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# U.S. Bank Regulators' Uncleared Swap Margin, Capital and Segregation Rules

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**Davis Polk**

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# Introduction

- U.S. banking regulators (OCC, Federal Reserve, FDIC, FCA and FHFA) have [finalized](#) uncleared swap\* margin, capital and segregation requirements. These rules apply to swap entities\*\* that are prudentially regulated by a U.S. banking regulator (“**covered swap entities**” or “**CSEs**”).
  - The [CFTC](#) and [SEC](#) have proposed, but not yet finalized, uncleared swap margin and capital rules that would apply to swap entities not prudentially regulated by a U.S. banking regulator.
- The U.S. banking regulators also adopted [interim final margin rules](#) providing an exemption for uncleared swaps entered into for hedging purposes by qualifying commercial end users, small banks, treasury affiliates acting as agent and certain cooperative entities.
- The U.S. banking regulators’ rules are broadly similar to the Basel Committee on Banking Supervision’s and the International Organization of Securities Commissions’ 2013 [final policy framework](#) on margin requirements for uncleared derivatives (as modified in March 2015).
- The variation margin compliance deadline for a given covered swap entity and counterparty is either September 1, 2016 or March 1, 2017, and the initial margin compliance deadline is phased in between September 1, 2016 and September 1, 2020, each depending upon the size of the covered swap entity’s (and its affiliates’) combined swap positions with the counterparty. See [slide 14](#) for more information.

\* Unless otherwise specified, “swap” refers to both swaps and security-based swaps.

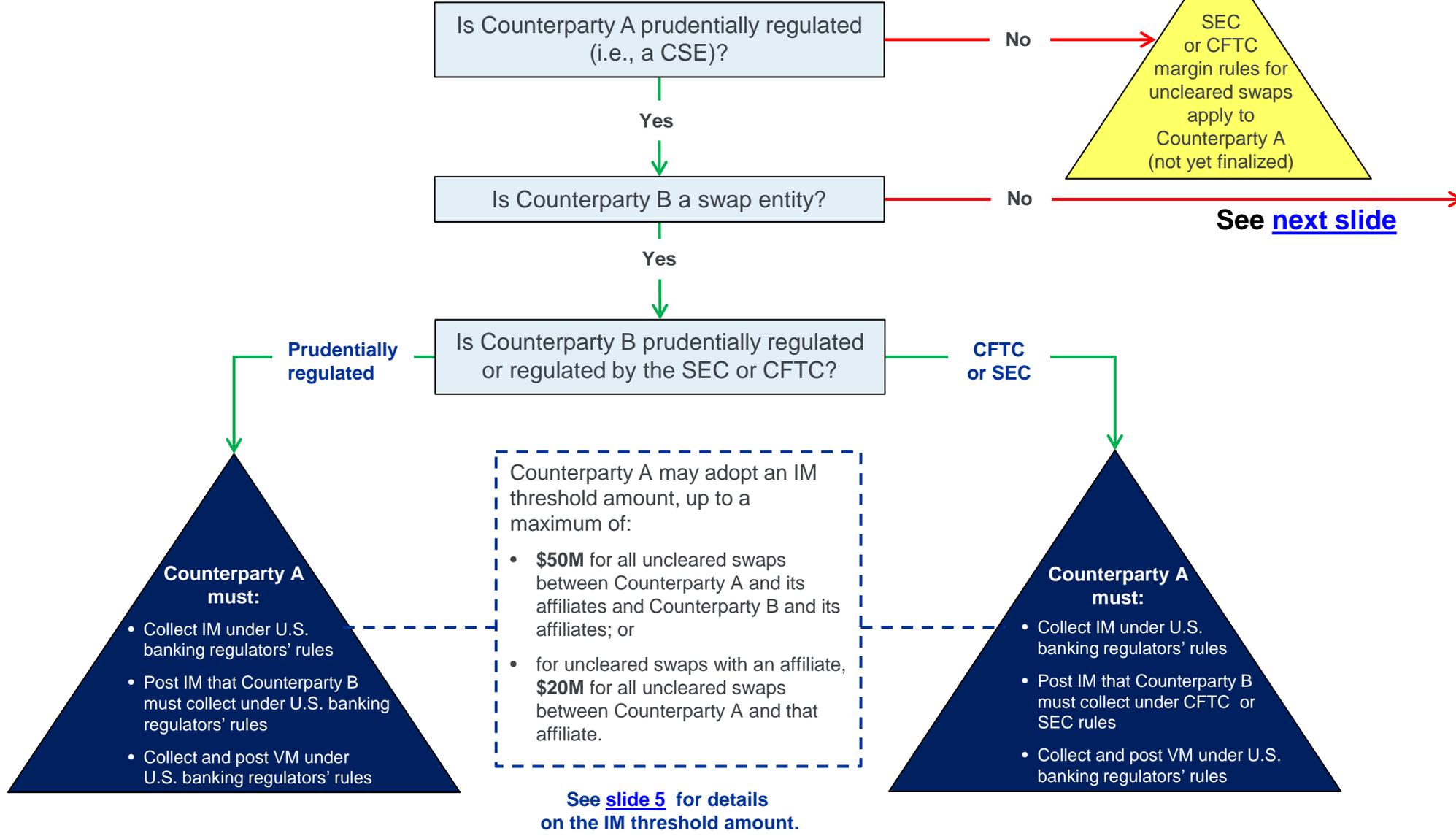
\*\* The term “swap entities” includes registered swap dealers, security-based swap dealers, major swap participants and major security-based swap participants.



# Application of the U.S. Banking Regulators' Rules

**CSE:** covered swap entity  
**FEU:** financial end user  
**IM:** initial margin  
**MSE:** material swaps exposure  
**VM:** variation margin

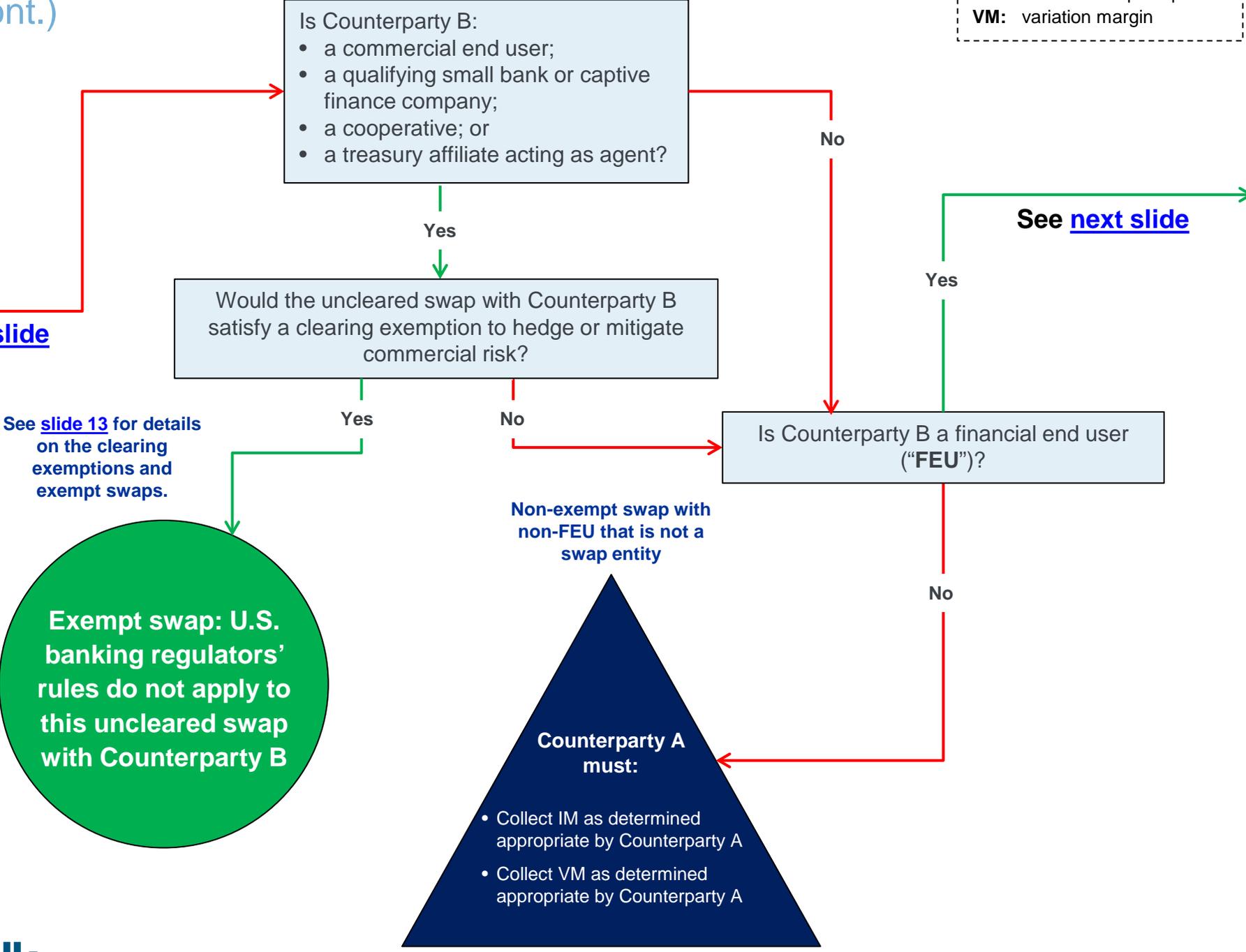
These flowcharts describe the margin rules directly applicable to Counterparty A, a swap entity. Counterparty A also may be indirectly subject to margin collection rules applicable to its counterparty, Counterparty B.



# Application of the U.S. Banking Regulators' Rules (cont.)

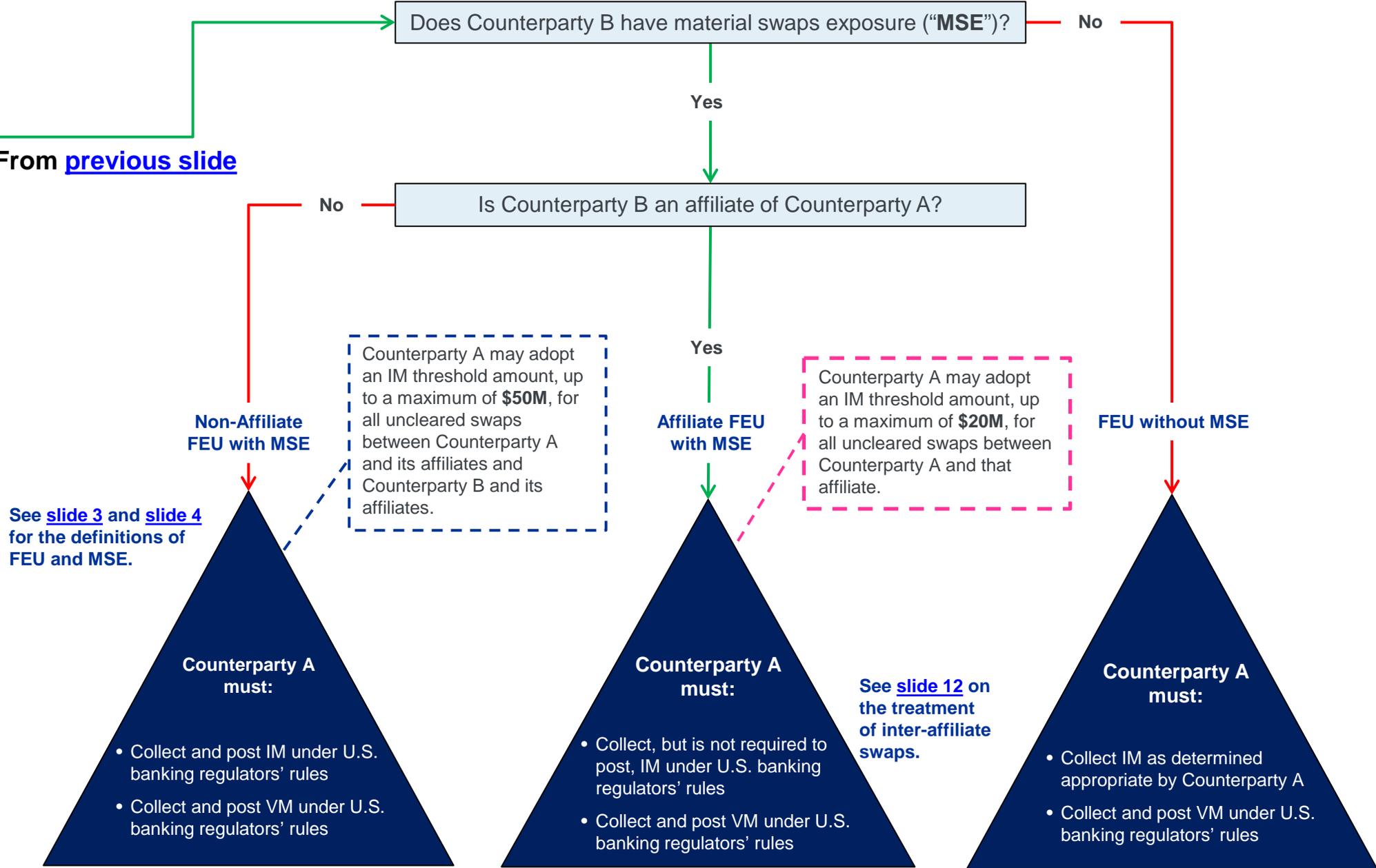
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From [previous slide](#)



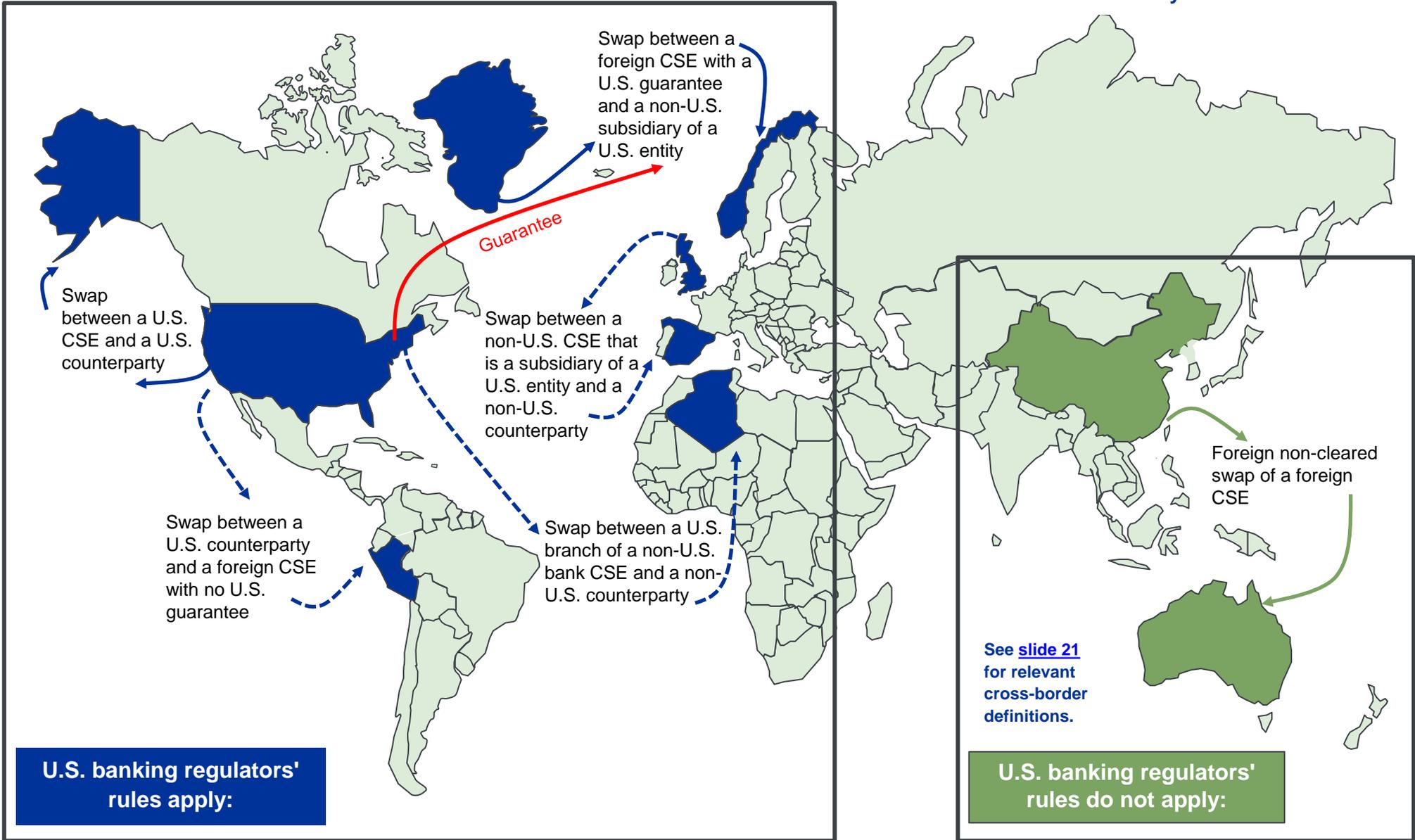
# Application of the U.S. Banking Regulators' Rules (cont.)

**CSE:** covered swap entity  
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# Examples of Cross-Border Application of the U.S. Banking Regulators' Rules

See [slides 21 to 23](#) for details on extraterritoriality.



# More Details on the U.S. Banking Regulators' Rules

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# Comparison to Proposed Rules

- Key changes from the U.S. banking regulators' 2014 proposal include:
  - increasing the threshold for material swaps exposure from \$3 billion to \$8 billion;
  - decreasing the initial margin threshold from \$65 million to \$50 million;
  - providing limited relief for swaps with an **affiliate**;
  - excluding from margin requirements pre-compliance date swaps held in a separate netting portfolio (without any post-effective date swaps) under an eligible master netting agreement (“**EMNA**”); and
  - using accounting definitions of affiliate and subsidiary rather than references to those definitions under the Bank Holding Company Act.

A company is an **affiliate** of another company if:

- either company consolidates the other on its financial statements or both companies are consolidated with a third company under GAAP, IFRS or other similar standards, or would be if any such standards had applied; or
- a U.S. banking regulator has determined that a company is an affiliate of another company because the regulator has concluded that either company provides significant support to, or is materially subject to the risks or losses of, the other company.

# Counterparty Classifications

## FOUR TYPES OF COUNTERPARTIES

- The U.S. banking regulators' rules divide a covered swap entity's counterparties into four categories:
  1. swap entities;
  2. financial end users *with* material swaps exposure;
  3. financial end users *without* material swaps exposure; and
  4. "other counterparties" not listed in categories 1 through 3 above, sovereign entities, multilateral development banks and the Bank of International Settlements.
- Whether, and how, margin requirements apply to uncleared swaps between a covered swap entity and a particular counterparty generally depends upon the type of counterparty, and for a counterparty that is a financial end user, whether it has material swaps exposure.
- **Exempt swaps.** The U.S. banking regulators' rules do not apply to transactions with commercial end users, qualifying small banks (generally insured depository institutions and credit unions with less than \$10 billion in assets), qualifying captive finance companies, treasury affiliates acting as agent and certain cooperative entities that would satisfy an applicable clearing exemption. See [slide 13](#) for more detail.

# Counterparty Classifications (cont.)

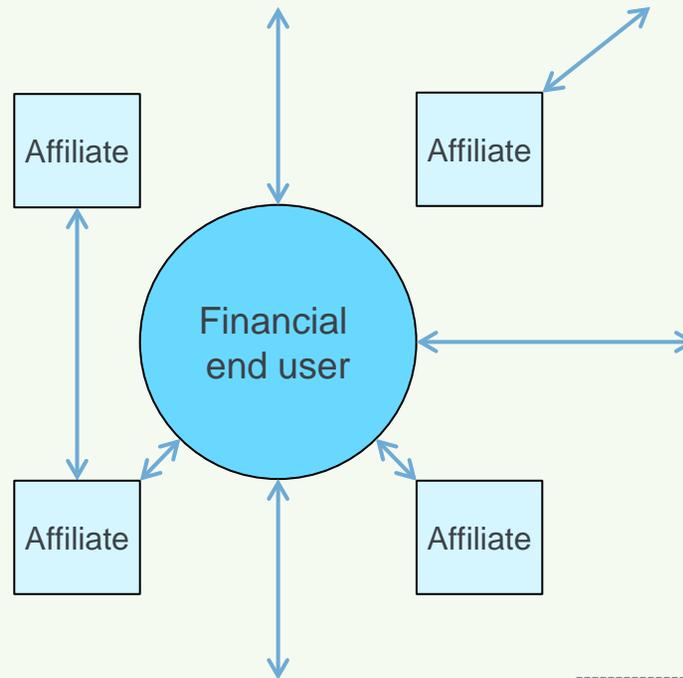
## DEFINITION OF FINANCIAL END USER

- Financial end user is defined broadly to capture entities or persons that are engaged in services or activities, or have sources of income, that are financial in nature. The U.S. banking regulators' rules include an extensive list of entities that would be financial end users. These include:
  - **A bank:** A U.S. or foreign bank; a credit union; a trust or fiduciary company; an IHC, BHC or affiliate; savings and loan company; an industrial loan company
  - **Fannie Mae, Freddie Mac or a Federal Home Loan Bank**
  - **An investment fund:** A registered investment company; a private fund; a vehicle that relies on section 3(c)(5)(c) or Rule 3a-7 under the 1940 Act; a commodity pool; a BDC; an ERISA employee benefit plan
  - **A state-licensed lender:** A state-licensed or registered lender or other state-licensed financial services firm
  - **A market intermediary:** A market intermediary or service provider, including a broker-dealer; investment adviser; CPO; CTA; FCM; IB; floor broker/trader
  - **A non-U.S. entity that would be a financial end user** if it were organized under the laws of the United States or any State
  - **A nonbank SIFI**
  - **An insurance company**
  - **A firm that trades in financial instruments for clients or with its own money:** A person, entity or arrangement that is, or holds itself out as, raising money from investors, accepting money from clients or using its own money primarily to invest, trade or facilitate the investing or trading in loans, securities, swaps, funds or other assets for resale or other trading
- The full definition of financial end user is available [here](#).

# Counterparty Classifications (cont.)

## MATERIAL SWAPS EXPOSURE

**Material Swaps Exposure if > \$8 billion**



Material swaps exposure is measured as: the average daily aggregate notional amount of uncleared swaps, FX swaps and FX forwards for each business day in June, July and August of the previous year of a financial end user and all of its affiliates to all counterparties, not including exempt swaps. Swaps with affiliates are counted once.

**Example:** For the period between January 1, 2017 through December 31, 2017, an entity would determine whether it had material swaps exposure with reference to June, July and August of 2016.

- A covered swap entity may reasonably rely on a representation from its counterparty as to whether the counterparty has material swaps exposure.
- FX swaps and FX forwards, although included in the material swaps exposure calculation, are not subject to the margin requirements under the U.S. banking regulators' rules.

# Initial and Variation Margin

## OVERVIEW

- Other than for exempt swaps, initial and variation margin will need to be posted and collected by a covered swap entity based upon a counterparty's classification and the result of the material swaps exposure calculation, as follows:

Counterparty	Initial Margin Requirement	Variation Margin Requirement
Swap entity	Collect*	Collect and post
Financial end user <i>with</i> material swaps exposure	Collect and post	Collect and post
Financial end user <i>without</i> material swaps exposure	Collect as determined appropriate by the covered swap entity	Collect and post
Other counterparty	Collect as determined appropriate by the covered swap entity	Collect as determined appropriate by the covered swap entity

- \$50 million initial margin threshold.** A covered swap entity may adopt a maximum initial margin threshold amount of \$50 million, below which it need not collect or post initial margin.
  - The threshold amount applies on a consolidated basis, both to the consolidated covered swap entity group and the consolidated counterparty group.
- \$20 million initial margin threshold for affiliates.** A covered swap entity may adopt a maximum initial margin threshold amount of \$20 million with each affiliate, below which it need not collect initial margin.

\*As a practical matter, swaps between two swap entities will require collecting and posting of initial margin. The amount that a covered swap entity will have to post will be determined by the margin rules applicable to its swap entity counterparty. For example, a covered swap entity transacting with a swap entity subject to the SEC or CFTC margin rules will need to post the amount its swap entity counterparty is required to collect under SEC or CFTC rules.

# Initial and Variation Margin (cont.)

## ADDITIONAL MECHANICS

- **Timing.** Required initial and variation margin must be collected and posted on or before the business day following the day of execution of an uncleared swap, and subsequently at least daily, until the swap terminates or expires. The definition of “day of execution” provides special treatment for late day and cross-time-zone transactions.
- **Minimum transfer amount.** A covered swap entity is not required to collect or post margin until the amount to be transferred exceeds \$500,000 of combined initial and variation margin.
  - The minimum transfer amount affects only the timing of margin collection. It does not change the amount of margin that must be collected once the counterparty crosses the \$500,000 threshold. For example, if the margin amount due from, or to, the counterparty increases from \$400,000 to \$950,000, the covered swap entity must collect the entire \$950,000, subject to the applicable initial margin threshold amount.
- **Minimum requirements.** The U.S. banking regulators’ rules establish only *minimum* requirements for initial and variation margin. A covered swap entity may collect or post margin in an amount greater than is required under the U.S. banking regulators’ rules.

# Initial and Variation Margin (cont.)

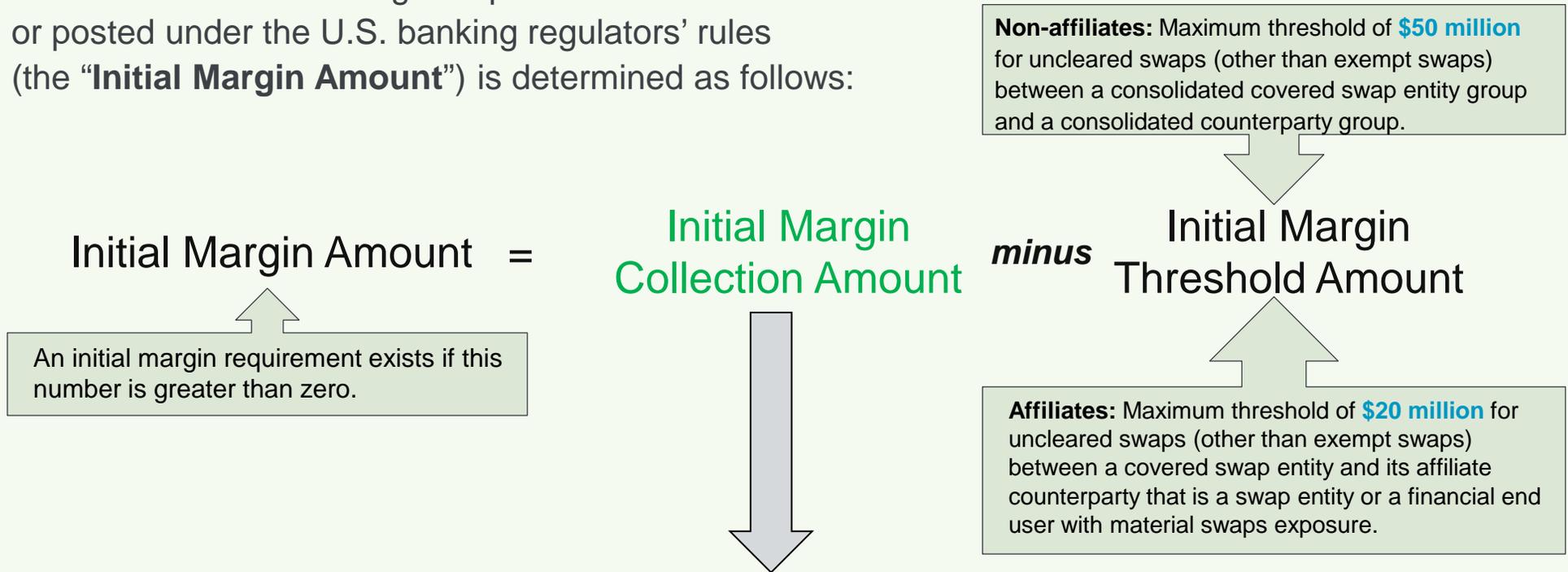
## SAFE HARBOR

- A covered swap entity will be deemed **not** to have violated its obligations to collect margin from, or post margin to, a counterparty if the counterparty has refused or failed to provide or accept the required margin and:
  - the covered swap entity has made the necessary efforts to collect or post the required margin; or
  - the covered swap entity has commenced termination of the uncleared swap following the applicable cure period.
- The preamble notes that it will also not be considered a violation if the counterparty is acting in accordance with agreed practices to settle a dispute.

# Calculating Initial Margin

## OVERVIEW

- The amount of initial margin required to be collected or posted under the U.S. banking regulators' rules (the "Initial Margin Amount") is determined as follows:



- The minimum Initial Margin Collection Amount may be determined in one of two ways:

using an initial margin model that must be approved by the relevant U.S. banking regulator and must conform to the requirements on [slide 9](#);

OR

using a standardized look-up table and formula as shown on [slide 10](#), which allows for limited netting of offsetting exposures.

# Calculating Initial Margin (cont.)

## MODELS

- Initial margin models must be approved by the U.S. banking regulators and are subject to ongoing notice to regulators in the event of changes. Models must be subject to robust oversight by the covered swap entity, including at least annual recalibration, validation, maintenance, testing, escalation and documentation.
- Any approved model:
  - must calculate initial margin requirements based on a one-tailed 99% confidence level over a 10-day close-out period (or 5 days for swaps making use of the CFTC inter-affiliate clearing exemption);
  - may recognize risk offsets within, but not across, the following risk categories:
    - commodity;
    - credit;
    - equity; and
    - FX / interest rate;
  - must capture all of the material risks that affect the uncleared swap, including material non-linear price characteristics of the swap; and
  - may not recognize risks, either as offsets or sources of additional risk, from other products that are not subject to the U.S. banking regulators' margin requirements.
- Covered swap entities may use a third-party developed model but must receive individual approval by the relevant U.S. banking regulator.

# Calculating Initial Margin (cont.)

## STANDARDIZED APPROACH

$$\frac{\text{Net current replacement cost}}{\text{Gross current replacement cost}}$$

$$\text{Initial Margin Collection Amount} = (0.4 \times \text{Gross Initial Margin}) + (0.6 \times \text{Net-to-Gross Ratio} \times \text{Gross Initial Margin})$$

**Standardized Approach Required Where No Approved Model.** Unless a covered swap entity's initial margin conforms to the initial margin model requirements on [slide 9](#), the covered swap entity must calculate the amount of initial margin required to be collected or posted for uncleared swaps on a daily basis pursuant to these minimum standards.

**No Cherry Picking.** The regulators noted that a covered swap entity may choose whether to use an approved model or standardized approach, but may not “cherry pick”—they would expect the method chosen to be based on fundamental considerations apart from which method produces the most favorable margin results, and covered swap entities may be asked to provide rationale for changing methodologies.

**30% Reduction.** Covered swap entities using this standardized approach for transactions with affiliates may reduce the initial margin amount by 30%.

Notional value x initial margin % below

Asset Class	Gross Initial Margin (% of Notional Exposure)
Credit: 0-2 years	2
Credit: 2-5 years	5
Credit: 5+ years	10
Commodity	15
Equity	15
Foreign Exchange/Currency	6
Cross Currency Swaps: 0-2 years	1
Cross-Currency Swaps: 2-5 years	2
Cross-Currency Swaps: 5+ years	4
Interest Rate: 0-2 years	1
Interest Rate: 2-5 years	2
Interest Rate: 5+ years	4
Other	15

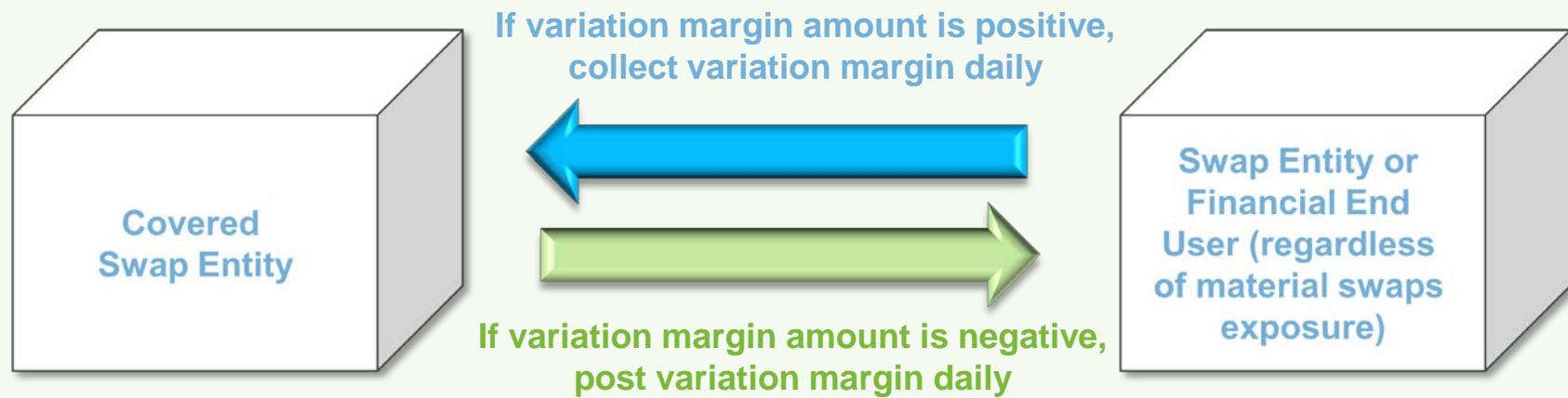
The **Net-to-Gross Ratio** calculation applies only to uncleared swaps that are subject to the same EMNA.

The **net current replacement cost** = the cost of replacing the entire portfolio of swaps covered under a single EMNA.

The **gross current replacement cost** = the cost of replacing those swaps that have a strictly positive replacement cost under the EMNA.

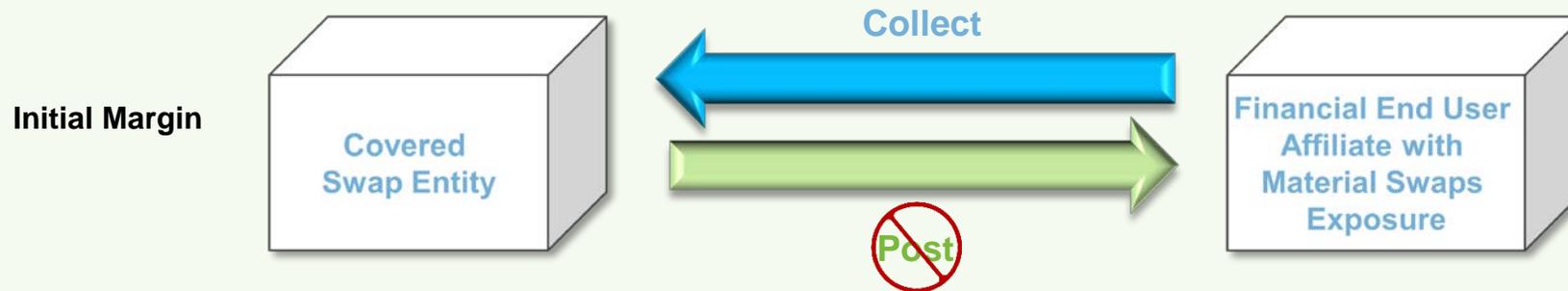
# Calculating Variation Margin

- The variation margin amount is measured in reference to the change in mark-to-market value since the prior exchange of variation margin.

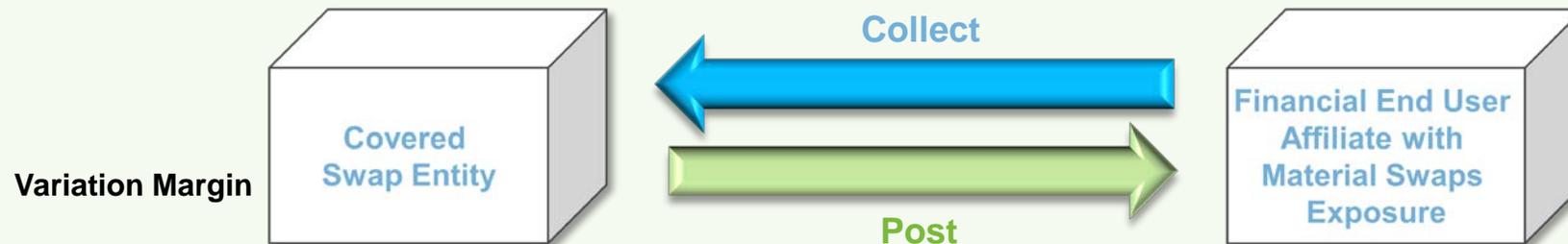


- A covered swap entity is permitted to calculate variation margin requirements on an aggregate net basis across all uncleared swaps with a counterparty that are executed under a single EMNA or a separate netting portfolio under an EMNA. See [slide 15](#) for further information on netting arrangements.
- No thresholds are permitted for variation margin.

# Special Rules for Inter-Affiliate Swaps



A covered swap entity does not need to post initial margin with an affiliate that is a financial end user with material swaps exposure. However, a covered swap entity must calculate the amount of initial margin it would be required to post to its affiliate (but for this exclusion) and provide that calculation to its affiliate each day. The covered swap entity must collect initial margin, subject to a \$20 million maximum threshold.



The exclusion does **not** apply to variation margin. A covered swap entity must collect and post variation margin from its affiliate each day, depending on the classification of the affiliate.

**Special rules also apply to the calculation of initial margin and segregation of collateral for inter-affiliate swaps.**

# Exemptions from the Margin Requirements

- Uncleared swaps between a covered swap entity and the following types of counterparties are exempt from the initial and variation margin requirements, if the swap would satisfy the applicable exemption from the clearing requirement:
  - An end user, such as a corporation, a small bank or a captive finance company, that would qualify for an exception from the end user clearing exemption under section 2(h)(7)(A) of the Commodity Exchange Act or section 3C(g)(1) of the Securities Exchange Act and any implementing regulations;
    - For these purposes, a small bank includes an insured depository institution, a credit union, a savings association or a farm credit system institution with total assets of \$10 billion or less.
  - A cooperative that would qualify for an exemption from clearing under section 4(c)(1) of the Commodity Exchange Act and any implementing rule, regulation or order; and
  - A treasury affiliate acting as agent that would satisfy the criteria for the exemption from clearing in section 2(h)(7)(D) of the Commodity Exchange Act or section 3C(g)(4) of the Securities Exchange Act and implementing regulations.

# Compliance Timing

## PHASED-IN COMPLIANCE SCHEDULE

- Once the Margin Calculation Amounts, as defined below, for **both** the covered swap entity and its counterparty exceed the relevant Margin Trigger Level, the counterparties must comply with the relevant margin requirement no later than the compliance date specified below for swaps entered into on or after that date.
  - The Margin Calculation Amount for an entity equals the combined average daily aggregate notional amount of uncleared swaps (including FX swaps and FX forwards) for each business day in March, April and May, of the entity and its affiliates.
    - Exempt swaps are not included in the Margin Calculation Amount.
  - Even if either counterparty subsequently falls below the Margin Trigger Level, the pair must continue to comply with the margin requirements.
- Swaps entered into before the relevant compliance date can be excluded from the margin requirements if they are restricted to EMNAs or separate netting portfolios within EMNAs that do not include post-compliance date swaps. A pre-effective date swap that is amended, novated, or assigned after the relevant compliance date may be considered to be a new post-compliance date swap for these purposes.

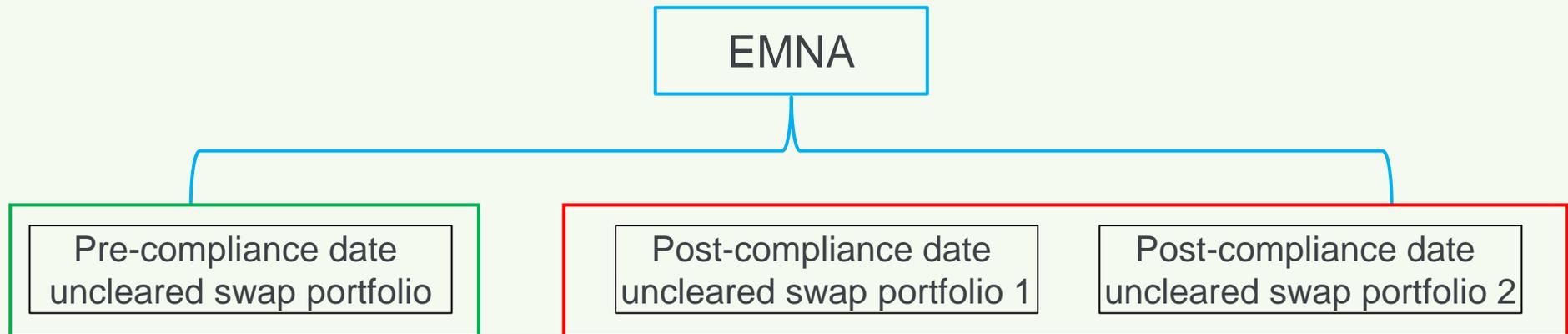


# Netting Arrangements

## ELIGIBLE MASTER NETTING AGREEMENTS

- **Netting.** The U.S. banking regulators' rules permit limited netting for swaps and security-based swaps under an EMNA but do not permit netting across other products.
- **Qualifying EMNAs.** Netting agreements must meet specified requirements to qualify as EMNAs. The full list of requirements is available [here](#). Among other things:
  - the agreement must create a single legal obligation for all individual transactions covered by the agreement upon an event of default following certain permitted stays, including upon an event of receivership, conservatorship, insolvency, liquidation or similar proceeding of the counterparty (the "**Close-Out Provision**");
  - the agreement must provide the covered swap entity the right to accelerate, terminate and close out on a net basis all transactions under the agreement and to liquidate or set off collateral promptly upon an event of default, provided additional circumstances are satisfied;
  - the agreement does not contain a walkaway clause; and
  - the covered swap entity that relies on the agreement to calculate margin must conduct sufficient legal review to conclude with a well-founded basis that (1) the agreement meets applicable requirements and (2) relevant court and administrative authorities would find the agreement to be legal, valid, binding and enforceable under local law.
- **Separate netting portfolios under a single EMNA.** An EMNA may consist of one or more "separate netting portfolios," defined as a set of transactions that independently meet the Close-Out Provision and to which collecting and posting of margin applies on an aggregate net basis separate from, and exclusive of, any other swaps covered by the EMNA.
  - The use of separate netting portfolios permits covered swap entities to ringfence swaps subject to different margin posting and collecting requirements.

## Netting Arrangements (cont.)



- **Permitted netting.** A covered swap entity may calculate initial margin (under a model) and variation margin requirements on an aggregate net basis for all uncleared swaps governed by a single EMNA.
- **Pre-compliance date uncleared swaps.** The margin requirements do not apply to uncleared swaps entered into before the relevant compliance date where:
  - the swaps were entered into under a single EMNA, and all swaps under the EMNA are pre-compliance date swaps; or
  - the pre-compliance date swaps entered into under the EMNA are restricted to a separate netting portfolio that does not include post-compliance date swaps.
- **Non-qualifying master agreements.** A covered swap entity trading under a netting agreement that is not an EMNA may apply the agreement's provisions for purposes of the posting requirement, but must collect on a gross basis.

# Eligible Collateral

- **Eligible collateral.** The U.S. banking regulators' rules limit the types of collateral that may be used to satisfy initial and variation margin requirements to high quality, liquid assets. These limitations do not apply to excess margin.

Eligible Collateral	
<b>Initial margin:</b>	Specified types of cash, securities and gold (see <a href="#">following slide</a> )
<b>Variation margin:</b>	
Swap between CSE and another swap entity	Cash in USD, another "major currency," or settlement currency of uncleared swap (see <a href="#">following slide</a> )
Swap between CSE and financial end user	Same as initial margin (see <a href="#">following slide</a> )

- **Ineligible collateral.** Securities issued by the following entities are not eligible collateral:
  - the party pledging the collateral or any of its affiliates;
  - a bank holding company, savings and loan holding company, an intermediate holding company, a foreign bank, a depository institution, a market intermediary, or any company that would be one of the foregoing if it were organized under the laws of the United States or any State, or an affiliate of any of these institutions; or
  - a non-bank SIFI.
- **Haircuts.** Specified haircuts apply to non-cash eligible collateral, as listed on [the following slide](#).
- **Daily monitoring.** A covered swap entity must monitor the market value and eligibility of all collateral collected and posted for required initial and variation margin on a daily basis.

# Eligible Collateral (cont.)

## ELIGIBLE COLLATERAL AND HAIRCUTS

Eligible Collateral	Haircut*
Cash in USD or another major currency	0.0
Cash in currency of settlement for the uncleared swap	0.0
Eligible government and related debt: residual maturity less than one year	0.5
Eligible government and related debt: residual maturity between one and five years	2.0
Eligible government and related debt: residual maturity greater than five years	4.0
Eligible GSE debt securities not identified in §.6(a)(2)(iv) or §.6(b)(5): residual maturity less than one year	1.0
Eligible GSE debt securities not identified in §.6(a)(2)(iv) or §.6(b)(5): residual maturity between one and five years	4.0
Eligible GSE debt securities not identified in §.6(a)(2)(iv) or §.6(b)(5): residual maturity greater than five years	8.0
Other eligible publicly traded debt: residual maturity less than one-year	1.0
Other eligible publicly traded debt: residual maturity between one and five years	4.0
Other eligible publicly traded debt: residual maturity greater than five years	8.0
Equities included in S&P 500 or related index	15.0
Equities included in S&P 1500 Composite or related index but not S&P 500 or related index	25.0
Gold	15.0
Additional (additive) haircut for collateral denominated in a currency that is not the currency of settlement**	8.0

\* Percentage of market value.

\*\* Does not apply to collateral posted for variation margin in cash in the currency of settlement or any major currency, or for collateral posted for initial margin, denominated in a single termination currency designated as payable to the non-posting counterparty as part of the EMNA.

For swaps between swap entities, only the cash instruments in the first two rows (in green) may be used to satisfy variation margin requirements.

# Segregation and Custody

## Segregation

- Collateral **collected by a covered swap entity** to satisfy required uncleared swap initial margin amounts must be held by one or more custodians unaffiliated with the covered swap entity and the counterparty.
  - Excess initial margin (i.e., collateral exceeding the amount required by the U.S. banking regulators' rules) and variation margin are not required to be segregated.
  - Required initial margin collected by a covered swap entity from an affiliate may be held by the covered swap entity or an affiliate as custodian.
- Any collateral **posted by a covered swap entity** as uncleared swap initial margin must be held by one or more custodians unaffiliated with the covered swap entity and the counterparty.
  - This requirement applies to excess initial margin but not to variation margin.

## Custody

- Collateral required to be segregated must be held by the custodian pursuant to an agreement that:
  - prohibits the custodian from rehypothecating, repledging, reusing, or otherwise transferring the collateral it holds;\* and
  - is legal, valid, binding, and enforceable under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding.
- The agreement may permit the substitution or direct reinvestment of received margin in eligible collateral, subject to restrictions and haircuts.

\* Cash collateral may be held in a general deposit account with the custodian if (1) the funds in the account are used to purchase eligible non-cash collateral, (2) the eligible non-cash collateral is held in compliance with the segregation requirements of the U.S. banking regulators' rules and (3) the purchase of the eligible non-cash collateral takes place within a reasonable time after the cash collateral is posted.

# Margin Documentation Requirements

- A covered swap entity must execute trading documentation with each swap entity or financial end user counterparty regarding credit support arrangements, provided that the credit support arrangements:
  - provide the covered swap entity and its counterparty with a contractual right to collect and post initial and variation margin in amounts and in the forms as required by the U.S. banking regulators' rules;
  - specify the methods, procedures, rules and inputs for determining the value of each uncleared swap for calculating variation margin;
  - specify the dispute resolution procedures concerning the valuation of uncleared swaps or assets collected or posted as initial or variation margin; and
  - describe the methods, procedures, rules and inputs used to calculate initial margin for uncleared swaps entered into between the covered swap entity and its counterparty.

# Extraterritorial Application

- The U.S. banking regulators' rules exclude a "foreign non-cleared swap" of a "foreign covered swap entity" from the scope of the margin requirements.

## Foreign Non-Cleared Swap

Any uncleared swap with respect to which neither the counterparty to the foreign covered swap entity nor any party that provides a guarantee of either party's obligations under the uncleared swap is—

- (1) An entity organized under the laws of the United States or any State (including a U.S. branch, agency, or **subsidiary** of a foreign bank) or a natural person who is a resident of the United States;
- (2) A branch or office of an entity organized under the laws of the United States or any State; or
- (3) A swap entity that is a subsidiary of an entity that is organized under the laws of the United States or any State.

## Foreign Covered Swap Entity

Any covered swap entity that is **not**—

- (1) An entity organized under the laws of the United States or any State, including a U.S. branch, agency or subsidiary of a foreign bank;
- (2) A branch or office of an entity organized under the laws of the United States or any State; or
- (3) An entity that is a subsidiary of an entity that is organized under the laws of the United States or any State.

A company is a "**subsidiary**" of another company if:

- the company is consolidated by the other company on financial statements under GAAP, IFRS or other similar standards, or would be if any such standards had applied; or
- A U.S. banking regulator has determined that a company is a subsidiary of another company because the regulator has concluded that either company provides significant support to, or is materially subject to the risks or losses of, the other company.

# Extraterritorial Application (cont.)

## FULL SUBSTITUTED COMPLIANCE

- Full substituted compliance (that is, the ability to collect and post margin in accordance with foreign regulatory requirements) may be available to:

- a foreign covered swap entity;
- a U.S. branch or agency of a foreign bank; or
- a subsidiary of a depository institution, an Edge corporation or an agreement corporation that is not organized under the laws of the United States or any State,

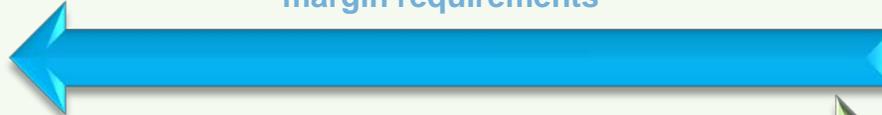
provided that its obligations are not guaranteed by

- an entity organized under the laws of the United States or any State, unless it is a U.S. branch or agency of a foreign bank;
- a natural person who is a resident of the United States; or
- a branch or office of an entity organized under the laws of the United States or any State.

### Example:



Collect pursuant to comparable foreign margin requirements



Post pursuant to comparable foreign margin requirements



- In order for substituted compliance to be available, the U.S. banking regulators must jointly make a “comparability” determination in the form of a public order with respect to the relevant foreign regulatory framework.

# Extraterritorial Application (cont.)

## PARTIAL SUBSTITUTED COMPLIANCE

- Even if full substituted compliance is not available, if the U.S. banking regulators make a comparability determination for a specific jurisdiction, any covered swap entity, including a U.S. covered swap entity, may (unless otherwise stated in the determination) satisfy its requirement to **post** (but not collect) initial margin to a financial end user with material swaps exposure by complying with the foreign jurisdiction's regulatory framework for margin collection applicable to the counterparty, provided that:

- the counterparty is required to collect initial margin pursuant to the foreign regulatory framework to which the counterparty is subject; and
- the counterparty's obligations under the uncleared swap do not have a guarantee from:
  - an entity organized under the laws of the United States or any State;
  - a U.S. branch, agency or subsidiary of a foreign bank;
  - a natural person who is a resident of the United States; or
  - a branch or office of an entity organized under the laws of the United States or any State.



- Subject to a number of conditions, the requirements to post and segregate collateral do not apply to an uncleared swap entered into by (1) a foreign branch of a covered swap entity that is a depository institution or (2) a covered swap entity that is a non-U.S. subsidiary of a depository institution, an Edge corporation or an agreement corporation, if there are certain limitations in the legal or operational infrastructure in the foreign jurisdiction.

# Capital Requirements

- A covered swap entity must comply with the capital requirements already applicable to it.
- No additional covered swap entity-specific capital rules are included in the U.S. banking regulators' rules.
- This may result in significant differences in required capital for swap entities with U.S. banking regulators and those regulated by the CFTC or the SEC.



# Davis Polk Contacts

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