)</td></tr>
</table>

***are not* guaranteed by a U.S. person**	• U.S. person (except as noted above for a CSE) • Non-U.S. person whose obligations under the swap **are** guaranteed by a U.S. person (except a non-U.S. CSE, U.S. branch of a non-U.S. CSE, and FCS whose obligations are guaranteed, as noted above) • Non-U.S. person (including non-U.S. CSE, U.S. branch of a non-U.S. CSE, and a FCS) whose obligations under the relevant swap **are not** guaranteed by a U.S. person	Substituted Compliance (All)
Non-U.S. CSE (that is not a FCS or a U.S. branch of a non-U.S. CSE) whose obligations under the relevant swap *are not* guaranteed by a U.S. person	• U.S. CSE • Non-U.S. CSE (including U.S. branch of a non-U.S. CSE and FCS**)** whose obligations under the swap **are** guaranteed by a U.S. person	U.S. (Initial Margin posted by CSE in column 1)
		Substituted Compliance (Initial Margin collected by CSE in column 1)
		U.S. (Variation Margin)
	• U.S. person (except as noted above for a CSE) • Non-U.S. person whose obligations under the swap **are** guaranteed by a U.S. person (except a non-U.S. CSE whose obligations **are** guaranteed, as noted above) • U.S. branch of a Non-U.S. CSE or FCS, in each case whose obligations under the relevant	Substituted Compliance (All)

	swap **are not** guaranteed by a U.S. person	
	• Non-U.S. person (including a non-U.S. CSE, but not a FCS or a U.S. branch of a non-U.S. CSE) whose obligations under the relevant swap **are not** guaranteed by a U.S. person	Excluded

1 This table should be read in conjunction with the rest of the preamble and the text of the Proposed Rule.

2 The term "U.S. person" is defined in section 23.160(a)(10) of the Proposed Rule. A "non-U.S. person" is any person that is not a "U.S. person." The term swap means an uncleared swap and is defined in section 151 of the Proposed Margin Rules. See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 FR 59898 (Oct. 3, 2014).

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

Issued in Washington, DC, on June __, 2015, by the Commission.

Christopher J. Kirkpatrick,

Secretary of the Commission.

NOTE: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Commission Voting Summary, Chairman's Statement, and Commissioners' Statements

Appendix 1 – Commission Voting Summary

On this matter, Chairman Massad and Commissioners Wetjen, Bowen, and Giancarlo voted in the affirmative. No Commissioner voted in the negative.

Appendix 2 – Statement of Chairman Timothy G. Massad

Today the Commission voted unanimously to issue a proposal on the cross-border application of our previously proposed rules on margin for uncleared swaps. I thank my fellow commissioners for their work and input on this proposal, and I also want to thank our staff for their hard work.

The proposed rule on margin for uncleared swaps, which we issued last fall, is one of the most important rules for the regulation of the over-the-counter swaps market.

That is because there will always be a large part of the swaps market that is not cleared through central counterparties. Although we are mandating clearing for certain swaps, we should not mandate clearing for all swaps. Some products are not appropriate for such a mandate because of their risk or liquidity characteristics.

Margin can be an effective tool for addressing counterparty credit risk arising from uncleared swaps. Our rule will make sure that registered swap dealers post and collect margin in their transactions with other registered swap dealers and financial institutions that are above certain thresholds. That helps lower the risk to the financial system and the overall economy. I also note that the requirements do not apply to commercial end users.

We saw what happened in 2008 when there was a build-up of excessive risk in bilateral swaps. That risk intensified and accelerated the financial crisis like gasoline poured on a fire. And that crisis cost our economy eight million jobs and untold suffering for American families.

Moreover, we saw how that risk could be created offshore, outside our borders, but still jeopardize our financial stability and our economy.

The excessive swap risk taken on by AIG was initiated from its overseas operation. In order to prevent the failure of AIG, our government had to commit over $180 billion.

We got all that money back, but that is a painful example of why the cross-border application of the margin rule is important.

The proposal we are issuing today addresses the possibility that risk created offshore can flow back into the U.S. And so it applies to activities of non-U.S. swap dealers that are registered with us. At the same time, our proposal recognizes the importance of harmonizing rules with other jurisdictions.

If a transaction by an offshore swap dealer is guaranteed by a U.S. person, such as the parent of the dealer, the risk of that transaction can flow back into the U.S. But the same can occur even if the transaction is not guaranteed by the U.S. parent. Our proposal addresses that. By doing so, I believe our proposal is a good way to address the risk that can arise from uncleared swaps in that situation.

The proposal draws a line as to when we should take this offshore risk into account that is both reasonable and clear. The line we are proposing is this: if the financial results and position of the non-U.S. swap dealer are consolidated in the financial statements of the U.S. parent, then we should take that into account, whether or not there is an explicit guarantee.

This is how the proposal works: U.S. swap dealers would be required to comply with the rule in all their transactions, but in their transactions with certain non-U.S. counterparties, they would be entitled to substituted compliance with respect to margin they post, but not the margin they collect. Non-U.S. swap dealers whose swap obligations are guaranteed by a U.S. person would be treated the same way. Substituted compliance would be available in the case of the laws of those jurisdictions which we have deemed comparable.

For non-U.S. swap dealers registered with us, whose obligations are not guaranteed by a U.S. person, they must still comply, but they would be entitled to substituted compliance to a greater extent. Generally, they could avail themselves of full substituted compliance unless the counterparty was a U.S. swap dealer or a swap dealer guaranteed by a U.S. person. And, transactions between a non-U.S. swap dealer (but not conducted through its U.S. branch) and a non-U.S. counterparty would be excluded from the margin rules, if neither party's obligations under the relevant swap are guaranteed by a U.S. person nor consolidated in the financial statements of its U.S. parent.

Limiting the exclusion from our rule to only those transactions where neither party is guaranteed or consolidated with a U.S. person helps address the concern that there is risk to the U.S. even if there is no explicit guarantee.

Lastly, when foreign banks conduct their swaps business within the U.S. through their branches located in the U.S., in direct competition with U.S. swap dealers, the exclusion would not apply. However, U.S. branches would be eligible for substituted compliance, which would reduce the potential for conflicts with foreign jurisdictions.

The broad scope of substituted compliance recognizes that we must work together with other jurisdictions to regulate this market, and we should design our rules to avoid conflict and duplication as much as possible. And the proposal may reduce competitive disparities that would otherwise result from different sets of rules applying to swap dealers engaged in essentially the same activity.

The proposal we are making today is very similar to the approach proposed last fall by the prudential regulators. That is appropriate, because the law requires us and the prudential regulators to harmonize our margin rules as much as possible. It also makes sense when you look at the composition of the registered swap dealers. There are approximately 100 swap dealers registered with us. Approximately 40 of those will be subject to the margin rules of the prudential regulators, while approximately 60 will be subject to our rules. About two thirds of those 60 swap dealers that will be subject to our margin rule have affiliates who will be subject to the margin rules of the prudential regulators. For example, of the approximately 60 swap dealers subject to our margin rules, over half are subsidiaries of just five major U.S. bank holding companies. Each of those large bank holding companies has other subsidiaries that are, subject to the margin rules of the prudential regulators. Therefore, if our margin rules are substantially different from the margin rules of the prudential regulators, then we have created incentives for firms to move activity from one entity to another solely to take advantage of potential differences in the rules. That is an outcome we should try very hard to avoid.

We also wish to coordinate our rules with the margin rules of other jurisdictions. That is why our proposal today provides for substituted compliance. In addition, at my direction, our staff is actively engaged with their counterparts in other jurisdictions to try to harmonize the rules as much as possible. Although much work remains to be done, and the Commission must take final action, I am hopeful that our final rules will be similar on many critical issues to those currently being developed in other major jurisdictions.

I would also like to say a word about our Cross-Border Guidance, which discussed how the Commission would generally apply Dodd-Frank requirements to cross-border swap activities. In doing so, the Commission recognized that the market is complex and dynamic and that a flexible approach is necessary. As stated in the Guidance, "the Commission will continue to follow developments as foreign regulatory regimes and the global swaps market continue to evolve. In this regard, the Commission will periodically review this Guidance in light of future developments." That is essentially what we are doing here. With each area of our rules, the implications of cross-border transactions for our policy objectives may vary. Margin for uncleared swaps is intended to protect the safety and soundness of swap dealers and ultimately, to ensure the stability of the U.S. financial system. Therefore, it is appropriate to take into account whether that risk flows back into the United States by virtue of a guarantee by a U.S. person, or financial consolidation with a U.S. person. But the approach we are proposing today for margin may not be appropriate with respect to other areas of regulation – such as swaps reporting or trading.

In conclusion, I believe the approach we are proposing today combines the best elements of the various approaches proposed last fall. It strikes the right balance between the Commission's supervisory interest in ensuring the safety and soundness of registered swap dealers and the need to recognize principles of international comity and reduce the potential for conflict with foreign regulatory requirements.

Appendix 3 – Statement of Commissioner Mark P. Wetjen

Today's release lays out a proposed framework for the application of the commission's margin rules to un-cleared swaps (the "Margin Rule") in cross-border transactions. Interestingly, the release states that there was no consensus among those who filed comments in response to the commission's Advance Notice of Proposed Rulemaking ("ANPR") last fall, which laid out three alternative, cross-border approaches: the Guidance Approach, the Prudential Regulators' Approach, and the Entity Approach. To the extent, therefore, that the release was designed to identify a consensus view concerning which of these three approaches was best, it failed.

The comment letters, however, provided a great deal of useful discussion that has aided the commission's thinking about the extra-territorial application of its rules. Ultimately, the agency was guided by those comments to propose today an approach that is essentially an entity approach, but because of more availability of substituted compliance, appears most similar to the Prudential Regulators' Approach in terms of its practical implementation.

I am comfortable supporting today's release, but for the reasons discussed below, continue to harbor some doubts as to whether we have selected the approach that best balances the commission's interests in protecting the financial system and U.S. taxpayers, meeting its statutory mandate to preserve an appropriate competitive landscape for participants in the global swaps market, and adopting policies whose costs to those affected do not exceed their benefits.[1]

The Commission's Responsibilities Regarding the Margin Rule

To begin, it is important to understand the scope of the commission's responsibilities with respect to implementing and enforcing the Margin Rule. As was made plain by the proposal seeking comment on the Margin Rule released last fall, the rulemaking is one of the most important component parts of the risk-focused requirements under Title VII of Dodd-Frank. The statute divides up responsibilities for implementing and enforcing the Margin Rule among this commission, the U.S. prudential regulators, and the Securities and Exchange Commission. Those responsibilities are weighty, requiring, among others, the review and approval of margin methodologies submitted by the covered swap entities under each authority's jurisdiction.

As of today, five U.S. bank holding companies regulated by the Board of Governors of the Federal Reserve System (the "Board") have 17 U.S. registered swap dealers that would fall exclusively within the CFTC's jurisdiction for margin purposes. These same five U.S. bank holding companies have 15 non-U.S. registered swap dealers that would fall exclusively within the CFTC's jurisdiction for margin purposes (the "U.S. Foreign-Affiliate Dealers"). That is a total of 32 registered swap dealers that the commission would have to oversee, supervise, and enforce compliance with respect to the Margin Rule.

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[1] See 7 U.S.C. 19(a).

There are another three non-U.S. parent entities regulated by the Board, which altogether have four entities registered with the commission as swap dealers, due to the level of swap-dealing activity they engage in with U.S. counterparties ("Non-U.S. Dealers"). There are only three non-U.S. registered swap dealers that do not have a parent entity regulated by the Board and that would fall exclusively within the CFTC's jurisdiction for margin purposes (the "Truly Foreign Dealers"), or just a fraction of the number of firms that are either based in the U.S. or controlled by a U.S. regulated parent. This brings to 39 the total number of swap dealers whose un-cleared swap activities would be subjected to the commission's Margin Rule.

The commission's regulatory interests in each of these categories of registered swap dealers is different, notwithstanding the fact the commission has responsibility over all of them. In most respects, the commission (and other U.S. policymakers and swap-market stakeholders) should be primarily concerned about the U.S. Foreign-Affiliate Dealers when thinking through and developing a cross-border framework to determine when these entities should follow U.S. law. This statement is based on the fact that concerns about risk importation into the U.S. are much lower, relatively speaking, when it comes to the activities of the Non-U.S. Dealers and Truly Foreign Dealers (none of the Non-U.S. Dealers or Truly Foreign Dealers would appear to meet the control test under the prudential regulators' September 2014 margin rule proposal). Instead, these latter categories of swap dealers raise different issues related to the commission's mandates to enhance market integrity and promote fair competition.[2]

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[2] See section 3(b) of the Commodity Exchange Act ("CEA"), 7 U.S.C. 5(b).

Appropriately, when Non-U.S. Dealers and Truly Foreign Dealers face other non-U.S. counterparties, they are excluded from having to comply with the Margin Rule under the proposal, so long as neither the registered swap dealer's nor its counterparty's obligations benefit from a guarantee by a U.S. person. Under the Guidance Approach, these Non-U.S. Dealers and Truly Foreign Dealers would be excluded from the Margin Rule as well, so long as neither the swap dealer's nor its counterparty's obligations benefit from a guarantee by a U.S. person.

I review the scope and weight of these responsibilities here because the context to deciding how much supervisory responsibilities to assert over the cross-border swap activities of entities located outside of the U.S. is important, both in understanding the practical implications of claiming those responsibilities as well as the potential effect on international comity. The review of the different categories of swap-dealer registrants also makes it clear to me that to pursue the Entity Approach without allowing substituted compliance, as some commenters suggested, is neither necessary for the commission to meet its statutory responsibilities nor advisable, not to mention impractical.

When the commission voted on the ANPR, I noted the potential benefits of the proposal set forth by the Prudential Regulators' Approach, which would effectively apply the margin rule as an entity-level rule with certain exclusions for foreign swap activities. At that time, however, I expressed my view that applying the margin rule as a transaction-level requirement under the Guidance Approach was the better option. In part, that view was shaped by the practical reality that it would be difficult for the commission to meet its challenge to supervise U.S. swap dealers' compliance with the margin rule, let alone the activities of the U.S. Foreign-Affiliate Dealers and Truly Foreign Dealers.

<u>Policy Advantages of Today's Proposal</u>

As it relates to the Truly Foreign Dealers, compliance obligations under today's proposal would be effectively the same as under the cross-border guidance, so presumably no new burdens or competitive considerations would be created here for those firms (as discussed above). Additionally, as it relates to the U.S. Foreign-Affiliate Dealers (some of which have affiliates not supervised by the commission and engaged in swap activities), today's proposal could dis-incentivize firms from moving swap activity transacted by an affiliated entity regulated by a U.S. prudential regulator, into the U.S. Foreign-Affiliate Dealer. Such a market response is conceivable given the fact there could be different compliance obligations under the proposal as compared to the Guidance Approach depending on whether the U.S. Foreign-Affiliate Dealer is a Foreign Consolidated Subsidiary, and whether the dealer's un-cleared swap is supported by a guarantee. Presumably, there is swap activity of some of these U.S. Foreign-Affiliate Dealers that would be required to comply with the Margin Rule under today's proposal, that would not have been subjected to the Margin Rule under the Guidance Approach.

U.S. domestic regulators should not knowingly create an opportunity for affiliates within a U.S. bank holding company to move swap activity from one affiliate to another for no other reason than to avoid application of U.S. law (even if there are legitimate policy reasons that U.S. law would not apply). Indeed, this is why the Dodd-Frank Act requires the relevant agencies implementing the Margin Rule to coordinate their efforts as closely as possible. Knowingly allowing such a result also would be inconsistent with the commission's statutory duty to promote fair competition.[3]

Similarly, the commission should be careful to avoid adopting a significantly different cross-border approach from the U.S. prudential regulators if it would incentivize affiliates of U.S. Foreign-Affiliate Dealers to move their swap activity to the U.S. Foreign-Affiliate Dealer in order to exploit the relative dearth of resources available to the commission for supervising and enforcing compliance. The CFTC currently is under-staffed. Meeting the challenge to monitor compliance with the complex and technical requirements of the Margin Rule as it applies to the swap activity conducted by U.S. Foreign-Affiliate Dealers today would be difficult. A cross-border approach that is substantively similar to the Prudential Regulators' Approach may facilitate the commission in meeting its supervisory challenge.

Relatedly, I am also cognizant of market efforts to develop a standard initial-margin methodology for un-cleared swaps, which I believe would be supported by the hybrid approach set forth in today's proposal. I am in favor of these efforts because the use of a standard initial margin methodology has the potential to reduce dispute burdens by using a common approach for reconciliation, promote the efficient use of limited market resources, and enhance fairness and transparency in the global OTC derivatives markets. As such, the commission should, if possible, avoid adopting a cross-border approach that would discourage the development of a standard initial-margin methodology, or would otherwise encourage the development of different margin methodologies across affiliated entities and/or the broader marketplace. This outcome

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[3] See section 3(b) of the Commodity Exchange Act ("CEA"), 7 U.S.C. 5(b).

would complicate the jobs of all supervisory authorities involved, perhaps especially the U.S. prudential regulators.

Policy Advantages of the Guidance Approach

Generally speaking, the commission in adopting its cross-border guidance intended to strike a reasonable balance in assuring that the swaps markets were brought under the new regulatory regime as directed by Congress and consistent with section 2(i) of the CEA.[4] We should not depart from those important policy judgments without a compelling reason to do so.

One advantage of the Guidance Approach, therefore, is that it would harmonize the commission's own cross-border policies as they related to both cleared and un-cleared swap activity. Because many firms under the commission's jurisdiction have incurred significant costs by building systems and practices designed to follow the commission's cross-border guidance, overall costs to registered swap dealers might be lower if the Guidance Approach were adopted, which obviously is relevant to the commission's mandate to consider the benefits and costs of its policies. But of course, with harmony of the commission's cross-border policies comes disharmony with the U.S. prudential regulators.

Another advantage to the Guidance Approach is that it provides a more elegant way for U.S. Foreign-Affiliate Dealers, Non-U.S. Dealers and Truly Foreign Dealers to comply with their regulatory obligations when the commission has made a substituted-compliance determination regarding another jurisdiction's margin requirements. Under the Guidance Approach, an affected swap dealer's obligations to post margin and collect

[4] See section 2(i) of the CEA, 7 U.S.C. 2(i).

margin would follow the same law or regulation of another jurisdiction if the commission had made such a substituted-compliance determination; which is to say, margin payments going in both directions would follow the same set of rules. This outcome has the added benefit of being consistent with the Basel Committee on Banking Supervision's ("BCBS") and the Board of the International Organization of Securities Commissions' ("IOSCO") final margin policy framework for margin requirements for non-centrally cleared derivatives (the "BCBS-IOSCO Framework"), which states that when a transaction is subject to two sets of rules, the regulators should endeavor to harmonize their rules to the extent possible.[5]

Given the relatively broad agreement among key jurisdictions about how the global framework for margin requirements ought to be structured, such a result should be an acceptable way to address any remaining concerns about risk from overseas activity transferring back to the U.S. Again, those concerns primarily would arise from the un-cleared swap activities of the U.S. Foreign-Affiliate Dealers. The proposal, on the other hand, would require a non-U.S. covered swap entity guaranteed by a U.S. person to follow U.S. initial margin rules, but only permit substituted compliance for the ***posting*** of initial margin when such non-U.S. covered swap entity trades with a non-U.S. counterparty.

In this scenario, it would be possible for two separate laws to apply to the same transaction. Under this framework, I question whether market participants engaging in

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[5] See BCBS and IOSCO, Margin requirements for non-centrally cleared derivatives (Sept. 2013) at 22, available at http://www.bis.org/publ/bcbs261.pdf. The BCBS-IOSCO Framework also provides that regulators should recognize the equivalence and comparability of their respective rules and apply only one set of rules to the transaction.

un-cleared swaps would have the necessary legal certainty as to which margin requirements they would face. While this framework is proposed ostensibly to help ensure the safety and soundness of covered swap entities and to support the stability of the U.S. financial markets, these goals arguably will be accomplished only if the framework is workable. The Guidance Approach would arguably provide greater certainty as to the law applicable to a particular transaction, and render the commission's policy more consistent with the BCBS-IOSCO Framework.[6]

To that end, I look forward to hearing additional comments on whether a swap between a non-U.S. covered swap entity and a non-U.S. counterparty should receive substituted compliance for the entire swap, rather than subject the swap to both U.S. and foreign margin requirements. Ideally, such comments would give the commission a better understanding of the feasibility of designing systems to assist the covered swap entity comply with two separate margin requirements for the same transaction.

To the degree that the commission should be concerned about deferring to other regulators to supervise the posting and collecting of margin for un-cleared swaps – as it would in the wake of a substituted-compliance determination – context again is important to remember here. As mentioned, there is relatively broad agreement among key jurisdictions about how the global framework for margin requirements should be structured, as a result of the issuance of the BCBS-IOSCO Framework. It's equally important to remember that the commission's capital rule is treated as an entity-level rule

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[6] See id.

under the commission's cross-border guidance.[7] As I stated when the commission released its proposal for the Margin Rule, credit risks not addressed through the Margin Rule could be addressed, at least in part, through indirect capital requirements at the holding company level, and direct capital requirements at the registrant level for those swap dealers relying on substituted compliance (or otherwise).

Yet another advantage to the Guidance Approach is that it might better avoid further diminishments to liquidity that the marketplace has experienced recently, as well as better avoid regulatory market fragmentation that materialized after the commission's new swap-execution framework went into effect. Several commenters expressed strong concerns that the Entity Approach could further fragment the swaps markets and impair liquidity, promote regulatory arbitrage, and place the foreign affiliates of U.S. entities at a competitive disadvantage beyond the circumstances they face in the cleared swap environment under the commission cross-border guidance. I have recognized and spoken about market fragmentation for years, and so do not take lightly such concerns being raised again in this context.

Clarifications of the Commission's Definition of "Guarantee" and "U.S. Person"

The proposal includes two important clarifications for market participants that I would like to acknowledge. First, I am supportive of the proposed removal of the U.S. majority-ownership prong from the U.S. person definition. For certain types of funds, it is extremely difficult for advisors or administrators to accurately determine whether, and how many of, the beneficial owners of fund entities within the fund structure are U.S.

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[7] See Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 FR 45292 (July 26, 2013).

persons. Given this complexity and the other elements of the U.S. person definition that would capture those funds that have a substantial nexus to the U.S. markets, I believe this exclusion is necessary and appropriate. I also support the release's proposed definition of "guarantee". This clearer definition will help market participants better identify those transactions that raise or implicate greater supervisory interest by the commission.

Conclusion

The questions asked in this proposal are intended to solicit comment in hopes of further clarifying the most appropriate way for the commission to meet its regulatory objectives as well as finding more consensus on the important issues raised in the release. As discussed above, I am open to the approach taken in this proposal and recognize its merits. I look forward to seeing whether comments filed in response to today's release can further build the case for the commission adopting the proposal, rather than the Guidance Approach.

Appendix 4 – Concurring Statement of Commissioner Sharon Y. Bowen

I'm pleased to support this new proposed rule on cross-border application of uncleared margin requirements for swap dealers and major swap participants. Margin requirements for uncleared swaps, needless to say, are a core piece of the new regulatory regime we are establishing as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

It is imperative that we get all aspects of our margin requirements right, and that includes getting the cross-border element of the requirements right. The swaps market is a global one - the market has organically evolved to rely on the ability of U.S. entities to trade with European entities as a matter of course. It is incumbent on us that our rules not severely restrict this flow of commerce, just as it is incumbent on us that our rules provide rigorous regulations on this market for the protection of investors, consumers, and the broader financial system.

To that end, I look forward to receiving comments on this proposal from a wide swath of stakeholders, from market participants to financial reform advocates. I hope we will receive comments on whether this rule is workable, whether it is sufficiently robust, and what changes would make the rule more effective on both of those metrics.

Appendix 5 – Statement of Commissioner J. Christopher Giancarlo

The Commission's proposal for the cross-border application of margin requirements for uncleared swaps is a highly complicated labyrinth. I look forward to the jolt to U.S. economic growth that will occur in the 3rd quarter of 2015 as a result of the thousands of billable hours that will be expended by lawyers and other professionals, who will have to read, interpret and respond to this tangled regulatory construct.

I have many concerns and questions regarding the proposal, including:

1. the shift from the transaction-level approach set forth in the July 2013 Cross-Border Interpretive Guidance and Policy Statement[1] ("Guidance") to a hybrid approach and what this means for the status of the Guidance moving forward;
2. the revised definitions of "U.S. person" (defined for the first time in an actual Commission rule) and "guarantee" and how these new terms will be

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[1] Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292 (Jul. 26, 2013).

interpreted and applied by market participants across their entire global operations;

3. the scope of when substituted compliance is allowed; and
4. the practical implications of permitting substituted compliance, but disallowing the exclusion from CFTC margin requirements ("Exclusion") for non-U.S. covered swap entities ("CSEs") who qualify as Foreign Consolidated Subsidiaries.

My concerns extend to the standards set forth for determining comparability. An appropriate framework for the cross-border application of margin requirements for uncleared swaps is essential if we are to preserve the global nature of the swaps market. Congress recognized this when it instructed the CFTC, the SEC and the prudential regulators to "coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation … of swaps."[2] Towards that end, representatives of more than 20 regulatory authorities, including the CFTC, participated in consultations with the Basel Committee on Banking Supervision ("BCBS") and the Board of the International Organization of Securities Commissions ("IOSCO"), which resulted in the issuance of a final BCBS-IOSCO framework in September 2013 that establishes minimum margin standards for uncleared swaps ("BCBS-IOSCO framework").[3]

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[2] 15 U.S.C. 8325(a) (added by section 752 of the Dodd-Frank Act).
[3] See Margin Requirements for Non-centrally Cleared Derivatives (Sep. 2013), available at http://www.bis.org/publ/bcbs261.pdf, revised Mar. 2015, available at http://www.bis.org/bcbs/publ/d317.pdf.

Element seven of the BCBS-IOSCO framework discusses the cross-border application of margin requirements and stresses the importance of developing consistent requirements across jurisdictions to ensure that implementation at a national jurisdictional level is appropriately interactive:

> that is, that each national jurisdiction's rule is territorially complementary such that (i) regulatory arbitrage opportunities are limited, (ii) a level playing field is maintained, (iii) there is no application of duplicative or conflicting margin requirements to the same transaction or activity, and (iv) there is substantial certainty as to which national jurisdiction's rules apply. When a transaction is subject to two sets of rules (duplicative requirements), the home and the host regulators should endeavor to (1) harmonize the rules to the extent possible or (2) apply only one set of rules, by recognizing the equivalence and comparability of their respective rules.[4]

Regulatory authorities in major financial centers continue to collaborate in the development of their rules and I commend CFTC staff for their continued dialogue with fellow domestic and foreign regulators. Nevertheless, there are bound to be differences across jurisdictions in the final rule sets that are ultimately adopted. Comparability determinations allowing for substituted compliance with the margin requirements of foreign jurisdictions will be essential to achieving a workable cross-border framework. I am concerned that the

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[4] Id. at 23.

standards for making comparability determinations outlined in the Commission's proposal may be too restrictive.

The Commission states that it will employ an outcome-based comparability standard focusing on whether the margin requirements in a foreign jurisdiction achieve the same regulatory objectives as the CFTC's margin requirements and will not require specific rules identical to the Commission's rules. The Commission states further, however, that it will make its outcome-based determinations on an element-by-element basis that will include, but not be limited to, analyzing: (i) the transactions subject to the foreign jurisdiction's margin requirements; (ii) the entities subject to the foreign jurisdiction's margin requirements; (iii) the methodologies for calculating the amounts of initial and variation margin; (iv) the process and standards for approving models for calculating initial and variation margin models; (v) the timing and manner in which initial and variation margin must be collected and/or paid; (vi) any threshold levels or amount; (vii) risk management controls for the calculation of initial and variation margin; (viii) eligible collateral for initial and variation margin; (ix) the requirements of custodial arrangements, including rehypothecation and segregation of margin; (x) documentation requirements relating to margin; and (xi) the cross-border application of the foreign jurisdiction's margin regime.

As proposed, the Commission will not be assessing whether the foreign authority's margin regime as a whole meets the broad regulatory objectives of requiring margin for uncleared swaps.[5] Rather, in looking at each element (and any other factor not included in the foregoing list) the Commission may determine that a foreign regime is comparable as to some elements, but not others, in which case substituted compliance might be allowed, for example, with respect to the methodologies for calculating initial and variation margin, but not for the eligible collateral.

Depending on how it is put into practice, this element-by-element approach may be difficult to distinguish from the rule-by-rule analysis the Commission claims to eschew. We have seen this before when the Commission made its comparability determinations for certain foreign countries regarding certain transaction-level requirements for swap dealers and major swap participants.[6] There, the Commission made its determinations on a "requirement-by-requirement" basis, rather than on the basis of the foreign regime as a whole.[7] Former Commissioner Scott O'Malia observed in that instance that this was a "rule-by-rule" analysis, which was contrary to the recommendations of the OTC Derivatives Regulators Group and afforded only limited substituted compliance relief.[8] Will our "element-by-element" analysis be any different than the "requirement-by-requirement" method the Commission employed then?

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[5] The regulatory objectives of requiring margin for uncleared swaps, as stated in the Dodd-Frank Act, are to help insure the safety and soundness of the swap dealer or major swap participant, the financial integrity of the markets and the stability of the U.S. financial system. Section 4s(e)(3)(A), (C), 7 U.S.C. 6s(e)(3)(A), (C).

[6] See, e.g., Comparablility Determination for the European Union: Certain Transaction-Level Requirements, 78 FR 78878 (Dec. 27, 2013).

[7] Id. at 78881.

[8] Id. at 78889.

I fear that the proposed element-by-element approach will be outcome-based in name only. In a perfect world all G-20 countries will adopt comparable margin requirements, but we cannot let the perfect be the enemy of the good. For substituted compliance to work, we must focus on broad objectives, not specific requirements.

I am also troubled by the provision of the proposed rule that would not permit swaps executed "through or by" a U.S. branch of a non-U.S. CSE to qualify for the Exclusion for non-U.S. CSEs who qualify as Foreign Consolidated Subsidiaries. Under the proposal, uncleared swaps entered into by a non-U.S. CSE with a non-U.S. person counterparty (purely foreign-to-foreign swaps), where neither counterparty is a Foreign Consolidated Subsidiary or guaranteed by a U.S. person, would be excluded from the Commission's margin rules. The Exclusion is not available, however, if the swap is executed "through or by" the U.S. branch of a non-U.S. CSE.[9] The request for comment following this discussion asks how the Commission should determine whether a swap is executed "through or by" a U.S. branch and suggests using the same analysis used in the Commission's Volcker Rule, which required that personnel that "arrange, negotiate, or execute" a purchase or sale conducted under the exemption for trading activity of a foreign banking entity must be located outside the U.S.[10]

Prior to its appearance in the Commission's final Volcker Rule this concept appeared in a hastily issued, November 2013 Staff Advisory 13-69 (sometimes referred to in the industry as the "elevator rule") that imposed swaps transaction rules on trades

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[9] I note that the "through or by" language appears in the preamble to the rule, not the rule text.

[10] See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 79 FR 5808, 5927 & n.1526 (Jan. 31, 2014).

between non-U.S. persons whenever anyone on U.S. soil "arranged, negotiated, or executed" the trade.[11] The effective date of this Staff Advisory has been delayed four times.[12] As I have stated before, the elevator rule is causing many overseas trading firms to consider cutting off all activity with U.S.-based trade support personnel to avoid subjecting themselves to the CFTC's flawed swaps trading rules. The Staff Advisory, if it goes into effect, will jeopardize the role of bank sales personnel in U.S. financial centers like Boston, Charlotte, Chicago, New Jersey and New York. It will likely have a ripple effect on technology staff supporting U.S. electronic trading systems, along with the thousands of jobs tied to the vendors who provide food services, office support, custodial services and transportation for the U.S. financial series industry. With this proposal, rather than recognizing the myriad of problematic issues arising from the Staff Advisory, the Commission is proposing to expand its scope from trading rules to margin rules.

Despite my many questions and concerns, I support issuing the proposed rule only so that the public may provide thorough analysis and thoughtful comment. My vote to issue the proposal for public comment should not signal, however, my agreement with it. I look forward to reviewing public comment.

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[11] CFTC Staff Advisory No. 13-69 (Nov. 14, 2013), available at http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/13-69.pdf.

[12] CFTC Letter No. 14-140, Extension of No-Action Relief: Transaction-Level Requirements for Non-U.S. Swap Dealers (Nov. 14, 2014), available at http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-140.pdf.