

## [Securities Regulation Daily Wrap Up, TOP STORY—CFTC adopts cross-border approach for uncleared swaps margin requirements, \(May 24, 2016\)](#)

Securities Regulation Daily Wrap Up

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In a long-anticipated rulemaking, the CFTC issued a final rule specifying how rules requiring margin for uncleared swaps transactions apply in the cross-border context. As explained in the [adopting release](#) and a [fact sheet](#), the final rule generally requires covered swaps entities (CSEs) to comply with the CFTC's margin requirements for all uncleared swaps in cross-border transactions, with a limited exclusion for certain non-U.S. CSEs. The exclusion is not available to non-U.S. CSEs that are consolidated with a U.S. parent. Importantly, the rule allows for certain substituted compliance with margin requirements in a foreign jurisdiction if the CFTC determines that the foreign jurisdiction's requirements are comparable to the CFTC's requirements.

According to the CFTC, the rule's requirements are similar to cross-border margin requirements adopted by U.S. federal banking regulators.

The Commission approved the rule in a 2-1 vote. Chairman Timothy Massad and Commissioner Sharon Bowen voted for the rule, while Commissioner J. Christopher Giancarlo dissented. The rule will become effective 60 days after publication in the Federal Register.

**Definitions.** The final rule details how the [CFTC rules on uncleared swaps margin](#), published in January 2016, apply in cross-border transactions. The rule provides definitions for key terms including "U.S. person," "Guarantee," and "Foreign Consolidated Subsidiary" or "FCS."

**General rule.** Requirements vary depending on the parties to a transaction. Generally, U.S. persons and U.S. Guaranteed CSEs are required to comply with CFTC margin requirements. However, U.S. CSEs and U.S. Guaranteed CSEs are eligible for substituted compliance regarding the requirement to post (but not the requirement to collect) initial margin, provided that the counterparty is a non-U.S. person whose obligations under the relevant swap are not guaranteed by a U.S. person.

Non-U.S. CSEs (including FCSs) whose obligations under the relevant uncleared swap are not guaranteed by a U.S. person are eligible for substituted compliance to a greater extent than U.S. CSEs and U.S. Guaranteed CSEs. Specifically, where the obligations of a non-U.S. CSE (including an FCS) under the relevant swap are not guaranteed by a U.S. person, substituted compliance is available for its uncleared swaps with any counterparty other than a U.S. CSE or a U.S. Guaranteed CSE.

**Exclusion.** An uncleared swap entered into by a non-U.S. CSE with a non-U.S. counterparty (including a non-U.S. CSE) is excluded from the Commission's margin rules, as long as neither counterparty's obligations under the relevant swap are guaranteed by a U.S. person and neither counterparty is an FCS. Uncleared swaps of a U.S. branch of a non-U.S. CSE are not eligible for the Exclusion.

**Special provisions.** The rule contains a special provision for swaps with counterparties in foreign jurisdictions where limitations in the legal or operational infrastructure of the jurisdiction make it impracticable for the CSE and its counterparty to comply with the custodial arrangement requirements in the Final Margin Rule. There is also a special provision for netting agreements with counterparties in foreign jurisdictions that do not meet the definition of an "eligible master netting agreement."

**Substituted compliance.** Under the substituted compliance provisions, CSEs may comply with comparable margin requirements in a foreign jurisdiction as an alternative means of complying with the CFTC's margin rule for uncleared swaps, to the extent the CFTC determines that the foreign jurisdiction's requirements are comparable to the CFTC's.

The Final Rule outlines a framework for CFTC comparability determinations, including eligibility and submission requirements. Eligible persons may request a comparability determination individually or collectively, for some or all of the margin requirements. The Commission will make comparability determinations on a jurisdiction-by-jurisdiction basis, and will consider certain key factors in making the determination.

The release notes that eligible CSEs may wish to coordinate with their home regulators and other CSEs in order to simplify and streamline the process. Due to the impending September 1, 2016 compliance date for the CFTC's margin rule, the CFTC encourages persons requesting a comparability determination to promptly submit their requests. Chairman Massad has asked CFTC staff to work closely with other domestic and international regulators, as well as industry participants, to aid the transition.

**Commissioner positions and reactions.** In [supporting](#) the rule, Chairman Massad emphasized that the derivatives market is global and risks created across the globe can flow back into the United States, even when a foreign subsidiary is not explicitly guaranteed by a U.S. parent. Therefore, the CFTC wants to ensure that either the CFTC rules or a comparable measure applies. Where the CFTC rules differ from that of an international regulator, the aim is to recognize and balance the interest of the foreign jurisdiction against the interest of the U.S.

In response to a question about whether the rule is overly complicated, Massad said the complexity is due to the nature of the industry, with foreign branches of U.S. banks and overseas affiliates of U.S. persons, and U.S. rules and potentially other jurisdictions' rules at issue. "The complication isn't from our rule, it's from the nature of the market," he said.

Commissioner Bowen [supported](#) the rule, despite having voted against the uncleared swaps margin rule last December because she was concerned it wasn't strong enough. Bowen said she supported the cross-border rule in order to give the market legal certainty, but cautioned that the CFTC's upcoming capital rule for swap dealers must be strong and comprehensive.

Commissioner Giancarlo [voted against](#) the rule, calling it a "muddled methodology" that may set the U.S. and E.U. on an uncertain path similar to the protracted process it took for the two jurisdictions to recognize each other's regulatory regimes for clearinghouses. In Giancarlo's view, the CFTC should focus on whether a foreign regulator's margin regime, in the aggregate, provides a sufficient level of risk mitigation in connection with the execution of uncleared swaps.

Better Markets [called](#) the rule "a good step in the right direction" that adequately captures the transactions of many foreign affiliates. However, the public interest group cautioned that margin rules alone are not enough to address the risk of contagion, and the CFTC must address clearing and swap execution facility mandates that the group believes are being widely evaded.

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