

# The SEC's Security-Based Swap Capital, Margin and Segregation Rules

## VISUAL MEMORANDUM

July 12, 2019



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# Introduction



# Background

- **The SEC Rules:** On June 21, 2019, the SEC adopted security-based swap (**SBS**) capital, margin and segregation requirements for SBS dealers (**SBSDs**) and major SBS participants (**MSBSPs**),\* revised the capital and segregation requirements for broker-dealers that are not SBSDs to the extent they engage in SBS activities, and increased the minimum capital requirements for broker-dealers authorized to use internal models to compute net capital (**ANC Broker-Dealers**).
  - The SEC Rules do not start the registration or compliance clock for SBSDs. Slide 55 describes the new SBSD registration and SBS compliance timing under the SEC Rules.
- The SEC Rules are a key final rule in the suite of capital, margin and segregation rules under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (**Title VII**).
  - The **U.S. Prudential Regulators**—the Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Farm Credit Administration and Federal Housing Finance Agency—finalized their uncleared swap capital, margin and segregation rules (the **PR Rules**) in 2015.
  - The Commodity Futures Trading Commission (**CFTC**) also finalized its uncleared swap margin and segregation rules (the **CFTC Rules**) in 2015.
    - For more information on the CFTC and PR Rules, see our previous [visual memorandum](#).
  - The CFTC has yet to finalize its capital requirements for swap dealers (**SDs**). In addition, the SEC and CFTC will coordinate on portfolio margining.

\* This visual memorandum does **not** address the application of the SEC Rules to MSBSPs.

# Application of Title VII Capital, Margin and Segregation Regimes

- Which Title VII capital, margin and segregation rules apply to an SBSD or broker-dealer will depend on whether the entity is:
  - registered with the SEC only as an SBSD (a **Stand-Alone SBSD**);
  - registered with the SEC as a broker-dealer, including an entity registered with the SEC as both a broker-dealer and an SBSD (a **Broker-Dealer SBSD**);
  - registered with the CFTC as an SD; or
  - an SBSD or SD that is regulated by a U.S. Prudential Regulator (a **bank SBSD** or **bank SD**).

Rules	Covered entities	In-scope products
<b>PR Rules</b>	Bank SBSDs* and bank SDs	<ul style="list-style-type: none"> <li>• SBS</li> <li>• Swaps</li> </ul>
<b>CFTC Rules</b>	Non-bank SDs	<ul style="list-style-type: none"> <li>• Swaps</li> </ul>
<b>SEC Rules</b>	<p><b>Margin Requirements:</b> Non-bank SBSDs, including Broker-Dealer SBSDs</p> <p><b>Capital Requirements:</b> Non-bank SBSDs, including Broker-Dealer SBSDs Broker-dealers with respect to SBS and swaps</p> <p><b>Segregation Requirements:</b> All SBSDs, including bank SBSDs (subject to exemptions) Broker-dealers with respect to SBS</p>	<ul style="list-style-type: none"> <li>• SBS**</li> </ul>

\* Bank SBSDs are also subject to the SEC Rules' segregation requirements unless an exemption applies (see slides 40–41 for details).

\*\* The SEC Rules' capital requirements impose general capital requirements for Stand-Alone SBSDs, not only for their SBS activities, and create capital charges for broker-dealers, including Broker-Dealer SBSDs, for swaps as well as SBS.

# Reader's Guide: SEC Registration Categories

- The application of the SEC Rules to an SBSD or broker-dealer will depend on the entity's registration status with the SEC. For ease of reference, this memorandum uses the following **color-coding scheme** to identify the different registration categories:

Non-SBSDs		SBSDs*	
<b>ANC Broker-Dealers</b>	Broker-dealers authorized to use internal models to compute net capital	<b>Stand-Alone SBSDs</b>	SBSDs that are not broker-dealers (including SBSDs registered as OTC derivatives dealers)
<b>Non-ANC Broker-Dealers</b>	Broker-dealers that are not ANC Broker-Dealers	<b>ANC Broker-Dealer SBSDs</b>	Entities that are both ANC Broker-Dealers and SBSDs
		<b>Non-ANC Broker-Dealer SBSDs</b>	Entities that are both Non-ANC Broker-Dealers and SBSDs
<p><b>*Note to Reader:</b> Because the SEC Rules' capital and margin requirements do not apply to bank SBSDs (see slide 5), references to SBSDs in this memorandum are to non-bank SBSDs, unless otherwise specified.</p>			

# SEC-CFTC Harmonization

- Some non-bank SDs will also be SBSDs. These entities will be subject to the margin and segregation requirements of both the SEC (for SBS) and the CFTC (for swaps).
- The SEC Rules for SBS margin, in particular, reflect significant efforts to harmonize the requirements for an SBSD with those under analogous rules of the CFTC for an SD. The SEC and CFTC Rules both contain:
  - A requirement that an SBSD/SD exchange variation margin with most counterparties
  - A \$50 million initial margin threshold
  - A \$500,000 minimum transfer amount
  - An exception so that an SBSD/SD need not collect initial margin from an affiliated counterparty
  - An option for an SBSD/SD to use models developed by third parties, including ISDA SIMM
  - An option for an SBSD/SD to use the standardized haircuts from the CFTC Rules
- **Alternative Compliance Mechanism:** In addition, an SBSD/SD may comply with only the CFTC’s capital, margin and segregation requirements (including for its SBS activities)—in lieu of complying with the SEC Rules—if the entity’s business is predominantly swap dealing and the SBSD/SD meets certain other requirements. See slides 10–13 for details on this Alternative Compliance Mechanism.

# SEC-CFTC Harmonization (cont'd)

- However, some key differences remain between the SEC Rules for SBSDs and the analogous CFTC Rules for SDs. The SEC Rules:
  - Do not require (but permit) an SBSD to post initial margin to any counterparty
  - Do not require (but permit) an SBSD to collect initial margin from counterparties that are financial intermediaries, such as SBSDs, SDs, futures commission merchants (**FCMs**), broker-dealers or banks
  - Do not contain the concept of material swaps exposure and, thus, do not contain an exception from the requirement to collect initial margin from a financial end user counterparty that does not have material SBS exposure; however, the SEC Rules contain a separate exception from the requirement to collect initial margin from a more limited set of financial intermediaries
  - Do not require (but permit) initial margin to be held at a third-party custodian

# Alternative Compliance with CFTC Rules



# Alternative Compliance Mechanism for Stand-Alone SBSDs/SDs Predominantly Engaged in Swaps Dealing

- **Alternative Compliance Mechanism:** The SEC Rules provide an Alternative Compliance Mechanism for a **Stand-Alone SBSD** that is also an SD and whose SBS business is not a significant part of the SBS market and predominantly involves dealing in swaps, not SBS. An eligible SBSD may elect to comply with the capital, margin and segregation requirements for SDs under the Commodity Exchange Act (the **CEA**) and CFTC regulations instead of those under the SEC Rules.
- **Eligibility Conditions:** The Alternative Compliance Mechanism is available to an SBSD that meets the following conditions:
  - 1) The firm is (i) a **Stand-Alone SBSD** that is not an OTC derivatives dealer and (ii) registered with the CFTC as an SD.
  - 2) The **Stand-Alone SBSD** must not clear SBS on behalf of customers and otherwise must comply with the exemption from the SEC Rule's segregation requirements described on slide 41.
  - 3) **SBS Business Threshold Test:** As of the most recently ended quarter of the firm's fiscal year, the aggregate gross notional amount of the **Stand-Alone SBSD's** outstanding SBS positions must not exceed the lesser of (i) the **Maximum Fixed-Dollar Amount** (see slide 11 for details); and (ii) 10% of the combined aggregate gross notional amount of the **Stand-Alone SBSD's** open SBS and swap positions.

# SBS Business Threshold Test

- Under the SBS Business Threshold Test, the combined aggregate gross notional amount is based on the notional amounts of the **Stand-Alone SBS D's** SBS and swaps that are outstanding as of the end of each quarter—not transaction volume during the quarter.
- The **Maximum Fixed-Dollar Amount** is as follows:

Transition period of 3 years starting on the compliance date of the SEC Rules (see slide 55 for details)	Post-transition period
\$250 billion	<b>\$50 billion, unless the SEC issues an order:</b> <ul style="list-style-type: none"><li>• <b>maintaining the \$250 billion threshold for an additional period of time or indefinitely or</b></li><li>• <b>lowering it to an amount less than \$250 billion but greater than \$50 billion</b></li></ul>

# Procedural Requirements

- **Procedural requirements:** A **Stand-Alone SBSB** that meets the Eligibility Conditions and elects to rely on the Alternative Compliance Mechanism must:
  - provide written disclosure to its SBS counterparties after it begins operating pursuant to the Alternative Compliance Mechanism, which must:
    - be provided before the first SBS transaction between the **Stand-Alone SBSB** and the counterparty after the firm begins relying on the Alternative Compliance Mechanism;
    - notify the counterparty that the **Stand-Alone SBSB** is complying with the CEA and CFTC capital, margin and segregation requirements in lieu of the SEC Rules;
  - provide prior written notice to the SEC and the CFTC of its intent to operate pursuant to the Alternative Compliance Mechanism; and
  - immediately notify the SEC and the CFTC in writing if it fails to meet an Eligibility Condition.
- Notices sent to the SEC and CFTC must:
  - include a brief summary of the reason for the notice and the contact information of an individual who can provide further information about the subject of the notice; and
  - be sent to the principal office of the SEC and the regional office for the region in which the **Stand-Alone SBSB** has its principal place of business and to the principal office of the CFTC in a manner consistent with the CFTC's notification requirements.

# Operating Under the Alternative Compliance Mechanism; Consequences of Lapse / Off-Ramp

- **Operating pursuant to the Alternative Compliance Mechanism:** A **Stand-Alone SBS** that has elected to rely on the Alternative Compliance Mechanism must:
  - comply with the capital, margin and segregation requirements for SDs under the CEA and CFTC regulations for swaps; and
  - treat SBS and related collateral as if they are subject to the requirements of the CEA and CFTC regulations for swaps.
    - This requirement is intended to prevent regulatory gaps for **Stand-Alone SBSs** operating under the Alternative Compliance Mechanism as a result of CEA and CFTC capital, margin and segregation requirements being silent as to the treatment of SBS and related collateral.
- A failure to comply with the capital, margin and segregation requirements of the CEA and CFTC Rules constitutes a failure to comply with the SEC Rules implementing the Alternative Compliance Mechanism.
- **Consequences of lapse / off-ramp:** The Eligibility Conditions must be met by a **Stand-Alone SBS** at all times the SBS is operating pursuant to the Alternative Compliance Mechanism. If an SBS relying on the Alternative Compliance Mechanism fails to maintain compliance with an Eligibility Condition, the **Stand-Alone SBS** must begin complying with the SEC Rules no later than either:
  - two months after the end of the month in which the SBS failed to meet the Eligibility Condition; or
  - such longer period of time as granted by the SEC by order and subject to such conditions as the SEC may impose.

# Capital Requirements



# Overview of the Capital Requirements

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- The SEC Rules establish capital requirements for SBSs that generally parallel existing capital requirements for broker-dealers. This means that SBSs, like broker-dealers, must maintain **net capital** in excess of the applicable minimum net capital requirement, and SBSs that are approved to use internal models are also subject to minimum **tentative net capital** requirements.
- The **net capital** requirements for SBSs vary based on whether the SBS is also registered as a broker-dealer and whether it has been approved by the SEC to use internal models to calculate net capital.
- The SEC Rules also modify certain existing capital requirements applicable to broker-dealers, including by:
  - raising minimum net capital requirements applicable to **ANC Broker-Dealers**. Specifically, **ANC Broker-Dealers** will be required to hold at least \$1 billion of net capital (up from \$500 million) and \$5 billion of **tentative net capital** (up from \$1 billion) and must provide an early warning notification if their tentative net capital falls below \$6 billion (up from \$5 billion); and
  - establishing new standardized haircuts and other deductions for SBS and swaps for all broker-dealers.
- **Tentative net capital** is the amount of a firm's net capital before deducting standardized haircuts or, in the case of firms that use models, market and credit risk charges, to the value of proprietary positions.

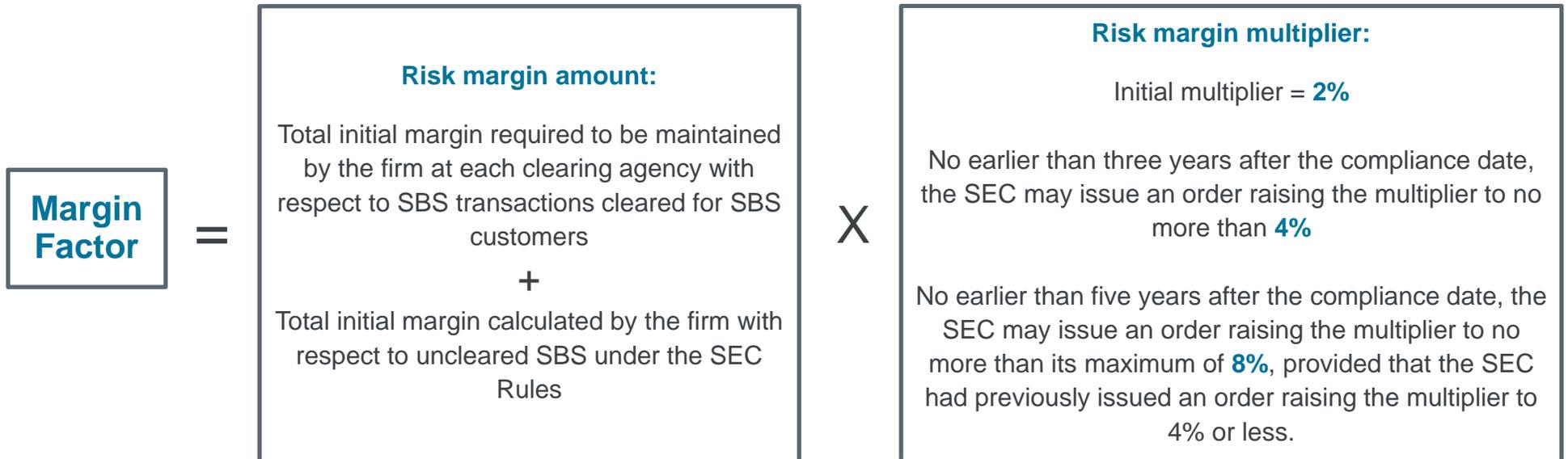
# Minimum Net Capital Requirements for SBSDs and ANC Broker-Dealers

- The following table sets forth the minimum tentative and net capital requirements under each Securities Exchange Act of 1934 (**Exchange Act**) rule based on the type of SBSD or ANC Broker-Dealer:

Registrant	Exchange Act rule	Tentative net capital	Net capital (greater of floor and ratio)	
			Floor	Ratio
<b>Stand-Alone SBSDs (not using internal models)</b>	18a-1	N/A	\$20 million	Margin Factor
<b>Stand-Alone SBSDs (using internal models), including OTC derivatives dealer SBSDs</b>	18a-1	\$100 million	\$20 million	Margin Factor
<b>Non-ANC Broker-Dealer SBSDs</b>	15c3-1	N/A	\$20 million	Margin Factor + 15c3-1 Ratio
<b>ANC Broker-Dealers</b> <b>ANC Broker-Dealer SBSDs</b>	15c3-1	\$5 billion	\$1 billion	Margin Factor + 15c3-1 Ratio

# Calculating Minimum Net Capital Requirements

- An SBSB's minimum net capital requirement is equal to the greater of (i) the applicable fixed-dollar amount and (ii) the **Margin Factor**, or, in the case of SBSBs that are broker-dealers, the **15c3-1 Ratio** plus the Margin Factor.
  - The **Margin Factor**, which generally represents a firm's exposures to its SBS customers, is equal to its **risk margin amount** multiplied by the then-applicable **risk margin multiplier**.



- The **15c3-1 Ratio**, which is applicable only to SBSBs that are broker-dealers, is the existing ratio-based minimum net capital requirement in the broker-dealer net capital rule (Exchange Act rule 15c3-1) (i.e., either 15-times aggregate indebtedness or 2% of customer debit items).

# Calculating Net Capital

- The SEC Rules establish new requirements for how **Stand-Alone SBSDs** calculate net capital that are largely based on the existing requirements for how broker-dealers calculate their net capital.
  - In addition, the SEC Rules modify the existing broker-dealer net capital calculation requirements by adding adjustments to account for SBS and swap positions.
- **Start with net worth:** The first input into the net capital calculation is the firm's net worth under U.S. generally accepted accounting principles.
- **Next make adjustments:** That net worth is modified by specific deductions or haircuts with the purpose of leaving the firm with each dollar of its unsubordinated liabilities being matched by more than one dollar of highly liquid assets.
  - The adjustments applicable to **Stand-Alone SBSDs** in Exchange Act rule 18a-1 are generally consistent with the adjustments applicable to broker-dealers in Exchange Act rule 15c3-1, as amended by the SEC Rules.

# Standardized Haircuts for SBS and Swaps

- Firms that are not approved to use internal models to calculate haircuts on SBS and swap positions must calculate deductions to net worth based on **standardized haircuts**:

Instrument	Haircut
<b>Cleared swaps and SBS</b>	<p>The amount of the applicable margin requirement of the clearing agency or DCO where the SBS or swap is cleared.</p> <p>If the SBS references an equity security or a narrow-based security index, or the swap references a broad-based equity security index, the firm may take the deduction using the method specified in Appendix A to each of Exchange Act rule 15c3-1 and 18a-1, as applicable.</p>
<b>Uncleared SBS that are CDS</b>  <b>Swaps that are CDS referencing broad-based security indices</b>	<p>A percentage of the notional amount of the CDS determined based on the current basis point spread of the CDS and the maturity of the CDS. For short positions, this haircut is a percentage of the notional amount, as set forth in a table, varying based on the current basis point spread of the CDS and its maturity. For long positions, the haircut is 50% of the amounts set forth in the table for short positions, except that the deduction may not exceed the current market value of the long position.</p> <p>Reduced haircuts may be available for certain offsetting long and short CDS positions and certain long CDS positions where the firm is long the reference asset(s) or short CDS positions where the firm is short the reference asset(s).</p>
<b>Uncleared interest rate swaps</b>	<p>A percentage of the notional amount that would be applicable to a U.S. government security of the same maturity under Exchange Act rule 15c3-1, provided that the percentage deduction must be no less than 1/8 of 1% of the amount of the long position that is netted against the short position in the case of an uncleared swap with a maturity of three months or more.</p>
<b>All other uncleared swaps and SBS</b>	<p>A percentage of the notional amount that would be applicable to the reference asset under Exchange Act rule 15c3-1.</p> <p>If Exchange Act rule 15c3-1 does not specify a percentage deduction for the reference asset, the percentage deduction applicable in CFTC Rule 1.17, if any, applies.</p>

# Model-Based Haircuts and Tentative Net Capital

- **Eligibility for model-based haircuts:** Broker-dealers and SBSBs may apply to the SEC to use internal models to calculate certain deductions from net worth.
- SBSBs that are broker-dealers are subject to the same approval requirements for the use of models as broker-dealers seeking to be **ANC Broker-Dealers**. **Stand-Alone SBSBs** are subject to approval requirements that the SEC intends to be generally consistent with **ANC Broker-Dealer** requirements.
- The SEC Rules will permit the SEC to approve **temporary use of provisional models** by all broker-dealers and SBSBs once the firm has submitted a completed application for its model if the provisional model has been approved by either a prudential regulator, the CFTC, a futures association registered with the CFTC or certain foreign financial regulatory authorities that the SEC has approved.
- Firms permitted to use internal models may take **credit risk charges** or **market risk charges** in lieu of the standardized haircuts and certain other adjustments to net worth.
- **Tentative net capital:** Firms using internal models are also subject to minimum tentative net capital requirements of **\$100 million** for **Stand-Alone SBSBs**, including OTC derivatives dealer SBSBs, and **\$5 billion** for **ANC Broker-Dealers** and **ANC Broker-Dealer SBSBs**.
  - Tentative net capital is the amount of a firm's net capital before deducting standardized haircuts or, in the case of firms that use models, market and credit risk charges, to the value of proprietary positions.

# Other Adjustments to Net Worth

- The SEC Rules require several other adjustments to net worth for calculating net capital, including but not limited to:

Adjustment	Description
<b>Deduction for posting initial margin</b>	<p>Broker-dealers and SBSs are generally required to take a deduction from net worth for initial margin posted to a counterparty. The SEC provided interpretive guidance that a firm may avoid deducting initial margin posted by the firm if:</p> <ul style="list-style-type: none"><li>the initial margin requirement is funded by a fully executed written loan agreement with an affiliate of the firm;</li><li>the loan agreement provides that the lender waives repayment of the loan until the initial margin is returned to the firm; and</li><li>the liability of the firm to the lender can be fully satisfied by delivering the collateral serving as initial margin to the lender.</li></ul>
<b>Deduction for unsecured receivables</b>	<p>Broker-dealers and SBSs generally must deduct the value of unsecured receivables, including those arising from an election not to collect variation margin.</p>
<b>Deduction for undermargined accounts</b>	<p>Broker-dealers and SBSs must deduct the amount of cash <u>required</u>, but not collected, in the account of each SBS and swap customer to meet the margin requirements of a clearing agency, FINRA, the SEC, the CFTC or a derivatives clearing organization (as applicable).</p>
<b>Deduction for uncollected initial margin</b>	<p>Broker-dealers and SBSs generally must deduct any amount of initial margin for SBS and swap positions that is not collected pursuant to an exception in the SEC Rules or CFTC Rules (less the margin value of collateral held in the account).</p> <p>This deduction applies to initial margin held by a third-party custodian, unless the custodian is an unaffiliated bank or other enumerated regulated entity and the collateral is delivered pursuant to a legally valid, binding and enforceable account control agreement.</p>

# Credit Risk Models

- When calculating net capital, broker-dealers and SBSBs must take deductions, as unsecured receivables, for the amount of uncollateralized current exposure to a counterparty arising from derivatives transactions.
- **Credit risk charge:** **ANC Broker-Dealers**, **ANC Broker-Dealer SBSBs** and **Stand-Alone SBSBs** that are approved to use internal models may take a credit risk charge in lieu of taking a 100% deduction for this exposure.
  - In addition, **ANC Broker-Dealers**, **ANC Broker-Dealer SBSBs** and **Stand-Alone SBSBs** that are approved to use internal models may take a credit risk charge in lieu of taking the deduction for initial margin for SBS and swap positions that is not collected pursuant to an exception in the SEC Rules or CFTC Rules.
- **Portfolio concentration charge:** **ANC Broker-Dealers**, but not **Stand-Alone SBSBs** or SBSBs that are OTC derivatives dealers, are subject to a **portfolio concentration charge** equal to 100% of the amount of the firm's aggregate current exposure to all counterparties in excess of 10% of the firm's tentative net capital.
  - Unsecured receivables arising from electing not to collect variation margin are included in the portfolio concentration charge. The charge does not include potential future exposure arising from electing not to collect initial margin.

# Broker-Dealer Requirements Extended to SBSDs

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- The SEC Rules also apply certain other capital-related requirements to **Stand-Alone SBSDs** that already apply to certain broker-dealers or OTC derivatives dealers:
- **Capital withdrawal notice requirements:** **Stand-Alone SBSDs** must provide written notice to the SEC of withdrawals of equity capital or any unsecured loan or advance to a stockholder, partner, employee or affiliate, if those transactions exceed certain thresholds.
- **Debt-equity ratio:** For **Stand-Alone SBSDs**, the ratio of outstanding principal amounts on subordinated loans to its total equity may not exceed 70% for a period of longer than 90 days.
- **Risk monitoring procedures:** **Stand-Alone SBSDs** must monitor the risk of each account and establish, maintain and document procedures and guidelines for monitoring the risk of accounts. These procedures must be part of the risk management control system required by Exchange Act rule 15c3-4. This includes periodically reviewing the SBSD's activities for consistency with risk monitoring procedures and guidelines.
  - The previously existing risk monitoring procedures only apply to **ANC Broker-Dealers** and OTC derivatives dealers.

# Margin Requirements



# Overview of the Margin Requirements

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- The margin requirements in the SEC Rules are the third, and final, set of U.S. margin requirements for uncleared swaps and SBS, as applicable. The CFTC Rules and PR Rules were adopted in 2015. Which margin requirements apply depends on the regulatory or registration status of the SD or SBS entity and the product type.
- Unless subject to an exception, the SEC Rules require an SBS to collect initial margin from a counterparty to an uncleared SBS transaction—but not to post initial margin. The SEC Rules also require SBSs and their counterparties to exchange variation margin, subject to exceptions.
  - **Initial margin:** The initial margin amount for the account of the counterparty, also known as potential future exposure, is calculated by applying standardized haircuts or through the use of a model approach approved by the SEC. See slides 31–32 for details.
  - **Variation margin:** The amount of current exposure in the account of the counterparty that must be collected or posted by an SBS is calculated by marking the SBS to market on a daily basis.

# Exceptions from the SEC's Initial and Variation Margin Requirements

- The SEC Rules provide exceptions from the margin requirements similar to those under the CFTC and PR Rules. An SBSB is not required to collect initial margin or exchange variation margin with the following types of counterparties:

SEC exception	Description	Comparison with the CFTC and PR Rules
<b>Commercial end users</b>	<ul style="list-style-type: none"> <li>An end user that qualifies for an exception from the clearing requirement in section 3C(g)(1) of the Exchange Act. An end user is an entity that is (i) not a financial entity and (ii) using the uncleared SBS to hedge or mitigate commercial risk.               <ul style="list-style-type: none"> <li>A financial entity is:                   <ul style="list-style-type: none"> <li>an SD;</li> <li>an SBSB;</li> <li>an MSP;</li> <li>an MSBSP;</li> <li>a commodity pool;</li> <li>a private fund;</li> <li>an employee benefit plan; or</li> <li>a person predominantly engaged in activities that are in the business of banking or financial in nature.</li> </ul> </li> </ul> </li> <li>Treasury affiliates that satisfy the criteria for the exception from the clearing requirement in section 3C(g)(4) of the Exchange Act.</li> </ul>	<p>The definition of financial entity under the Exchange Act is the same as the definition used in the CEA. Therefore, most entities that are not financial entities and rely on the end user exemption from the CFTC and PR Rules are also excepted from the SEC's initial and variation margin requirements. If the SEC exempts small banks, captive finance companies and cooperatives from the mandatory clearing requirement, they will also be eligible for the commercial end user exception, just as under the CFTC and PR Rules.</p> <p>The scope of the treasury affiliates exception under the SEC Rules is the same as under the CFTC and PR Rules.</p>
<b>SBS legacy accounts</b>	An SBS legacy account is one that holds no SBS entered into after the compliance date for the SEC's margin requirements and that is only used to hold pre-compliance date SBS and the collateral for those SBS.	The CFTC and PR Rules exempt legacy swaps on a netting portfolio basis. The SEC Rules except legacy SBS on an account basis. All three rule sets provide that, to be exempt, legacy accounts may only hold collateral for the pre-compliance date swaps or SBS.

# Exceptions from the SEC's Initial and Variation Margin Requirements (cont'd)

- The SEC Rules provide exceptions from the margin requirements similar to those under the CFTC and PR Rules. An SBSB is not required to collect initial margin or exchange variation margin with the following types of counterparties:

SEC exception	Description	Comparison with the CFTC and PR Rules
<p><b>The Bank for International Settlements</b></p> <p><b>The European Stability Mechanism</b></p> <p><b>Multilateral Development Banks</b></p>	<p>The multilateral development banks include:</p> <ul style="list-style-type: none"> <li>The International Bank for Reconstruction and Development;</li> <li>The Multilateral Investment Guarantee Agency;</li> <li>The International Finance Corporation;</li> <li>The Inter-American Development Bank;</li> <li>The Asian Development Bank;</li> <li>The African Development Bank;</li> <li>The European Bank for Reconstruction and Development;</li> <li>The European Investment Bank;</li> <li>The European Investment Fund;</li> <li>The Nordic Investment Bank;</li> <li>The Caribbean Development Bank;</li> <li>The Islamic Development Bank;</li> <li>The Council of Europe Development Bank; or</li> <li>Any other multilateral development bank that provides financing for national or regional development in which the U.S. government is a shareholder or contributing member.</li> </ul>	<p>The entities included in this SEC exception are generally the same as those included in the exemptions in the CFTC and PR Rules. However, the SEC Rules provide an exception for SBS with the European Stability Mechanism but the CFTC and PR Rules do not contain comparable exemptions. The CFTC provided no-action relief for swaps with the European Stability Mechanism. The U.S. Prudential Regulators have not provided similar relief.</p>

# Exceptions from the Initial Margin Collection Requirements

- An SBSB is not required to collect initial margin (but must exchange variation margin) for uncleared SBS from the following counterparties:

SEC exception	Description	Comparison with the CFTC and PR Rules
<b>Financial market intermediaries</b>	<ul style="list-style-type: none"> <li>SBSBs</li> <li>SDs</li> <li>Broker-dealers</li> <li>FCMs</li> </ul>	<ul style="list-style-type: none"> <li>Banks</li> <li>Foreign banks</li> <li>Foreign broker-dealers</li> </ul> <p>No analogous exemption exists under the CFTC and PR Rules.</p>
<b>Sovereign entities</b>	<p>A counterparty that is a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government if the SBSB has determined that the counterparty has only a minimal amount of credit risk.</p>	<p>The CFTC and PR Rules are the same but without the credit risk condition.</p>
<b>Affiliates</b>	<p>A counterparty that is an affiliate of the SBSB.</p>	<ul style="list-style-type: none"> <li><b>CFTC:</b> An SD does not need to post initial margin to its affiliate counterparty and may not be required to collect initial margin from such counterparty, subject to certain conditions.</li> <li><b>PR:</b> An SD or SBSB does not need to post initial margin to its affiliate counterparty, subject to certain conditions, but is required to collect initial margin from its affiliate counterparty.</li> </ul>

# Mechanics of Exchanging Initial and Variation Margin

## Timing for calculation and exchange of margin

- The SEC Rules require an SBSB to calculate, with respect to each account of a counterparty, the initial margin amount and the variation margin amount by the close of business on each business day.
  - In periods of extreme volatility and for accounts with concentrated positions, the margin calculations must be made more frequently than the close of each business day.
- The SBSB must collect initial margin and collect or post variation margin by the close of business on the first business day following the day of calculation.
  - If the counterparty is located in a different country than the SBSB and is more than four time zones away, the SBSB must collect (and post, if applicable) by the close of business on the second business day following the day of calculation.
  - The **CFTC** and **PR Rules** require the exchange of margin on or before the business day after execution of an uncleared swap or uncleared SBS unless the counterparties are in different time zones such that the day of execution is a different calendar day for each, in which case the day of execution is the later of the two days.

# Mechanics of Exchanging Initial and Variation Margin (cont'd)

## Initial Margin Threshold

- The **Initial Margin Threshold**, below which an SBSB need not collect initial margin, is \$50 million. It is determined by calculating the initial margin amount plus all other credit exposures resulting from uncleared SBS and swaps of the SBSB and its affiliates with the counterparty and its affiliates. An SBSB can exclude any exposures arising from SBS with commercial end users and swaps with counterparties that are exempt from the CFTC Rules.
  - The **CFTC** and **PR Rules** also have an Initial Margin Threshold of \$50 million, although the threshold set by the **CFTC Rules** only includes exposures arising from uncleared swaps and does not include exposures from uncleared SBS.
  - An SBSB may defer collecting the initial margin amount for up to two months after the month in which the counterparty exceeded the Initial Margin Threshold for the first time.

## Minimum Transfer Amount

- The **Minimum Transfer Amount** is \$500,000.
  - An SBSB is not required to collect or deliver margin if the total amount of the collateral that is required to be collected or delivered is equal to or less than \$500,000. If the Minimum Transfer Amount is exceeded, margin must be collected to cover the entire amount and not just the amount that exceeds \$500,000.
  - The **CFTC** and **PR Rules** also have a Minimum Transfer Amount of \$500,000.

## Minimum / house requirement

- The SEC Rules establish only the **minimum requirements** for initial and variation margin. An SBSB is free to establish more stringent “house” requirements.
  - The **CFTC** and **PR Rules** also permit SDs or SBSBs to establish more stringent margin requirements.

# Calculating Initial Margin

- An SBSB may calculate the amount of required initial margin it must collect (the **Initial Margin Amount**) using either the **standardized approach** or, if the SBSB receives approval from the SEC, the **model approach**.
  - The **standardized approach** divides SBS into (i) CDS and (ii) all other SBS for purposes of calculating the Initial Margin Amount. In both cases, the Initial Margin Amount is calculated using the standardized haircuts contained in the capital rules for SBSBs. See slide 19 for details.
  - The **model approach**, and its availability to an SBSB, depends on whether or not the SBS is an equity SBS:

	SBS that are <u>not</u> equity SBS	Equity SBS
<b>SBSB eligibility</b>	<ul style="list-style-type: none"> <li>• Model can be used by any SBSB</li> </ul>	<ul style="list-style-type: none"> <li>• Model can be used <b>only</b> by <b>Stand-Alone SBSBs</b></li> </ul>
<b>Model requirements</b>	<ul style="list-style-type: none"> <li>• Must use a 99%, one-tailed confidence level with price changes equivalent to a 10 business-day movement in rates and prices;</li> <li>• Must use risk factors sufficient to cover all the material price risks inherent in the positions for which the Initial Margin Amount is being calculated, including FX or interest rate risk, credit risk, equity risk and commodity risk, as appropriate; and</li> <li>• May recognize empirical correlations within each broad risk category, but not across broad risk categories.</li> </ul>	<ul style="list-style-type: none"> <li>• Model is subject to the same requirements</li> </ul>
<b>Regulator approval</b>	<ul style="list-style-type: none"> <li>• Model must be approved by the SEC</li> </ul>	<ul style="list-style-type: none"> <li>• Model must be approved by the SEC</li> </ul>
<b>Other requirements</b>	<ul style="list-style-type: none"> <li>• N/A</li> </ul>	<ul style="list-style-type: none"> <li>• The account of the counterparty may not hold equity security positions other than equity SBS and equity swaps</li> </ul>

# Calculating Initial Margin (cont'd)

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- An SBSB that calculates the Initial Margin Amount using the **model approach** may use third party-developed models, including ISDA SIMM, if the SBSB receives approval from the SEC.
- The SEC may approve the temporary use of a provisional model by an SBSB for calculating the Initial Margin Amount for SBS if the model has been approved for initial margin calculations by certain other supervisors.

# Collateral Eligibility Requirements

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- Unlike the CFTC and PR Rules, the SEC Rules do not set out a specific list of assets that are eligible collateral. Instead, the SEC Rules describe general categories of eligible collateral with applicable haircuts and requirements for how that collateral must be held by the SBS (or an independent custodian).
- The fair market value of collateral posted by a counterparty may be taken into account by the SBS, provided that the collateral:
  - has a ready market;
  - is readily transferable;
  - consists of **cash, securities, money market instruments**, a **major foreign currency**, the **settlement currency** of the SBS or **gold**;
  - does not consist of securities and / or money market instruments issued by the counterparty or a party related to the SBS or the counterparty; and
  - is subject to a legally enforceable agreement that the SBS may enforce against other parties.

# Collateral Eligibility Requirements (cont'd)

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- The collateral must either be:
  - subject to the physical possession or control of the SBSB and may be liquidated promptly by the SBSB without intervention by any other party; or
  - carried by an independent third-party custodian that is a bank or a registered clearing organization or depository that is not affiliated with the counterparty (or if the collateral consists of foreign securities or currencies, a supervised foreign bank, clearing organization or depository that is not affiliated with the counterparty and that customarily maintains custody of such currencies or securities).
- **Comparison with the CFTC and PR Rules:**
  - The SEC Rules are more flexible than the CFTC and PR Rules by permitting collateral for both initial and variation margin in the form of any cash, securities or money market instruments that meet the liquidity requirements.
    - Under the CFTC and PR Rules, only cash in USD, another major currency or the settlement currency may be posted as collateral for variation margin for interdealer transactions.
  - Any collateral that can be posted as collateral under the CFTC or PR Rules can be posted as collateral under the SEC Rules.
  - Unlike the CFTC and PR Rules, the SEC Rules do not require third-party custody of collateral posted by an SBSB as initial margin.

# Haircuts on Collateral

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- The fair market value of the collateral delivered by the counterparty or SBSB must be reduced by the standardized deductions, or haircuts, under the SBSB capital rules or the standard haircuts specified under the CFTC Rules.
- While largely comparable, there are some differences between the haircuts required by the CFTC and PR Rules and those required by the SEC Rules. In some instances, the SEC's standardized haircuts are more risk sensitive than those required by the CFTC and PR Rules.
  - For example, the SEC calls for a range of four haircuts of 0% – 1% for securities issued or guaranteed by the U.S. Government with a maturity of less than one year while the CFTC and PR Rules require a haircut of 0.5%.
- Utilizing the CFTC deductions reduces the likelihood that an SBSB would need to amend its existing collateral agreements if those agreements specifically reference the haircuts in the CFTC and PR Rules.
- An SBSB cannot cherry pick between the SBSB capital rules haircuts and the CFTC Rules' haircuts depending on which set provides the more advantageous haircut. The SBSB must apply the chosen haircuts consistently with respect to each counterparty.

# Netting Agreements

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- For cash and securities to be eligible as collateral, **the SEC Rules require that the collateral be subject to a netting and collateral agreement with the counterparty**, but unlike the CFTC and PR Rules, the SEC Rules do not require specific margin documentation in the form of an eligible master netting agreement.
- An SBSB may include the effect of a netting agreement under the SEC Rules that provides for the netting of gross receivables from, and gross payables to, a counterparty upon the default of the counterparty if:
  - the agreement is legally enforceable in each relevant jurisdiction, including insolvency proceedings;
  - the gross receivables and gross payables subject to the agreement can be determined at any time; and
  - the SBSB monitors and controls its exposure to the counterparty on a net basis, for internal risk management purposes.
- Existing netting and collateral arrangements entered into to comply with the CFTC and PR Rules should suffice for purposes of the SEC's requirements.

# Risk Monitoring

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- An SBSB is required under the SEC Rules to monitor the risk of each account and establish, maintain, and document procedures and guidelines for monitoring the risk of accounts as part of the risk management control system required by Exchange Act rule 15c3-4. The SEC Rules provide for eight specific elements that are the minimum elements required to be included in the SBSB's risk monitoring procedures and guidelines.
- The SBSB must review, in accordance with written procedures, at reasonable periodic intervals, its uncleared SBS activities for consistency with the risk monitoring procedures and guidelines.
- The SBSB also must determine whether information and data necessary to apply the risk monitoring procedures and guidelines are accessible on a timely basis and whether information systems are available to adequately capture, monitor, analyze, and report relevant data and information.

# Segregation Requirements



# Segregation Requirements

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- **The default—omnibus segregation:** SBSDs and broker-dealers must, as a default, hold money, securities and property of an SBS customer for both cleared and uncleared SBS in **omnibus segregation**, such that SBS customer money, securities, and property:
  - must be segregated from the funds of the SBSD or broker-dealer;
  - but may be commingled with money, security and property of other SBS customers.
- **Subject to customer election:** An SBS customer may, in some circumstances:
  - **waive segregation**, so that the customer's property could be commingled with that of the SBSD; or
  - elect **individual segregation**, in which case the customer's collateral would be held with an independent custodian.
- These requirements apply to **all SBSDs**, including bank SBSDs, and broker-dealers for their SBS activities, subject to an exemption described on slide 41.
- However, whether the requirements apply depends on the particular status of the SBSD or broker-dealer and its counterparty, as described on slide 40.

# Application of the Segregation Requirements

	<b>Stand-Alone SBSDs</b> (including bank SBSDs*)	<b>ANC Broker-Dealer SBSDs</b> Non-ANC Broker-Dealer SBSDs	<b>ANC Broker-Dealers</b> Non-ANC Broker-Dealers
<b>Cleared SBS</b>	<ul style="list-style-type: none"> <li>Omnibus segregation required (counterparty cannot elect individual segregation and segregation <b>cannot be waived</b>)</li> </ul>		
<b>Uncleared SBS with non-affiliate**</b>	<ul style="list-style-type: none"> <li>Omnibus segregation default, but counterparty <b>may waive</b> segregation or elect individual segregation</li> </ul>	<ul style="list-style-type: none"> <li>Omnibus segregation default and counterparty may elect individual segregation, but segregation <b>cannot be waived</b></li> </ul>	
<b>Uncleared SBS with affiliate</b>	<ul style="list-style-type: none"> <li>Omnibus segregation default, but counterparty <b>may waive</b> segregation or elect individual segregation</li> </ul>		

\* Bank SBSDs are also subject to the segregation requirements of the PR Rules.

\*\* The term “affiliate” is not defined in the SEC’s segregation rules. In other contexts, the SEC treats an entity as an affiliate if it controls, is controlled by or is under common control with the other entity, with “control” meaning the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of securities, by contract or otherwise.

# Exemption for Stand-Alone SBSDs that Do Not Clear on Behalf of Customers

- A **Stand-Alone SBSD** (including a bank SBSD) that meets the following conditions is **exempt** from the segregation requirements under the SEC Rules:
  - **No clearing SBS on behalf of customers:** The **Stand-Alone SBSD** must not:
    - effect transactions in cleared SBS for or on behalf of another person;
    - have any open transactions in cleared SBS executed for or on behalf of another person; and
    - hold or control any money, securities, or other property (including money, securities, or other property accruing to another person as a result of a cleared SBS transaction) to margin, guarantee, or secure cleared SBS executed for or on behalf of another person.
  - **Notice of Right to Segregate:** The **Stand-Alone SBSD** must provide its SBS counterparty with a notice that the counterparty has the right to require segregation of the funds or other property supplied to margin, guarantee or secure the counterparty's obligations. This written notice must be provided prior to the execution of the first uncleared SBS transaction with the counterparty after the compliance date.
    - This is the same notice that is required of all SBSDs for uncleared SBS. See slide 47 for details.
  - **Disclosure:** The **Stand-Alone SBSD** must provide its counterparty with a written notice disclosing (i) that any margin collateral received and held by the **Stand-Alone SBSD** will not be subject to a segregation requirement; and (ii) how a claim of a counterparty for the collateral would be treated in a bankruptcy or other formal liquidation proceeding of the **Stand-Alone SBSD**.

# Segregation Requirements for Excess Securities Collateral

- An SBSB or broker-dealer that receives **excess securities collateral** must promptly obtain and thereafter maintain **physical possession or control** of all excess securities collateral carried for the SBS accounts of SBS customers.
  - The SEC Rules set out detailed requirements for an SBSB or broker-dealer to establish control of excess securities collateral.
    - These requirements are substantially similar to the requirements for broker-dealers with respect to securities under the SEC's existing broker-dealer customer protection rules. However, the SEC Rules do not include provisions allowing SBSBs or broker-dealer to establish control either via a broker-dealer credit account at another broker-dealer under Regulation T or via custody by a foreign depository, foreign clearing agency or foreign custodian bank, as provided under the broker-dealer customer protection rules.
- **Excess securities collateral** includes:
  - securities and money market instruments carried for the account of an SBS customer
  - that have a market value in excess of the current exposure of the SBSB or broker-dealer to the customer (after reducing the current exposure by the amount of cash in the account).
- Exclusions from the definition of excess securities collateral are discussed on the following slide.

- The definition of excess securities collateral is designed to apply to securities collateral held by an SBSB or broker-dealer (including initial margin) that is **not being used to satisfy a variation margin requirement** of the customer.
- The requirement to reduce the current exposure amount by the amount of cash in a customer's account effectively requires the SBSB or broker-dealer to **allocate customers' cash first** to variation margin for purposes of the excess securities collateral requirement.

# Exclusions from Excess Securities Collateral

- The definition of excess securities collateral excludes the following securities collateral held by an SBSD or broker-dealer:
  - securities collateral held in a qualified clearing agency account that is **being used to meet a margin requirement of the clearing agency** resulting from an SBS transaction of the SBS customer; and
  - securities collateral held in a qualified account at another SBSD, including an affiliated SBSD, or in a qualified third-party custodial account, that is **being used to meet a regulatory margin requirement of another SBSD** resulting from the SBSD or broker-dealer entering into an uncleared SBS transaction with the other SBSD to offset the risk of an uncleared SBS transaction between the SBSD or broker-dealer and the SBS customer.



**Clearing agency margin:** This exclusion is designed to apply to margin the SBSD or broker-dealer must post to a clearing agency on behalf of a customer with respect to a cleared SBS transaction.



**Other SBSD margin:** This exclusion is designed to apply to margin the SBSD or broker-dealer must post to another SBSD where the SBSD or broker-dealer hedges the risk of an uncleared SBS transaction with a customer by entering a matched offsetting transaction with the other SBSD.

# Requirements for the Special Reserve Account

- An SBSB or broker-dealer must maintain at an unaffiliated bank\* a special reserve account for the exclusive benefit of SBS customers that (i) is separate from any other bank account of the SBSB or broker-dealer and (ii) holds cash and/or qualified securities equal to the net cash owed to customers, according to a specified formula:

**§ 240.18a-4a Exhibit A – Formula for determination of security-based swap customer reserve requirements under § 240.18a-4.**

**Specified formula  
for net cash owed to  
customers**

	Credits	Debits
1. Free credit balances and other credit balances in the accounts carried for security-based swap customers (See Note A)	\$ _____	
2. Monies borrowed collateralized by securities in accounts carried for security-based swap customers (See Note B)	\$ _____	
3. Security-based swap customers' securities failed to receive (See Note C)	\$ _____	
4. Credit balances in firm accounts which are attributable to principal sales of security-based swap customers deposited in a qualified clearing agency account at a clearing agency registered with the Commission pursuant to section 17A of the Act (15 U.S.C. 78q-1)		\$ _____
14. Margin related to non-cleared security-based swap transactions in accounts carried for security-based swap customers required and held in a qualified registered security-based swap dealer account at another security-based swap dealer or at a third-party custodial account		\$ _____
Total Credits	\$ _____	
Total Debits		\$ _____
Excess of Credits over Debits	\$ _____	

\* Although technically not required by the SEC Rules, the practical effect of not counting any cash held at an affiliated bank towards the minimum requirement means that the special reserve account, in all likelihood, will be held at an unaffiliated bank.

# Requirements for the Special Reserve Account (cont'd)

- The special reserve account must hold:

**Cash or qualified securities**

**≥**

**Net cash owed to customers**

- **Qualified securities** include (i) obligations of the United States, (ii) obligations that are fully guaranteed as to principal and interest by the United States and (iii) certain general obligations of any state or political subdivision of a state.
- Certain **deductions** must be made from amounts in the special reserve account, including, e.g., cash deposited at an affiliated bank.

- The SEC Rules include a detailed **formula** for determining net cash owed to customers.
- The formula requires an SBSB or broker-dealer to net credits owed to customers (e.g., balances in SBS customer accounts) against certain debits owed by customers (e.g., securities borrowed by an SBS customer to effect a short sale or to make delivery on securities that fail to deliver).

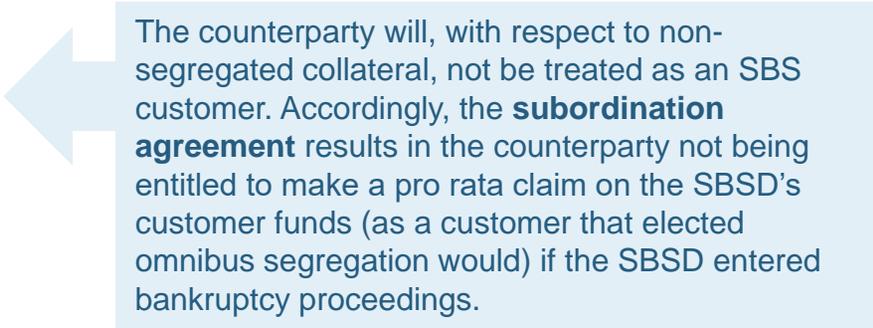
# Requirements for the Special Reserve Account (cont'd)

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- An SBSD or broker-dealer's special reserve account must be:
  - designated "Special Reserve Account for the Exclusive Benefit of the Security-Based Swap Customers of [name of SBSD or broker-dealer]";
  - subject to a written acknowledgement by the bank that the funds and other property held in the account are being held for the exclusive benefit of the SBS customers in accordance with SEC regulations and kept separate from any other accounts maintained by the SBSD or broker-dealer with the bank; and
  - subject to a written contract that provides that the funds and other property in the account shall at no time:
    - be used directly or indirectly as security for a loan or other extension of credit to the SBSD or broker-dealer; or
    - be subject to any right, charge, security interest, lien or claim of any kind in favor of the bank or any person claiming through the bank.

# SBSD Notice and Subordination Requirements for Uncleared SBS Transactions

- The SEC Rules establish notice and subordination requirements for SBSBs (but not stand-alone broker-dealers) that engage in **uncleared SBS transactions**.
- **Notice:**
  - An SBSB must provide its SBS counterparty with a notice that the counterparty has the right to require segregation of the funds or other property supplied to margin, guarantee, or secure the counterparty's obligations (**customer collateral**). The SBSB must provide this written notice prior to the execution of the first uncleared SBS transaction with the counterparty after the compliance date for the SEC Rules.
- **Subordination agreement where segregation is waived:**
  - If a counterparty elects to waive segregation for its customer collateral, then:
    - The SBSB must obtain an agreement from the counterparty, providing that the counterparty subordinates all of its claims against the SBSB to the claims of the SBSB's SBS customers.
    - For an **ANC Broker-Dealer SBSB** or **Non-ANC Broker-Dealer SBSB**, this requirement only applies with respect to affiliated counterparties because non-affiliated counterparties cannot waive segregation, as described on slide 40.



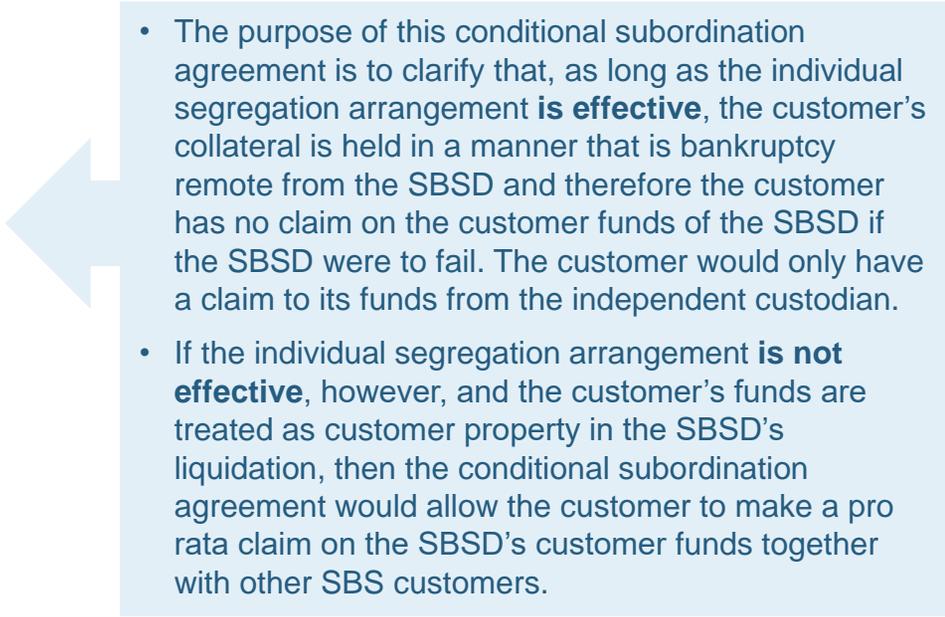
The counterparty will, with respect to non-segregated collateral, not be treated as an SBS customer. Accordingly, the **subordination agreement** results in the counterparty not being entitled to make a pro rata claim on the SBSB's customer funds (as a customer that elected omnibus segregation would) if the SBSB entered bankruptcy proceedings.

# SBSD Notice and Subordination Requirements for Uncleared SBS Transactions (cont'd)

- **Subordination agreement for individual segregation:**

- If a counterparty elects individual segregation at an independent third-party custodian for its customer collateral, then:

- The SBSD must obtain an agreement from the counterparty under which the counterparty agrees to subordinate its claims against the SBSD for customer collateral held at the third-party custodian to the claims of the SBSD's SBS customers, but only to the extent that the customer collateral is not treated as customer property in the SBSD's liquidation.
- The subordination agreement would apply with respect to the customer's claims against the SBSD only for customer collateral held at the third-party custodian and not with respect to other claims against the SBSD.

- 
- The purpose of this conditional subordination agreement is to clarify that, as long as the individual segregation arrangement **is effective**, the customer's collateral is held in a manner that is bankruptcy remote from the SBSD and therefore the customer has no claim on the customer funds of the SBSD if the SBSD were to fail. The customer would only have a claim to its funds from the independent custodian.
  - If the individual segregation arrangement **is not effective**, however, and the customer's funds are treated as customer property in the SBSD's liquidation, then the conditional subordination agreement would allow the customer to make a pro rata claim on the SBSD's customer funds together with other SBS customers.

# Cross-Border Application



# Capital and Margin Requirements

- The SEC Rules treat the SBSB capital and margin requirements as entity-level requirements, which apply to an SBSB for all of its SBS, regardless of the jurisdiction of its counterparty.
- Substituted compliance—the ability to comply with the SEC capital and margin rules through compliance with comparable rules of another jurisdiction—is available to non-U.S. SBSBs if the SEC makes a comparability determination in relation to the relevant jurisdiction.
- Comparison to PR Rules and CFTC Rules margin requirements:

Rules	Categorization of margin requirements	Availability of full substituted compliance <sup>*,**</sup>
<b>PR Rules</b>	<ul style="list-style-type: none"> <li>• N/A</li> </ul>	<ul style="list-style-type: none"> <li>• Non-U.S. SBSBs/SDs including U.S. branches (with no U.S. guarantee)</li> </ul>
<b>CFTC Rules</b>	<ul style="list-style-type: none"> <li>• Transaction-level requirement</li> </ul>	<ul style="list-style-type: none"> <li>• Non-U.S. SDs including U.S. branches (with no U.S. guarantee) depending on counterparty</li> </ul>
<b>SEC Rules</b>	<ul style="list-style-type: none"> <li>• Entity-level requirement</li> </ul>	<ul style="list-style-type: none"> <li>• Non-U.S. SBSBs, regardless of counterparty</li> </ul>

\* Availability of substituted compliance is contingent on the relevant U.S. regulator(s) making a comparability determination for a particular non-U.S. jurisdiction's analogous requirements.

\*\* Under the CFTC and PR Rules, an SBSB or SD may also be eligible for partial substituted compliance with respect to some of its initial margin requirements.

# Segregation Requirements

- The SEC Rules treat the segregation requirements as transaction-level requirements, so that their application to cross-border transactions depends on the jurisdictional status of the SBS and its counterparty.
- In general, the segregation requirements apply to all SBSs, Broker-Dealer SBSs and broker-dealers with respect to their SBS transactions.
- Only **foreign Stand-Alone SBSs**—i.e., **Stand-Alone SBSs** that are not U.S. persons—are exempt from the segregation requirements under the SEC Rules, depending on whether the foreign **Stand-Alone SBS** qualifies as either:
  - a **foreign bank Stand-Alone SBS**—i.e., a foreign **Stand-Alone SBS** that is a bank, savings bank, cooperative bank, savings and loan association, building and loan association or credit union.
  - a **foreign non-bank Stand-Alone SBS**—i.e., a foreign **Stand-Alone SBS** that is **not** a bank, savings bank, cooperative bank, savings and loan association, building and loan association or credit union.

For purposes of determining whether the SBS or its counterparty is a **U.S. person**, the term U.S. person means any person that is:

- a natural person resident in the United States;
- 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;
- an account (whether discretionary or non-discretionary) of a U.S. person; or
- an estate of a decedent who was a resident of the United States at the time of death.

# Segregation Requirements (cont'd)

- **Application of the segregation requirements to cross-border transactions:** The following chart depicts how the segregation requirements apply to cross-border SBS transactions of foreign bank **Stand-Alone SBSDs** and foreign non-bank **Stand-Alone SBSDs**.

	Foreign Bank <b>Stand-Alone SBSD</b>		Foreign Non-Bank <b>Stand-Alone SBSD</b>
	U.S. Branch or Agency	Non-U.S. Branch or Agency	
<b>Cleared SBS with U.S. person</b>	<ul style="list-style-type: none"> <li>• Segregation rules apply</li> </ul>	<ul style="list-style-type: none"> <li>• Segregation rules apply</li> </ul>	<ul style="list-style-type: none"> <li>• Segregation rules apply if funds or other property held by SBSD</li> </ul>
<b>Cleared SBS with non-U.S. person</b>	<ul style="list-style-type: none"> <li>• Segregation rules apply if funds or other property held by SBSD</li> </ul>	<ul style="list-style-type: none"> <li>• Segregation rules <b>do not apply</b></li> </ul>	<ul style="list-style-type: none"> <li>• Segregation rules apply if SBSD holds customer funds for <b>any</b> U.S. customer</li> </ul>
<b>Uncleared SBS with U.S. person</b>	<ul style="list-style-type: none"> <li>• Segregation rules apply</li> </ul>	<ul style="list-style-type: none"> <li>• Segregation rules apply</li> </ul>	<ul style="list-style-type: none"> <li>• Segregation rules apply if funds or other property held by SBSD</li> </ul>
<b>Uncleared SBS with non-U.S. person</b>	<ul style="list-style-type: none"> <li>• Segregation rules apply if funds or other property held by SBSD</li> </ul>	<ul style="list-style-type: none"> <li>• Segregation rules <b>do not apply</b></li> </ul>	<ul style="list-style-type: none"> <li>• Segregation rules <b>do not apply</b></li> </ul>

- **Substituted compliance not available:** Substituted compliance is **not available** with respect to the segregation requirements.

# Segregation Disclosure Requirements

- A **foreign Stand-Alone SBSD** must disclose in writing to an SBS customer that is a **U.S. person** the potential treatment of funds or other property segregated by the foreign **Stand-Alone SBSD** in an insolvency proceeding under U.S. bankruptcy law and any applicable foreign insolvency laws prior to receiving, acquiring or holding funds or other property for the SBS customer with respect to an SBS.

- This disclosure **must include:**

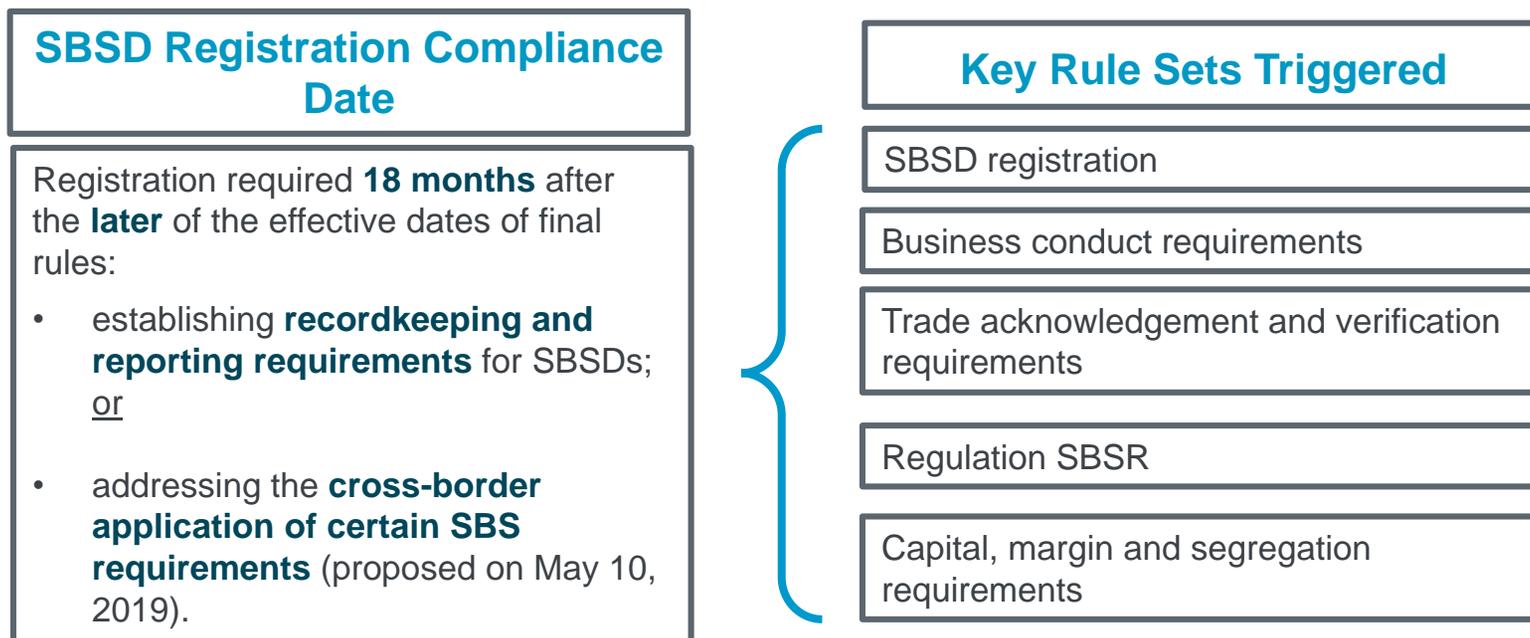
- whether the foreign **Stand-Alone SBSD** is **subject to the SEC's segregation requirement** with respect to the funds or other property received, acquired or held for the SBS customer;
- whether the foreign **Stand-Alone SBSD** could be **subject to the stockbroker liquidation provisions** in the U.S. bankruptcy code;
- whether the segregated funds or other property could be **afforded customer property treatment** under U.S. bankruptcy law; and
- **any other relevant considerations** that may affect the treatment of the funds or other property segregated under the SEC Rules in insolvency proceedings of the foreign **Stand-Alone SBSD**.

# Registration and Compliance Timing



# Registration and Compliance Timing

- The SEC Rules reset the compliance date for the SBSD registration requirements (the **SBSD Registration Compliance Date**), which is also the compliance date for the SEC Rules and a number of other key rule sets.



- Under the SBSD registration rules, an entity is not required to begin calculating whether its activities meet or exceed the *de minimis* threshold for the exception from SBSD registration until two months prior to the SBSD Registration Compliance Date.
- The SEC will consider requests for comparability determinations before the SBSD Registration Compliance Date and before SBSDs must begin compliance with the SEC's SBSD capital and margin rules.

# Davis Polk Contacts

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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