



Commodity Futures Trading Commission

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May 24, 2016

Fact Sheet – Final Rule Regarding the Cross-Border Application of the Margin Requirements

The Commodity Futures Trading Commission (CFTC or Commission) is adopting a rule for the application of the Commission's margin requirements to cross-border transactions (Final Rule).

Overview of the Final Rule

The Final Rule establishes a cross-border approach to the CFTC's rule setting margin requirements for the uncleared swaps of registered swap dealers or major swap participants that are not subject to the margin requirements of the prudential regulators (Covered Swap Entities or CSEs). Certain uncleared swaps are eligible for substituted compliance or are excluded from the Commission's margin rule based on the counterparties' nexus to the United States relative to other jurisdictions. The Final Rule is closely aligned with the cross-border margin requirements already adopted by the prudential regulators.

On July 14, 2015, the Commission published a proposed rule to address the cross-border application of the Commission's margin requirements on uncleared swaps of covered swap entities. On January 6, 2016, the Commission published final margin requirements for CSEs (margin rule).

Application of the Commission's Margin Rule to U.S. CSEs

Under the Final Rule, the Commission's margin rule applies to all uncleared swaps of a U.S. CSE. By virtue of their being domiciled or organized in the United States, U.S. CSEs give rise to greater supervisory interests relative to other CSEs. However, substituted compliance is available with respect to initial 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.

Application of the Commission's Margin Rule to Non-U.S. CSEs

The extent to which the Commission's margin rule applies to a non-U.S. CSE depends on whether the non-U.S. CSE's swap obligations are guaranteed by a U.S. person or its financial statements are consolidated with those of a U.S. ultimate parent entity in accordance with U.S. generally accepted accounting principles. The term "ultimate parent entity" refers to an entity that is not controlled by any other entity in the consolidated group.

Where a non-U.S. CSE's obligations under the relevant swap are guaranteed by a U.S. person ("U.S. Guaranteed CSE"), the swap is treated the same as an uncleared swap of a U.S. CSE.

Non-U.S. CSEs whose obligations under the relevant swap are not guaranteed by a U.S. person, but whose financial statements are included in those of a U.S. ultimate parent entity ("Foreign Consolidated Subsidiary" or "FCS") are treated the same as other non-U.S. CSEs and thus are broadly eligible for substituted compliance, except that Foreign Consolidated Subsidiaries are not entitled to an exclusion from the margin rule (as described below).

Exclusion of Certain Uncleared Swaps from the Commission's Margin Rule

Under the Final 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) is excluded from the Commission's margin rule, 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. However, a non-U.S. CSE is not eligible to rely on this exclusion (and therefore, is required to collect initial margin on the market-facing trade) if the risk from the trade is transferred to a U.S. covered swap entity (or U.S. Guaranteed CSE) through inter-affiliate trade(s) and the market-facing trade is not subject to comparable initial margin collection requirements in its home jurisdiction.

Substituted Compliance

As discussed above, the Final Rule permits a U.S. CSE or a non-U.S. CSE, as applicable, to avail itself of substituted compliance (to the extent applicable under the Final 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.

The comparability standard in the Final Rule is outcome-based with a focus on whether the margin requirements in the foreign jurisdiction achieve the same regulatory objectives as the margin requirements in the Commodity Exchange Act.

The Final Rule sets forth a process for requests for comparability determinations, including eligibility and submission requirements, as well as the standard of review that will apply to Commission determinations.

Definition of "U.S. Person"

Generally speaking, the Final Rule defines the term "U.S. person" 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. The 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. The Final Rule does 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). In addition, the definition of "U.S. person" 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.

Definition of "Guarantee"

The Final Rule defines 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 Final 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), 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. To address concerns about potential evasion, the term "guarantee" also encompasses any arrangement pursuant to which the guarantor itself has rights of recourse against a third party with respect to the counterparty's obligations under the uncleared swap.

Special Provision for Non-Segregation Jurisdictions

In jurisdictions where compliance with custodial arrangement requirements is impracticable, FCSs and foreign branches of U.S. CSEs are permitted to engage in swaps with non-U.S. counterparties that are not guaranteed by a U.S. person, without complying with either (1) the requirement to post initial margin or (2) the custodial arrangement requirements that pertain to initial margin collected by a CSE, subject to a 5% limit that applies separately to each of four broad risk categories.

Special Provision for Non-Netting Jurisdictions

In jurisdictions that do not have netting arrangements that comply with the Commission's margin rule, qualifying CSEs would be permitted to engage in uncleared swaps if they treat swaps under the netting agreement on a gross basis in determining the amount of margin they collect (and would be permitted to net those swaps in determining the amount of margin they post, in accordance with the netting provisions of the margin rule).