



# Commodity Futures Trading Commission

## Office of Public Affairs

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## Proposed Rule Regarding the Cross-Border Application of the Margin Requirements

The Commodity Futures Trading Commission (“CFTC” or “Commission”) is proposing a rule for the application of the Commission’s margin requirements to cross-border transactions (“Proposed Rule”).

### Overview of the Proposed Rule; Use of Hybrid, Firm-Wide Approach

In an Advance Notice of Proposed Rulemaking, the Commission sought comment on alternative approaches to the cross-border application of margin requirements—a transaction-level approach that is consistent with the Commission’s cross-border guidance (“Guidance Approach”); an approach that is consistent with the approach proposed by the Prudential Regulators (the “Prudential Regulators’ Approach”); and (3) an Entity-Level Approach that would apply margin rules at the entity-level, without exclusion.

The approach taken in the Proposed Rule is a hybrid 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 CFTC-registered swap dealer or major swap participant that does not have a Prudential Regulator (referred to as a “Covered Swap Entity” or “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). The Proposed Rule is designed to effectively address the risk posed to the safety and soundness of CSEs, while reducing the potential for conflicts with the relevant foreign jurisdiction’s margin requirements.

### Application of the Commission’s Margin Rules to U.S. CSEs

Under the Proposed Rule, the Commission’s margin rules would apply to all uncleared swaps of a U.S. CSE, with no exclusions. However, substituted compliance would be 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. 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 an equal or greater interest in the collection of margin by the non-U.S. counterparty. This approach differs from the Guidance Approach, where a U.S. CSE would not be eligible for substituted compliance under any circumstances.

### Application of the Commission’s Margin Rules to Non-U.S. CSEs

The extent to which the Commission’s margin rules would apply 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 an ultimate U.S. parent entity, such swap would be treated the same as an uncleared swap 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.

A non-U.S. CSE 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 "FSC") are treated the same as any other non-U.S. CSEs (who are neither guaranteed nor consolidated with a U.S. parent entity) and thus are broadly eligible for substituted compliance, **except** that Foreign Consolidated Subsidiaries would not be entitled to an exclusion from the margin rules (the "Exclusion", as described below). The Exclusion would not be available for swaps with a Foreign Consolidated Subsidiary because its swap activities have a direct impact on the financial position, risk profile, and market value of the U.S. ultimate parent entity that consolidates its financial statements, which could have a potential spill-over effect on the U.S. financial system.

### **Exclusion of Certain Uncleared Swaps from the Commission's Margin Rules**

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.

### **Substituted Compliance**

As discussed, 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.

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 margin requirements in the Commodity Exchange Act. 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.

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

### **Definition of "U.S. Person"**

Generally speaking, the Proposed Rule would define 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 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. 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). In addition, 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.

### **Definition of “Guarantee”**

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 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), 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.