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Part III

Department of the Treasury

Office of the Comptroller of the Currency

Board of Governors of The Federal Reserve System

Federal Deposit Insurance Corporation

Farm Credit Administration

Federal Housing Finance Agency

12 CFR Parts 45, 237, 349, et al.

Margin and Capital Requirements for Covered Swap Entities; Proposed Rule

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 45

[Docket No. OCC–2011–0008]

RIN 1557–AD43

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

12 CFR Part 237

[Docket No. R–1415]

RIN 7100–AD74

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 349

RIN 3064–AE21

FARM CREDIT ADMINISTRATION

12 CFR Part 624

RIN 3052–AC69

FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1221

RIN 2590–AA45

Margin and Capital Requirements for Covered Swap Entities

AGENCY: Office of the Comptroller of the Currency, Treasury (''OCC''); Board of Governors of the Federal Reserve System (''Board''); Federal Deposit Insurance Corporation (''FDIC''); Farm Credit Administration (''FCA''); and the Federal Housing Finance Agency (''FHFA'').

ACTION: Notice of proposed rulemaking and request for comment.

SUMMARY: The OCC, Board, FDIC, FCA, and FHFA (each an ''Agency'' and, collectively, the ''Agencies'') are seeking comment on a proposed joint rule to establish minimum margin and capital requirements for registered swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants for which one of the Agencies is the prudential regulator. This proposed rule implements sections 731 and 764 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which require the Agencies to adopt rules jointly to establish capital requirements and initial and variation margin requirements for such entities and their counterparties on all non-cleared swaps and non-cleared security-based swaps in order to offset the greater risk to such entities and the financial system arising from the use of swaps and security-based swaps that are not cleared.

DATES: Comments should be received on or before November 24, 2014.

ADDRESSES: Interested parties are encouraged to submit written comments jointly to all of the Agencies. Commenters are encouraged to use the title ''Margin and Capital Requirements for Covered Swap Entities'' to facilitate the organization and distribution of comments among the Agencies.

Office of the Comptroller of the Currency. Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are encouraged to submit comments by the Federal eRulemaking Portal or email, if possible. Please use the title ''Margin and Capital Requirements for Covered Swap Entities'' to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- Federal eRulemaking Portal—''regulations.gov'': Go to *http://www.regulations.gov.* Enter ''Docket ID OCC–2011–0008'' in the Search Box and click ''Search''. Results can be filtered using the filtering tools on the left side of the screen. Click on ''Comment Now'' to submit public comments.
- Click on the ''Help'' tab on the Regulations.gov home page to get information on using Regulations.gov, including instructions for submitting public comments.
- Email: *regs.comments@occ.treas.gov.*
- Mail: Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, 400 7th Street SW., Suite 3E–218, Mail Stop 9W–11, Washington, DC 20219.
- Hand Delivery/Courier: 400 7th Street SW., Suite 3E–218, Mail Stop 9W–11, Washington, DC 20219.
- Fax: (571) 465–4326.

Instructions: You must include ''OCC'' as the agency name and ''Docket ID OCC–2011–0008'' in your comment. In general, OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, email addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this rulemaking action by any of the following methods:

- Viewing Comments Electronically: Go to *http://www.regulations.gov.* Enter ''Docket ID OCC–2011–0008'' in the Search box and click ''Search''. Comments can be filtered by Agency using the filtering tools on the left side of the screen.
- Click on the ''Help'' tab on the Regulations.gov home page to get information on using Regulations.gov, including instructions for viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.
- Viewing Comments Personally: You may personally inspect and photocopy comments at the OCC, 400 7th Street SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 649–6700. Upon arrival, visitors will be required to present valid government-issued photo identification and to submit to a security screening in order to inspect and photocopy comments.
- Docket: You may also view or request available background documents and project summaries using the methods described above.

Board of Governors of the Federal Reserve System: You may submit comments, identified by Docket No. R–1415 and RIN 7100 AD74, by any of the following methods:

- Agency Web site: *http://www.federalreserve.gov.* Follow the instructions for submitting comments at *http://www.federalreserve.gov/apps/foia/proposedregs.aspx.*
- Federal eRulemaking Portal: *http://www.regulations.gov.* Follow the instructions for submitting comments.
- Email: *regs.comments@federalreserve.gov.* Include the docket number in the subject line of the message.
- Fax: (202) 452–3819 or (202) 452–3102.
- Mail: Address to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551.

All public comments will be made available on the Board's Web site at *http://www.federalreserve.gov/apps/foia/proposedregs.aspx* as submitted, unless modified for technical reasons. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in

paper in Room MP–500 of the Board's Martin Building (20th and C Streets NW.) between 9:00 a.m. and 5:00 p.m. on weekdays.

Federal Deposit Insurance Corporation: You may submit comments, identified by RIN 3064–AE21, by any of the following methods:

- Agency Web site: *http://www.fdic.gov/regulations/laws/federal/propose.html.* Follow instructions for submitting comments on the Agency Web site.
- Email: *Comments@FDIC.gov.* Include RIN 3064–AE21 on the subject line of the message.
- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street NW., Washington, DC 20429.
- Hand Delivery: Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7:00 a.m. and 5:00 p.m.

Instructions: All comments received must include the agency name and RIN for this rulemaking and will be posted without change to *https://www.fdic.gov/regulations/laws/federal/index.html,* including any personal information provided.

Federal Housing Finance Agency: You may submit your written comments on the proposed rulemaking, identified by regulatory information number: RIN 2590–AA45, by any of the following methods:

- Agency Web site: *www.fhfa.gov/open-for-comment-or-input.*
- Federal eRulemaking Portal: *http://www.regulations.gov.* Follow the instructions for submitting comments. If you submit your comment to the Federal eRulemaking Portal, please also send it by email to FHFA at *RegComments@fhfa.gov* to ensure timely receipt by the Agency. Please include ''RIN 2590–AA45'' in the subject line of the message.
- Hand Delivery/Courier: The hand delivery address is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590–AA45, Federal Housing Finance Agency, Constitution Center (OGC Eighth Floor), 400 7th St. SW., Washington, DC 20024. Deliver the package to the Seventh Street entrance Guard Desk, First Floor, on business days between 9:00 a.m. and 5:00 p.m.
- U.S. Mail, United Parcel Service, Federal Express, or Other Mail Service: The mailing address for comments is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590–AA45, Federal Housing Finance Agency, Constitution Center (OGC Eighth Floor), 400 7th St. SW., Washington, DC 20024.

All comments received by the deadline will be posted for public inspection without change, including any personal information you provide, such as your name, address, email address and telephone number on the FHFA Web site at *http://www.fhfa.gov.* Copies of all comments timely received will be available for public inspection and copying at the address above on government-business days between the hours of 10 a.m. and 3 p.m. To make an appointment to inspect comments please call the Office of General Counsel at (202) 649–3804.

Farm Credit Administration: We offer a variety of methods for you to submit your comments. For accuracy and efficiency reasons, commenters are encouraged to submit comments by email or through the FCA's Web site. As facsimiles (fax) are difficult for us to process and achieve compliance with section 508 of the Rehabilitation Act, we are no longer accepting comments submitted by fax. Regardless of the method you use, please do not submit your comments multiple times via different methods. You may submit comments by any of the following methods:

- Email: Send us an email at *reg-comm@fca.gov.*
- FCA Web site: *http://www.fca.gov.* Select ''Law & Regulation,'' then ''FCA Regulations,'' then ''Public Comments,'' then follow the directions for ''Submitting a Comment.''
- Federal eRulemaking Portal: *http://www.regulations.gov.* Follow the instructions for submitting comments.
- Mail: Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102–5090.

You may review copies of all comments we receive at our office in McLean, Virginia or on our Web site at *http://www.fca.gov.* Once you are in the Web site, select ''Law & Regulation,'' then ''FCA Regulations,'' then ''Public Comments,'' and follow the directions for ''Reading Submitted Public Comments.'' We will show your comments as submitted, including any supporting data provided, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove email addresses to help reduce Internet spam.

FOR FURTHER INFORMATION CONTACT:

OCC: Kurt Wilhelm, Director, Financial Markets Group, (202) 649–6437, Carl Kaminski, Counsel, Legislative and Regulatory Activities Division, (202) 649–5490, or Laura Gardy, Counsel, Securities and Corporate Practices, (202) 649–5510, for persons who are deaf or hard of hearing, TTY (202) 649–5597, Office of the Comptroller of the Currency, 400 7th Street SW., Washington, DC 20219.

Board: Sean D. Campbell, Deputy Associate Director, Division of Research and Statistics, (202) 452–3760, Victoria M. Szybillo, Counsel, (202) 475–6325, or Anna M. Harrington, Senior Attorney, Legal Division, (202) 452–6406, Elizabeth MacDonald, Senior Supervisory Financial Analyst, Banking Supervision and Regulation, (202) 475–6316, Board of Governors of the Federal Reserve System, 20th and C Streets NW., Washington, DC 20551.

FDIC: Bobby R. Bean, Associate Director, Capital Markets Branch, *bbean@fdic.gov,* John Feid, Senior Policy Analyst, *jfeid@fdic.gov,* Ryan Clougherty, Capital Markets Policy Analyst, *rclougherty@fdic.gov,* Jacob Doyle, Capital Markets Policy Analyst, *jdoyle@fdic.gov,* Division of Risk Management Supervision, (202) 898–6888; Thomas F. Hearn, Counsel, *thohearn@fdic.gov,* or Catherine Topping, Counsel, *ctopping@fdic.gov,* Legal Division, Federal Deposit Insurance Corporation, 550 17th Street NW., Washington, DC 20429.

FHFA: Robert Collender, Principal Policy Analyst, Office of Policy Analysis and Research, (202) 649–3196, *Robert.Collender@fhfa.gov,* or Peggy K. Balsawer, Associate General Counsel, Office of General Counsel, (202) 649–3060, *Peggy.Balsawer@fhfa.gov,* Federal Housing Finance Agency, Constitution Center, 400 7th St. SW., Washington, DC 20024. The telephone number for the Telecommunications Device for the Hearing Impaired is (800) 877–8339.

FCA: Timothy T. Nerdahl, Senior Financial Analyst, Jeremy R. Edelstein, Financial Analyst, Office of Regulatory Policy, (703) 883–4414, TTY (703) 883–4056, or Richard A. Katz, Senior Counsel, Office of General Counsel, (703) 883–4020, TTY (703) 883–4056, Farm Credit Administration, 1501 Farm Credit Drive, McLean, VA 22102–5090.

SUPPLEMENTARY INFORMATION:

I. Background

A. The Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the ''Act'' or ''Dodd-Frank Act'') was enacted on July 21, 2010.[1] Title VII of the Dodd-

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

Frank Act established a comprehensive new regulatory framework for derivatives, which the Act generally characterizes as ''swaps'' (which are defined in section 721 of the Dodd-Frank Act to include interest rate swaps, commodity-based swaps, and broad-based credit swaps) and ''security-based swaps'' (which are defined in section 761 of the Dodd-Frank Act to include single-name and narrow-based credit swaps and equity-based swaps).[2] For the remainder of this preamble, the term ''swaps'' refers to swaps and security-based swaps unless the context requires otherwise.

As part of this new regulatory framework, sections 731 and 764 of the Dodd-Frank Act add a new section, section 4s, to the Commodity Exchange Act of 1936, as amended (''Commodity Exchange Act'') and a new section, section 15F, to the Securities Exchange Act of 1934, as amended (''Exchange Act''), respectively, which require the registration by the Commodity Futures Trading Commission (the ''CFTC'') and the Securities and Exchange Commission (the ''SEC'') of swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants (each a ''swap entity'' and, collectively, ''swap entities'').[3] For swap entities that are prudentially regulated by one of the Agencies,[4] sections 731 and 764 of the Dodd-Frank Act require the Agencies to adopt rules jointly for swap entities under their respective jurisdictions imposing (i) capital requirements and (ii) initial and variation margin requirements on all swaps not cleared by a central counterparty (''CCP'').[5] Swap entities that are prudentially regulated by one of the Agencies and therefore subject to the proposed rule are referred to herein as ''covered swap entities.''

Sections 731 and 764 of the Dodd-Frank Act also require the CFTC and SEC separately to adopt rules imposing capital and margin requirements for swap entities for which there is no prudential regulator.[6] The Dodd-Frank Act requires the CFTC, SEC, and the Agencies to establish and maintain, to the maximum extent practicable, capital and margin requirements that are comparable, and to consult with each other periodically (but no less than annually) regarding these requirements.[7]

The capital and margin standards for swap entities imposed under sections 731 and 764 of the Dodd-Frank Act are intended to offset the greater risk to the swap entity and the financial system arising from non-cleared swaps.[8] Sections 731 and 764 of the Dodd-Frank Act require that the capital and margin requirements imposed on swap entities must, to offset such risk, (i) help ensure the safety and soundness of the swap entity and (ii) be appropriate for the greater risk associated with non-cleared swaps.[9] In addition, sections 731 and 764 of the Dodd-Frank Act require the Agencies, in establishing capital requirements for entities designated as covered swap entities for a single type or single class or category of swap or

[2] *See* 7 U.S.C. 1a(47); 15 U.S.C. 78c(a)(68).

[3] *See* 7 U.S.C. 6s; 15 U.S.C. 78o–10. Section 731 of the Dodd-Frank Act requires swap dealers and major swap participants to register with the CFTC, which is vested with primary responsibility for the oversight of the swaps market under Title VII of the Dodd-Frank Act. Section 764 of the Dodd-Frank Act requires security-based swap dealers and major security-based swap participants to register with the SEC, which is vested with primary responsibility for the oversight of the security-based swaps market under Title VII of the Dodd-Frank Act. Section 712(d)(1) of the Dodd-Frank Act requires the CFTC and SEC to issue joint rules further defining the terms swap, security-based swap, swap dealer, major swap participant, security-based swap dealer, and major security-based swap participant. The CFTC and SEC issued final joint rulemakings with respect to these definitions in May 2012 and August 2012, respectively. *See* 77 FR 30596 (May 23, 2012); 77 FR 39626 (July 5, 2012) (correction of footnote in the **SUPPLEMENTARY INFORMATION** accompanying the rule); and 77 FR 48207 (August 13, 2012). 17 CFR part 1; 17 CFR parts 230, 240 and 241.

[4] Section 1a(39) of the Commodity Exchange Act defines the term ''prudential regulator'' for purposes of the capital and margin requirements applicable to swap dealers, major swap participants, security-based swap dealers and major security-based swap participants. The Board is the prudential regulator for any swap entity that is (i) a State-chartered bank that is a member of the Federal Reserve System, (ii) a State-chartered branch or agency of a foreign bank, (iii) a foreign bank which does not operate an insured branch, (iv) an organization operating under section 25A of the Federal Reserve Act (an Edge corporation) or having an agreement with the Board under section 25 of the Federal Reserve Act (an Agreement corporation), and (v) a bank holding company, a foreign bank that is treated as a bank holding company under section 8(a) of the International Banking Act of 1978, as amended, or a savings and loan holding company (on or after the transfer date established under section 311 of the Dodd-Frank Act), or a subsidiary of such a company or foreign bank (other than a subsidiary for which the OCC or FDIC is the prudential regulator or that is required to be registered with the CFTC or SEC as a swap dealer or major swap participant or a security-based swap dealer or major security-based swap participant, respectively). The OCC is the prudential regulator for any swap entity that is (i) a national bank, (ii) a federally chartered branch or agency of a foreign bank, or (iii) a Federal savings association. The FDIC is the prudential regulator for any swap entity that is (i) a State-chartered bank that is not a member of the Federal Reserve System or (ii) a State savings association. The FCA is the prudential regulator for any swap entity that is an institution chartered under the Farm Credit Act of 1971, as amended (the ''Farm Credit Act''). FHFA is the prudential regulator for any swap entity that is a ''regulated entity'' under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended (the ''Federal Housing Enterprises Financial Safety and Soundness Act'') (*i.e.,* the Federal National Mortgage Association (''Fannie Mae'') and its affiliates, the Federal Home Loan Mortgage Corporation (''Freddie Mac'') and its affiliates, and the Federal Home Loan Banks). *See* 7 U.S.C. 1a(39). In addition, OCC regulations provide that an operating subsidiary may engage only in activities that are permissible for its parent to conduct directly and require operating subsidiaries to conduct activities subject to the same authorization, terms, and conditions as apply to the conduct of those activities by the parent bank. FDIC regulations for subsidiaries of state-chartered banks incorporate similar limits to those imposed by the OCC for operating subsidiaries. Thus, if operating subsidiaries of a national bank or subsidiaries of a state-chartered bank engage in swap dealing below the aggregate *de minimis* dealer registration exemption thresholds established by the CFTC and SEC for registration as a swap dealer or security-based swap dealer, those subsidiaries must comply with the banking agencies' swap counterparty credit risk exposure safety and soundness requirements, regardless of whether the parent bank is registered as a swap dealer. If those subsidiaries engage in dealing activities above the CFTC and SEC registration thresholds, the subsidiaries must also comply with the margin requirements of this rule.

[5] *See* 7 U.S.C. 6s(e)(2)(A); 15 U.S.C. 78o–10(e)(2)(A). Section 6s(e)(1)(A) of the Commodity Exchange Act directs registered swap dealers and major swap participants for which there is a prudential regulator to comply with margin and capital rules issued by the prudential regulators, while section 6s(e)(1)(B) directs registered swap dealers and major swap participants for which there is not a prudential regulator to comply with margin and capital rules issued by the CFTC and SEC. Section 78o–10(e)(1) generally parallels section 6s(e)(1), except that section 78o–10(e)(1)(A) refers to registered security-based swap dealers and major security-based swap participants for which ''there is not a prudential regulator.'' The Agencies construe the ''not'' in section 78o–10(e)(1)(A) to have been included by mistake, in conflict with section 78o–10(e)(2)(A), and of no substantive meaning. Otherwise, registered security-based swap dealers and major security-based swap participants for which there is not a prudential regulator could be subject to multiple capital and margin rules, and institutions regulated by the prudential regulators and registered as security-based swap dealers and major security-based swap participants might not be subject to any capital and margin requirements under section 78o–10(e).

[6] *See* 7 U.S.C. 6s(e)(2)(B); 15 U.S.C. 78o–10(e)(2)(B).

[7] *See* 7 U.S.C. 6s(e)(2)(A); 6s(e)(3)(D); 15 U.S.C. 78o–10(e)(2)(A), 78o–10(e)(3)(D). Staff of the Agencies have consulted with staff of the CFTC and SEC in developing the proposed rule.

[8] *See* 7 U.S.C. 6s(e)(3)(A); 15 U.S.C. 78o–10(e)(3)(A).

[9] *See* 7 U.S.C. 6s(e)(3)(A); 15 U.S.C. 78o–10(e)(3)(A). In addition, section 1313 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 requires the Director of FHFA, when promulgating regulations relating to the Federal Home Loan Banks, to consider the following differences between the Federal Home Loan Banks and Fannie Mae and Freddie Mac: Cooperative ownership structure; mission of providing liquidity to members; affordable housing and community development mission; capital structure; and joint and several liability. *See* 12 U.S.C. 4513. The Director of FHFA also may consider any other differences that are deemed appropriate. For purposes of this proposed rule, FHFA considered the differences as they relate to the above factors. FHFA requests comments from the public about whether differences related to these factors should result in any revisions to the proposal.

activities, to take into account the risks associated with other types, classes, or categories of swaps engaged in, and the other activities conducted by swap entities that are not otherwise subject to regulation.[10] Sections 731 and 764 become effective not less than 60 days after publication of the final rule or regulation implementing these sections.

In addition to the Dodd-Frank Act authorities mentioned above, the Agencies also have safety and soundness authority over the entities they supervise.[11] The Dodd-Frank Act specified that the provisions of its Title VII shall not be construed as divesting any Agency of its authority to establish or enforce prudential or other standards under other law.[12]

The capital and margin requirements for non-cleared swaps under sections 731 and 764 of the Dodd-Frank Act complement other Dodd-Frank Act provisions that require all sufficiently standardized swaps to be cleared through a derivatives clearing organization or clearing agency.[13] This requirement is consistent with the consensus of the G–20 leaders to clear derivatives through central counterparties where appropriate.[14]

In the derivatives clearing process, CCPs manage credit risk through a range of controls and methods, including a margining regime that imposes both initial margin and variation margin requirements on parties to cleared transactions.[15] Thus, the mandatory clearing requirement established by the Dodd-Frank Act for swaps effectively will require any party to any transaction subject to the clearing mandate to post initial and variation margin in connection with that transaction.

However, if a particular swap is not cleared because it is not subject to the mandatory clearing requirement (or because one of the parties to a particular swap is eligible for, and uses, an exemption from the mandatory clearing requirement), that swap will be a ''non-cleared'' swap and may be subject to the capital and margin requirements for such transactions established under sections 731 and 764 of the Dodd-Frank Act.

The swaps-related provisions of Title VII of the Dodd-Frank Act, including sections 731 and 764, are intended in general to reduce risk, increase transparency, promote market integrity within the financial system, and, in particular, address a number of weaknesses in the regulation and structure of the swaps markets that were revealed during the financial crisis of 2008 and 2009. During the financial crisis, the opacity of swap transactions among dealers and between dealers and their counterparties created uncertainty about whether market participants were significantly exposed to the risk of a default by a swap counterparty. By imposing a regulatory margin requirement on non-cleared swaps, the Dodd-Frank Act reduces the uncertainty around the possible exposures arising from non-cleared swaps.

Further, the most recent financial crisis revealed that a number of significant participants in the swaps markets had taken on excessive risk through the use of swaps without sufficient financial resources to make good on their contracts. By imposing an initial and variation margin requirement on non-cleared swaps, sections 731 and 764 of the Dodd-Frank Act will reduce the ability of firms to take on excessive risks through swaps without sufficient financial resources. Additionally, the minimum margin requirement will reduce the amount by which firms can leverage the underlying risk associated with the swap contract.

The Agencies originally published proposed rules to implement sections 731 and 764 of the Act in May 2011 (the ''2011 proposal'').[16] Over 100 comments were received in response to the 2011 proposal from a variety of commenters, including banks, asset managers, commercial end users, and various trade associations. Like the current proposal, the 2011 proposal was issued pursuant to the Dodd-Frank Act and each Agency's safety and soundness authority.

B. Other Dodd-Frank Act Provisions Affecting the Margin and Capital Rule

The applicability of the prudential regulators' margin requirements rely in part on regulatory action taken by the CFTC, the SEC, and the Secretary of the Treasury. The margin requirements will apply to an entity listed as prudentially regulated by the Agencies under the definition of ''prudential regulator'' in the Commodity Exchange Act[17] if that entity: (1) Is a swap dealer, major swap participant, security-based swap dealer, major security-based swap participant and (2) enters into a non-cleared swap. In addition, as a means of ensuring the safety and soundness of the covered swap entity's non-cleared swap activities under the proposed rule, the requirements would apply to all of a covered swap entity's swap and security-based swap activities without regard to whether the entity has registered as both a swaps entity and a security-based swaps entity. Thus, for example, for an entity that is a swap dealer but not a security-based swap dealer or major security-based swap participant, the proposed rule's requirements would apply to all of that swap dealer's non-cleared swaps and security-based swaps.

On May 23, 2012, the CFTC and SEC adopted a final joint rule defining ''swap dealer,'' ''major swap participant,'' ''security-based swap dealer,'' and ''major security-based swap dealer.'' These definitions include quantitative thresholds in the relevant activity that affect whether an entity subject to the ''prudential regulator'' definition also will be subject to the margin regulations being proposed.[18]

On August 13, 2012, the CFTC and SEC adopted a final joint rule defining ''swap,'' ''security-based swap,'' ''foreign exchange swap,'' and ''foreign

[10] *See* 7 U.S.C. 6s(e)(2)(C); 15 U.S.C. 78o–10(e)(2)(C). In addition, the margin requirements imposed by the Agencies must permit the use of noncash collateral, as the Agencies determine to be consistent with (i) preserving the financial integrity of the markets trading swaps and (ii) preserving the stability of the U.S. financial system. *See* 7 U.S.C. 6s(e)(3)(C); 15 U.S.C. 78o–10(e)(3)(C).

[11] 12 U.S.C. 221 *et seq.,* 12 U.S.C. 1818, 12 U.S.C. 1841 *et seq.,* 12 U.S.C. 3101 *et seq.* and 12 U.S.C. 1461 *et seq.* (Board); 12 U.S.C. 2001 *et seq.;* 12 U.S.C. 2241 through 2274; 12 U.S.C. 2279aa–11; 12 U.S.C. 2279bb through bb–7 (FCA); 12 U.S.C. 4513 (FHFA).

[12] *See* Dodd-Frank Act sections 741(c) and 764(b).

[13] *See* 7 U.S.C. 2(h); 15 U.S.C. 78c–3. Certain types of counterparties (*e.g.,* counterparties that are not financial entities and are using swaps to hedge or mitigate commercial risks) are exempt from this mandatory clearing requirement and may elect not to clear a swap that would otherwise be subject to the clearing requirement.

[14] G–20 Leaders, June 2010 Toronto Summit Declaration, Annex II, ¶ 25. The dealer community has also recognized the importance of clearing—beginning in 2009, in an effort led by the Federal Reserve Bank of New York, the dealer community agreed to increase central clearing for certain credit derivatives and interest rate derivatives. *See* Press Release, Federal Reserve Bank of New York, New York Fed Welcomes Further Industry Commitments on Over-the-Counter Derivatives (June 2, 2009), *available at www.newyorkfed.org/newsevents/news/markets/2009/ma090602.html.*

[15] CCPs interpose themselves between counterparties to a swap transaction, becoming the buyer to the seller and the seller to the buyer and, in the process, taking on the credit risk that each party poses to the other. For example, when a swaps contract between two parties that are members of a CCP is executed and submitted for clearing, it is typically replaced by two new contracts—separate contracts between the CCP and each of the two original counterparties. At that point, the original counterparties are no longer counterparties to each other; instead, each faces the CCP as its counterparty, and the CCP assumes the counterparty credit risk of each of the original counterparties.

[16] 76 FR 27564 (May 11, 2011).

[17] *See* Dodd-Frank Act section 721; 7 U.S.C. 1(a)(39).

[18] *See* 77 FR 30596 (May 23, 2012), 77 FR 39626 (July 5, 2012) (correction of footnote in **SUPPLEMENTARY INFORMATION** accompanying the rule) and 77 FR 48207 (August 13, 2012); 17 CFR part 1; 17 CFR parts 230, 240, and 241.

exchange forward.'' [19] On November 16, 2012, the Secretary of the Treasury made a determination pursuant to sections 1a(47)(E) and 1(b) of the Commodity Exchange Act to exempt foreign exchange swaps and foreign exchange forwards from certain swap requirements, including margin requirements, that Title VII of the Dodd-Frank Act added to the Commodity Exchange Act.[20]

The CFTC has adopted a final rule requiring registration by entities meeting the substantive definition of swap dealer or major swap participant and engaging in relevant activities above the applicable quantitative thresholds.[21] As of June 29, 2014, 102 entities have registered as swap dealers, and 2 entities have registered as major swap participants, neither of which are insured depository institutions or otherwise among the entities listed in the prudential regulator definition. The SEC has not yet imposed a registration requirement on entities that meet the definition of ''security-based swap dealer,'' or ''major security-based swap participant.''

The CFTC and SEC have also adopted policies addressing how the Commodity Exchange Act's and Exchange Act's swap requirements will apply to ''cross-border swaps.'' [22]

C. The 2013 International Framework

Following the release of the Agencies' 2011 proposal, the Basel Committee on Banking Supervision (''BCBS'') and the Board of the International Organization of Securities Commissions (''IOSCO'') proposed an international framework for margin requirements on non-cleared swaps with the goal of creating an international standard for non-cleared swaps (the ''2012 international framework'').[23] Following the issuance of the 2012 international framework, the Agencies re-opened the comment period on the Agencies' 2011 proposal to allow for additional comment in relation to the 2012 international framework.[24] The 2012 international framework was also subject to extensive public comment before being finalized in September 2013 (the ''2013 international framework'').[25]

The 2013 international framework articulates eight key principles for non-cleared derivatives margin rules, which are described in further detail below. These principles represent the minimum standards approved by BCBS and IOSCO and recommended to the regulatory authorities in member jurisdictions of these organizations. Key principles 1 through 8 are described below.[26]

1. Appropriate Margining Practices Should Be in Place With Respect to All Non-Cleared Derivative Transactions

The 2013 international framework recommends that appropriate margining practices be in place with respect to all derivative transactions that are not cleared by CCPs. The 2013 international framework does not include a margin requirement for physically settled foreign exchange (FX) forwards and swaps.[27] The framework would also not apply initial margin requirements to the fixed physically settled FX component of cross-currency swaps.

2. Financial Firms and Systemically Important Nonfinancial Entities (Covered Entities) Must Exchange Initial and Variation Margin

The 2013 international framework recommends bilateral exchange of initial and variation margin for non-cleared derivatives between covered entities. The precise definition of ''covered entities'' is to be determined by each national regulator, but in general should include financial firms and systemically important nonfinancial entities. Sovereigns, central banks, certain multilateral development banks, the Bank for International Settlements (BIS), and non-systemic, nonfinancial firms are not included as covered entities.

Under the 2013 international framework, all covered entities that engage in non-cleared derivatives should exchange, on a bilateral basis, the full amount of variation margin with a zero threshold on a regular basis (*e.g.,* daily). All covered entities are also expected to exchange, on a bilateral basis, initial margin with a threshold not to exceed €50 million. The threshold applies on a consolidated group, rather than legal entity, basis. In addition, and in light of the permitted initial margin threshold, the 2013 international framework recommends that entities with non-cleared derivative activity of €8 billion notional or more would be subject to initial margin requirements.

3. The Methodologies for Calculating Initial and Variation Margin Should (i) Be Consistent Across Covered Entities, and (ii) Ensure That All Counterparty Risk Exposures Are Covered With a High Degree of Confidence

The 2013 international framework states that the potential future exposure of a non-cleared derivative should reflect an estimate of an increase in the value of the instrument that is consistent with a one-tailed 99% confidence level over a 10-day horizon (or longer, if variation margin is not collected on a daily basis), based on historical data that incorporates a period of significant financial stress.

The 2013 international framework permits the amount of initial margin to be calculated by reference to internal models approved by the relevant national regulator or a standardized margin schedule, but covered entities should not ''cherry pick'' between the two calculation methods. Models may allow for conceptually sound and empirically demonstrable portfolio risk offsets where there is an enforceable netting agreement in effect. However, portfolio risk offsets may only be recognized within, and not across, certain well-defined asset classes: Credit, equity, interest rates and foreign exchange, and commodities. A covered entity using the standardized margin schedule may adjust the gross initial margin amount (notional exposure multiplied by the relevant percentage in the table) by a ''net-to-gross ratio,'' which is also used in the bank counterparty credit risk capital rules to reflect a degree of netting of derivative

[19] *See* 77 FR 48207 (August 13, 2012); 17 CFR part 1; 17 CFR parts 230, 240, and 241.

[20] 77 FR 69694 (November 20, 2013).

[21] 77 FR 2613 (January 1, 2012); 17 CFR 23.21.

[22] 78 FR 45292 (July 26, 2013); 17 CFR part 1; 79 FR 39067 (July 9, 2014); 17 CFR parts 240, 241, and 250.

[23] See BCBS and IOSCO ''Consultative Document—Margin requirements for non-centrally cleared derivatives'' (July 2012), *available at http://www.bis.org/publ/bcbs226.pdf* and ''Second consultative document—Margin requirements for non-centrally cleared derivatives'' (February 2013), *available at http://www.bis.org/publ/bcbs242.pdf.*

[24] 77 FR 60057 (October 2, 2012).

[25] *See* BCBS and IOSCO ''Margin requirements for non-centrally cleared derivatives,'' (September 2013), *available at https://www.bis.org/publ/bcbs261.pdf.*

[26] The 2013 international framework refers to swaps as ''derivatives.'' For purposes of the discussion in this section, the terms ''swaps'' and ''derivatives'' can be used interchangeably.

[27] The 2013 international framework states that variation margin standards for physically settled FX forwards and swaps should be addressed by national supervisors in a manner consistent with the BCBS supervisory guidance recommendations for these products. *See* BCBS ''Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions,'' (February 2013), *available at: https://www.bis.org/publ/bcbs241.pdf* (BCBS FX supervisory guidance). The Board implemented the BCBS FX supervisory guidance in SR letter 13–24 ''Managing Foreign Exchange Settlement Risks for Physically Settled Transactions'' (December 23, 2013) available at *http://www.federalreserve.gov/bankinforeg/srletters/sr1324.htm.* As discussed elsewhere in this preamble, in 2012, the Secretary of the Treasury made a determination that physically-settled foreign exchange forwards and swaps are not to be considered swaps under the Dodd-Frank Act. 77 FR 69694 (November 20, 2012).

positions that are subject to an enforceable netting agreement.

4. To Ensure That Assets Collected as Collateral Can Be Liquidated in a Reasonable Amount of Time To Generate Proceeds That Could Sufficiently Protect Covered Entities From Losses in the Event of a Counterparty Default, These Assets Should Be Highly Liquid and Should, After Accounting for an Appropriate Haircut, Be Able To Hold Their Value in a Time of Financial Stress

The 2013 international framework recommends that national supervisors develop a definitive list of eligible collateral assets. The 2013 international framework includes examples of permissible collateral types, provides a schedule of standardized haircuts, and indicates that model-based haircuts may be appropriate. In the event that a dispute arises over the value of eligible collateral, the 2013 international framework provides that both parties should make all necessary and appropriate efforts, including timely initiation of dispute resolution protocols, to resolve the dispute and exchange any required margin in a timely fashion.

5. Initial Margin Should Be Exchanged on a Gross Basis and Held in Such a Way as To Ensure That (i) the Margin Collected Is Immediately Available to the Collecting Party in the Event of the Counterparty's Default, and (ii) the Collected Margin Is Subject to Arrangements That Fully Protect the Posting Party

The 2013 international framework provides that collateral collected as initial margin from a ''customer'' (defined as a ''buy-side financial firm'') should be segregated from the initial margin collector's proprietary assets. The initial margin collector also should give the customer the option to individually segregate its initial margin from other customers' margin. In very specific circumstances, the initial margin collector may use margin provided by the customer to hedge the risks associated with the customer's positions with a third party. To the extent that the customer consents to rehypothecation, it should be permitted only where applicable insolvency law gives the customer protection from risk of loss of initial margin in instances where either the initial margin collector or the third party become insolvent, or they both do. Where a customer has consented to rehypothecation and adequate legal safeguards are in place, the margin collector and the third party to whom customer collateral is rehypothecated should comply with additional restrictions detailed in the 2013 international framework, including a prohibition on any further rehypothecation of the customer's collateral by the third party.

6. Requirements for Transactions Between Affiliates Are Left to the National Supervisors

The 2013 international framework recommends that national supervisors establish margin requirements for transactions between affiliates as appropriate in a manner consistent with each jurisdiction's legal and regulatory framework.

7. Requirements for Margining Non-Cleared Derivatives Should Be Consistent and Non-Duplicative Across Jurisdictions

Under the 2013 international framework, home-country supervisors may allow a covered entity to comply with a host-country's margin regime if the host-country margin regime is consistent with the 2013 international framework. A branch may be subject to the margin requirements of either the headquarters' jurisdiction or the host country.

8. Margin Requirements Should Be Phased in Over an Appropriate Period of Time

The 2013 international framework phases in margin requirements between December 2015 and December 2019. Covered entities should begin exchanging variation margin by December 1, 2015. The date on which a covered entity should begin to exchange initial margin with a counterparty depends on the notional amount of non-cleared derivatives (including physically settled FX forwards and swaps) entered into both by its consolidated corporate group and by the counterparty's consolidated corporate group.

Currency denomination. The 2013 international framework generally lays out a broad conceptual framework for margining requirements on non-cleared derivatives. It also recommends specific quantitative levels for several parameters such as the level of notional derivative exposure that results in an entity being subject to the margin requirements (€8 billion), permitted initial margin thresholds (€50 million), and minimum transfer amounts (€500,000). In the 2013 international framework, all such amounts are denominated in Euros. In this proposal all such amounts are denominated in U.S. dollars. The Agencies are aware that, over time, amounts that are denominated in different currencies in different jurisdictions may fluctuate relative to one another due to changes in exchange rates. The Agencies seek comment on whether and how fluctuations resulting from exchange rate movements should be addressed. In particular, should these amounts be expressed in terms of a single currency in all jurisdictions to prevent such fluctuations? Should the amounts be adjusted over time if and when exchange rate movements necessitate realignment? Are there other approaches to deal with fluctuations resulting from significant exchange rate movements? Are there other issues that should be considered in connection to the effects of fluctuating exchange rates?

II. Overview of Proposed Rule

A. Margin Requirements

The Agencies have reviewed the comments received on the 2011 proposal and the 2013 international framework. The Agencies believe that a number of changes to the 2011 proposal are warranted in order to reflect certain comments received, as well as to achieve the 2013 international framework's goal of promoting global consistency and reducing regulatory arbitrage opportunities. In light of the significant differences from the 2011 proposal, the Agencies are seeking comment on a revised proposed rule to implement section 4s of the Commodity Exchange Act and section 15F of the Exchange Act (the ''proposal'' or the ''proposed rule'').

The Agencies are proposing to adopt a risk-based approach that would establish initial and variation margin requirements for covered swap entities. Consistent with the statutory requirement, the proposed rule would help ensure the safety and soundness of the covered swap entity and would be appropriate for the risk to the financial system associated with non-cleared swaps held by covered swap entities. The proposed rule takes into account the risk posed by a covered swap entity's counterparties in establishing the minimum amount of initial and variation margin that the covered swap entity must exchange with its counterparties.

In implementing this risk-based approach, the proposed rule distinguishes among four separate types of swap counterparties: (i) Counterparties that are themselves swap entities; (ii) counterparties that are financial end users with a material swaps exposure; (iii) counterparties that are financial end users without a material swaps exposure, and (iv) other

counterparties, including nonfinancial end users, sovereigns, and multilateral development banks.[28] These categories reflect the Agencies' current belief that risk-based distinctions can be made between these types of swap counterparties.

The proposed rule's initial and variation margin requirements generally apply to the posting, as well as the collection, of minimum initial and variation margin amounts by a covered swap entity from and to its counterparties. This proposal represents a refinement to the Agencies' original collection-only approach to margin requirements based on consideration of comments made on the 2011 proposal and the 2013 international framework. While the Agencies believe that imposing requirements with respect to the minimum amount of initial and variation margin to be collected is a critical aspect of offsetting the greater risk to the covered swap entity and the financial system arising from the covered swap entity's non-cleared swap exposure, the Agencies also believe that requiring a covered swap entity to post margin to other financial entities could forestall a build-up of potentially destabilizing exposures in the financial system. The proposed rule's approach therefore is designed to ensure that covered swap entities transacting with other swap entities and with financial end users in non-cleared swaps will be collecting and posting appropriate minimum margin amounts with respect to those transactions.

For initial margin, the proposed rule would require a covered swap entity to calculate its minimum initial margin requirement in one of two ways. The covered swap entity may use a standardized margin schedule, which is set out in Appendix A of the proposed rule. The standardized margin schedule allows for certain types of netting and offsetting of exposures. In the alternative, a covered swap entity may use an internal margin model that satisfies certain criteria outlined within § __.8 of the proposed rule and that has been approved by the relevant prudential regulator.[29]

Where a covered swap entity transacts with another swap entity (regardless of whether the other swap entity meets the definition of a ''covered swap entity'' under the proposed rule), the covered swap entity must collect at least the amount of initial margin required under the proposed rule. Likewise, the swap entity counterparty also will be required, under margin rules that are applicable to that swap entity,[30] to collect a minimum amount of initial margin from the covered swap entity.[31] Accordingly, covered swap entities will both collect and post a minimum amount of initial margin when transacting with another swap entity. A covered swap entity transacting with a financial end user with a material swaps exposure as specified by this proposed rule must collect at least the amount of initial margin required by the proposed rule and must post at least the amount of initial margin that the covered swap entity would be required by the proposal to collect if the covered swap entity were in the place of the counterparty. In addition, a covered swap entity must post or collect initial margin on at least a daily basis as required under the proposed rule in response to changes in the required initial margin amounts stemming from changes in portfolio composition or any other factors that result in a change in the required initial margin amounts.[32]

The proposed rule permits a covered swap entity to adopt a maximum initial margin threshold amount of $65 million, below which it need not collect or post initial margin from or to swap entities and financial end users with material swaps exposures. The threshold would be applied on a consolidated basis, and would apply both to the consolidated covered swap entity as well as to the consolidated counterparty.[33]

With respect to variation margin, the proposed rule generally requires a covered swap entity to collect or post variation margin on swaps with a swap entity or a financial end user (regardless of whether the financial end user has a material swaps exposure) in an amount that is at least equal to the increase or decrease in the value of the swap since the counterparties' previous exchange of variation margin. The proposed rule would not permit a covered swap entity to adopt a threshold amount below which it need not collect or post variation margin on swaps with swap entity and financial end user counterparties. In addition, a covered swap entity must collect or post variation margin with swap entities and financial end user counterparties under the proposed rule on at least a daily basis.[34]

The proposed rule's margin provisions establish only *minimum* requirements with respect to initial and variation margin. Nothing in the proposed rule is intended to prevent or discourage a covered swap entity from collecting or posting margin in amounts greater than is required under the proposed rule.

Under the proposal, a covered swap entity's collection of margin from ''other counterparties'' that are not swap entities or financial end users (e.g., nonfinancial or ''commercial'' end users that generally engage in swaps to hedge commercial risk, sovereigns, and multilateral developments banks), is subject to the judgment of the covered swap entity. That is, under the proposed rule, a covered swap entity is not required to collect initial and variation margin from these ''other counterparties'' as a matter of course. However, a covered swap entity should continue with the current practice of collecting initial or variation margin at such times and in such forms and amounts (if any) as the covered swap entity determines in its overall credit risk management of the swap entity's exposure to the customer.

Although covered swap entities would be required to collect variation margin from all financial end user counterparties under the proposed rule, no minimum initial margin requirement would apply to transactions with those financial end users that are not swap entities and that do not have a material swaps exposure. Thus, for the purpose of the initial margin requirements, financial end users that are not swap entities and that do not have a material swaps exposure would be treated in the same manner as entities characterized as ''other counterparties.''

The Agencies believe that differential treatment of ''other counterparties'' is consistent with the Dodd-Frank Act's

[28] *See* § __.2 of the proposed rule for the various constituent definitions that identify these four types of swap counterparties.

[29] *See* § __.8 and Appendix A of the proposed rule for a complete description of the requirements for initial margin models and standardized minimum initial margin requirements.

[30] All swap entities will be subject to a rule on minimum margin for non-cleared swaps promulgated by one of the Agencies, the SEC or the CFTC.

[31] The counterparty may be a covered swap entity subject to this proposed rule or a swap entity that is subject to the margin rules of the CFTC or SEC. If the counterparty is a covered swap entity, it must collect at least the amount of margin required under this proposal. If the counterparty is a swap entity subject to the margin rules of the CFTC or SEC, it must collect the amount of margin required under the CFTC or SEC margin rules.

[32] Under the proposed rule, when entering into a swap transaction, the first collection and posting of initial margin may be delayed for one day following the day the swap transaction is executed. Thereafter, posting and collecting initial margin must be made on at least a daily basis in response to changes in portfolio composition or any other factors that would change the required initial margin amounts.

[33] *See* §§ __.3 and ___.8 of the proposed rule for a complete description of the initial margin requirements.

[34] *See* § __.4 of the proposed rule for a complete description of the variation margin requirements.

risk-based approach to establishing margin requirements. However, the Agencies recognize that a covered swap entity may find it prudent from a risk management perspective to collect margin from one or more of these ''other counterparties.'' [35]

The proposed rule limits the types of collateral that are eligible to be used to satisfy both the initial and variation margin requirements. Eligible collateral is generally limited to high-quality, liquid assets that are expected to remain liquid and retain their value, after accounting for an appropriate risk-based ''haircut,'' during a severe economic downturn. Eligible collateral for variation margin is limited to cash only. Eligible collateral for initial margin includes cash, debt securities that are issued or guaranteed by the U.S. Department of Treasury or by another U.S. government agency, the Bank for International Settlements, the International Monetary Fund, the European Central Bank, multilateral development banks, certain U.S. Government-sponsored enterprises' (''GSEs'') debt securities, certain foreign government debt securities, certain corporate debt securities, certain listed equities, and gold.[36] When determining the collateral's value for purposes of satisfying the proposed rule's margin requirements, non-cash collateral and cash collateral that is not denominated in U.S. dollars or the currency in which payment obligations under the swap are required to be settled would be subject to an additional ''haircut'' as determined using Appendix B of the proposed rule.[37] The limits on eligible collateral and application of a haircut would not apply to margin collected in excess of what is required by the rule.

Separate from the proposed rule's requirements with respect to the collection and posting of initial and variation margin, the proposed rule also would require a covered swap entity to require that any collateral other than variation margin that it posts to its counterparty (even collateral in excess of any required by the proposed rule) be segregated at one or more custodians that are not affiliates of the covered swap entity or the counterparty (''third-party custodian''). The proposed rule would also require a covered swap entity to place the initial margin it collects (in accordance with the proposed rule) from a swap entity or a financial end user with material swaps exposure at a third-party custodian.[38] In both of the foregoing cases, the proposed rule would require that the third-party custodian be prohibited by agreement from certain actions with respect to any of the funds or other property it holds as initial margin. First, the custodial agreement must prohibit rehypothecating, repledging, reusing or otherwise transferring, any of the funds or other property the third-party custodian holds. Second, with respect to initial margin required to be posted or collected, the custodial agreement must prohibit substituting or reinvesting any funds or other property in any asset that would not qualify as eligible collateral under the proposed rule. Third, the custodial agreement must require that after such substitution or reinvestment, the amount net of applicable discounts described in Appendix B continue to be sufficient to meet the requirements for initial margin under the proposal.[39] Funds or other property held by a third-party custodian but not required to be posted or collected under the rule are not subject to any of these restrictions on collateral substitution or reinvestment.

Given the global nature of swaps markets and swap transactions, margin requirements will be applied to transactions across different jurisdictions. As required by the Dodd-Frank Act, the Agencies are proposing a specific approach to address cross-border non-cleared swap transactions. Under the proposal, foreign swaps of foreign covered swap entities would not be subject to the margin requirements of the proposed rule.[40] In addition, certain covered swap entities that are operating in a foreign jurisdiction and covered swap entities that are organized as U.S. branches of foreign banks may choose to abide by the swap margin requirements of the foreign jurisdiction if the Agencies determine that the foreign regulator's swap margin requirements are comparable to those of the proposed rule.[41]

B. Capital Requirements

Sections 731 and 764 of the Dodd-Frank Act also require each Agency to issue, in addition to margin rules, joint rules on capital for covered swap entities for which it is the prudential regulator.[42] The Board, FDIC, and OCC (each a ''banking agency'' and, collectively, the ''banking agencies'') have had risk-based capital rules in place for banks to address over-the-counter (''OTC'') swaps since 1989 when the banking agencies implemented their risk-based capital adequacy standards (general banking risk-based capital rules) [43] based on the first Basel Accord.[44] The general banking risk-based capital rules have been amended and supplemented over time to take into account developments in the swaps market. These supplements include the addition of the market risk rule which requires banks and bank holding companies meeting certain thresholds to calculate their capital requirements for trading positions through models approved by their primary Federal supervisor.[45] In addition, certain large, complex banks and bank holding companies are subject to the banking agencies' advanced approaches risk-based capital rule (advanced approaches rules), based on the advanced approaches of the Basel II Accord.[46]

[35] *See* § __.3 and § __.4 of the proposed rule for a complete description of the initial and variation margin requirements that apply to ''other counterparties.''

[36] An asset-backed security guaranteed by a U.S. Government-sponsored enterprise is eligible collateral for purposes of initial margin if the GSE is operating with capital support or another form of direct financial assistance from the U.S. government (§ __.6(a)(2)(iii)).

[37] *See* § __.6 and Appendix B of the proposed rule for a complete description of the eligible collateral requirements.

[38] The segregation requirement therefore applies only to the minimum amount of initial margin that a covered swap entity is required to collect by the rule from a swap entity or financial end user with a material swaps exposure, but applies to all collateral (other than variation margin) that the covered swap entity posts to any counterparty.

[39] *See* § __.7 of the proposed rule for a complete description of the segregation requirements.

[40] *See* § __.9 of the proposed rule.

[41] *See* § __.9 of the proposed rule for a complete description of the treatment of cross-border swap transactions.

[42] 7 U.S.C. 6s(e)(2); 15 U.S.C. 78o–10(e)(2).

[43] *See* 54 FR 4186 (January 27, 1989). The general banking risk-based capital rules are at 12 CFR part 3, Appendices A, B, and C (national banks); 12 CFR part 167 (federal savings banks); 12 CFR part 208, Appendices A, B, and E (state member banks); 12 CFR part 225, Appendices A, D, and E (bank holding companies); 12 CFR part 325, Appendices A, B, C, and D (state nonmember banks); 12 CFR part 390, subpart Z (state savings associations). The general risk-based capital rules are supplemented by the market risk capital rules.

[44] The Basel Committee on Banking Supervision developed the first international banking capital framework in 1988, entitled, *International Convergence of Capital Measurement and Capital Standards.*

[45] The banking agencies' market risk capital rules are currently at 12 CFR part 3, Appendix B (OCC); 12 CFR parts 208 and 225, Appendix E (Board); and 12 CFR part 325, Appendix C (FDIC). The rules apply to banks and bank holding companies with trading activity (on a worldwide consolidated basis) that equals 10 percent or more of the institution's total assets, or $1 billion or more.

[46] *See* BCBS, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (2006). The banking agencies implemented the advanced approaches of the Basel II Accord in 2007. *See* 72 FR 69288 (December 7, 2010). The advanced approaches rules are codified at 12 CFR part 3, Appendix C (OCC); 12 CFR part

Continued

In July 2013 the Board and the OCC issued a final rule (revised capital framework) implementing regulatory capital reforms reflecting agreements reached by the BCBS in ''Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems.'' [47] The revised capital framework includes the capital requirements for OTC swaps described above. The FDIC adopted an interim final rule that was substantively identical to the revised capital framework in July 2013 and later issued a final rule in April 2014 identical to the Board's and the OCC's final rule.[48]

FHFA's predecessor agencies used a methodology similar to that endorsed by the BCBS prior to the development of its recent revised and enhanced framework to develop the risk-based capital rules applicable to those entities now regulated by FHFA. Those rules still apply to all FHFA-regulated entities.[49] FHFA is in the process of revising and updating these regulations for the Federal Home Loan Banks. The FCA's risk-based capital regulations for Farm Credit System (''FCS'') institutions, except for the Federal Agricultural Mortgage Corporation (''Farmer Mac''), have been in place since 1988 and were last updated in 2005.[50] The FCA's risk-based capital regulations for Farmer Mac have been in place since 2001 and were updated in 2011.[51] On May 8, 2014, the FCA proposed revisions to its capital rules for all FCS institutions, except Farmer Mac, that are comparable to the Basel III framework.[52]

As described below, the proposed rule requires a covered swap entity to comply with regulatory capital rules already made applicable to that covered swap entity as part of its prudential regulatory regime. Given that these existing regulatory capital rules specifically take into account and address the unique risks arising from swap transactions and activities, the Agencies are proposing to rely on these existing rules as appropriate and sufficient to offset the greater risk to the covered swap entity and the financial system arising from the use of swaps that are not cleared and to protect the safety and soundness of the covered swap entity.

C. 2011 FCA and FHFA Special Section

In the 2011 proposal, FHFA and FCA (but not the other Agencies) had proposed an additional provision, § __.11 of FHFA's and FCA's proposed rules. Proposed § __.11 would have required any entity that was regulated by FHFA or FCA, but was not itself a covered swap entity, to collect initial margin and variation margin from its swap entity counterparty when entering into a non-cleared swap.[53] Federal Home Loan Banks, Fannie Mae and its affiliates, Freddie Mac and its affiliates, and all Farm Credit System institutions including Farmer Mac (each a ''regulated entity'' and, collectively, ''regulated entities'') would have been subject to this provision. Regulated entities that were covered swap entities would have been subject to §§ 1 through 9 of the 2011 proposal with respect to margin.

FHFA and FCA proposed § __.11 to account for the fact that the 2011 proposal only required covered swap entities to collect initial and variation margin from, but did not require them to post initial and variation margin to, their counterparties.[54] The approach that FHFA and FCA proposed in § __.11 recognized that a default by a swap counterparty to a regulated entity could adversely affect the safe and sound operations of the regulated entity. FHFA and FCA proposed § __.11 pursuant to each Agency's role as safety and soundness regulator for its respective regulated entities.

FHFA and FCA are not re-proposing as part of this proposal a provision similar to that found in § __.11 of the 2011 proposal. Unlike the 2011 proposal, this proposal generally would require two-way margining in swap transactions between covered swap entities and FHFA- and FCA-regulated entities.[55] This two-way margining regime effectively reduces systemic risk by protecting both the regulated entity and its covered swap entity counterparty from the effects of a counterparty default, thereby eliminating the need for FHFA and FCA to propose a separate provision similar to the earlier proposed § __.11. However, should any changes adopted as part of the final joint rule alter the current proposed two-way margining regime in ways that raise safety and soundness concerns for FHFA or FCA with regard to their respective regulated entities, FHFA or FCA may decide to exercise its authority to adopt a provision similar to § __.11 of the 2011 proposal to address these concerns.[56]

208, Appendix F and 12 CFR part 225, Appendix G (Board); and 12 CFR part 325, Appendix D (FDIC).

[47] *See* BCBS, *Basel III: A Global Regulatory Framework For More Resilient Banks and Banking Systems* (2010), *available at www.bis.org/publ.bcbs189.htm.*

[48] 78 FR 62018 (October 11, 2013) (Board and OCC); 78 FR 20754 (April 14, 2014) (FDIC). These rules are codified at 12 CFR part 3 (national banks and federal savings associations), 12 CFR part 217 (state member banks, bank holding companies, and savings and loan holding companies), and 12 CFR part 324 (state nonmember banks and state savings associations).

[49] For the duration of the conservatorships of Fannie Mae and Freddie Mac (together, the ''Enterprises''), FHFA has directed that its existing regulatory capital requirements would not be binding. However, FHFA continues to closely monitor the Enterprises' activities. Such monitoring, coupled with the unique financial support available to the Enterprises from the U.S. Department of the Treasury and the likelihood that FHFA will promulgate new risk-based capital rules in due course to apply to the Enterprises (or their successors) once the conservatorships have ended, lead to FHFA's preliminary view that the reference to existing capital rules is sufficient to address the risks discussed in the text above as to the Enterprises.

[50] *See* 53 FR 40033 (October 13, 1988); 70 FR 35336 (June 17, 2005); 12 CFR part 615, subpart H.

[51] *See* 66 FR 19048 (April 12, 2001); 76 FR 23459 (April 27, 2011); 12 CFR part 652.

[52] The FCA recently proposed revisions to its capital rules for all FCS institutions, except Farmer Mac, that are comparable to the Basel III Framework.

[53] *See* 76 FR 27564, 27582–83 (May 11, 2011). Section __.11 of the 2011 proposal would have required regulated entities to collect initial and variation margin from their swap entity counterparties on parallel terms to the requirements governing collection by covered swap entities under other sections of the 2011 proposal, including with respect to initial margin calculation methods (via the use of a model or a standardized ''lookup'' table), documentation standards and segregation requirements. Section __.11 of the 2011 proposal would not have applied to swaps entered into between regulated entities and end users.

[54] Where a covered swap entity's counterparty was another covered swap entity, the collection requirement would have applied in both directions to make the requirement effectively bilateral.

[55] Two-way margining would not necessarily apply in all circumstances. A regulated entity that is not itself a swap entity would meet the proposed definition of financial end user. As a result, if it engaged in swap activity above the threshold set in the definition of material swaps exposure, then the rule would require two-way margining as to both initial and variation margin, with respect to its transactions with covered swap entities. If a regulated entity does not have material swaps exposure, then a covered swap entity and the regulated entity would be required to exchange variation margin with each other but would only be required to collect or post initial margin in such amounts as the parties determine to be appropriate. In such circumstances, no specific amount of initial margin would be required to be collected or posted pursuant to this proposal.

[56] Any final joint rule issued by the Agencies, once effective, would address these safety and soundness concerns only in circumstances where a regulated entity is transacting with a covered swap entity regulated by a prudential regulator. Where a regulated entity is instead engaged in a non-cleared swap with a swap entity that is not subject to the oversight of one of the prudential regulators, the applicable margin requirements would be those issued by the regulator having jurisdiction over the swap entity, namely the CFTC or the SEC. If one of those agencies were to diverge from the two-way margining regime proposed here (and recommended by the 2013 international framework) in a manner that raises safety and soundness concerns for FHFA or FCA with regard to their respective regulated entities, FHFA or FCA also may exercise its authority to adopt a special section to account for those situations as well, either in the final joint rulemaking, or in a separate rulemaking or guidance at a later date.

Furthermore, FHFA and FCA each reserves the right and authority to address its safety and soundness concerns through the Agencies' final joint rulemaking or through a separate rulemaking or guidance applicable only to its respective regulated entities.

D. The Proposed Rule and Community Banks

The Agencies expect that the proposed rule likely will have minimal impact on community banks. The Agencies anticipate that community banks will not engage in swap activity to the level necessary to meet the definition of a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant; and therefore, are unlikely to fall within the proposed definition of a covered swap entity. Because the proposed rule imposes requirements on covered swap entities, no community bank will likely be directly subject to the rule. Thus, a community bank that enters into non-cleared interest rate swaps with its commercial customers would not be required to apply to those swaps the proposed rule's requirements for initial margin or variation margin.

When a community bank enters into a swap with a covered swap entity, the covered swap entity would be required to post and collect initial margin pursuant to the rule only if the community bank had a material swaps exposure.[57] The Agencies believe that the vast majority of community banks do not engage in swaps at or near that level of activity. Thus, for most, if not all community banks, the proposed rule would only require a covered swap entity to collect initial margin that it determines is appropriate to address the credit risk posed by such a community bank. The Agencies believe covered swap entities currently apply this approach as part of their credit risk management practices.

The proposed rule would require a covered swap entity to exchange daily variation margin with a community bank, regardless of whether the community bank had material swaps exposure. However, the covered swap entity would only be required to collect variation margin from a community bank when the amount of both initial margin and variation margin required to be collected daily exceeded $650,000. The Agencies expect that the vast majority of community banks will have a daily margin requirement that is below this amount.

The Agencies seek comment on the potential impact that this proposed rule might have on community banks.

E. The Proposed Rule and Farm Credit System Institutions

Similar to community banks, the proposed rule will have a minimal impact on the Farm Credit System. Currently, no FCS institution, including Farmer Mac, engage in swap activity at the level necessary to meet the definition of a swap dealer, major swap participant, security-based swap dealer, or a major security-based swap participant. For this reason, no FCS institution, including Farmer Mac, would fall within the proposed definition of a covered swap entity and, therefore, become directly subject to this rule. Furthermore, an overwhelming majority of FCS institutions do not currently engage in non-cleared swaps at or near the level that they would have a material swaps exposure. Therefore, a majority of FCS institutions would not be required by this rule to exchange initial margin with a covered swap entity. For those few FCS institutions that currently have a material swaps exposure, initial margin exchange would be mandated only when non-cleared swap transactions with an individual counterparty and its affiliates exceed the $65 million threshold. All FCS institutions, including Farmer Mac, are financial end users and, therefore, they must exchange variation margin daily once the parties reach the $650,000 minimum transfer amount.

The Agencies also seek specific comments on the potential impact of this proposal on FCS institutions.

III. Section by Section Summary of Proposed Rule

A. Section __.1: Authority, Purpose, Scope, and Compliance Dates

Sections __.1(a)–(c) of the proposal are agency-specific. Section __.1(a) sets out each Agency's specific authority, and § __.1(b) describes the purpose of the rule, including the specific entities covered by each Agency's rule. Section __.1(c) of the proposal specifies the scope of the transactions to which the margin requirements apply. It provides that the margin requirements apply to *all* non-cleared swaps into which a covered swap entity enters. Each prudential regulator is proposing rule text for its Agency-specific version of § ___.1(c) that specifies the entities to which that prudential regulator's rule applies. Section __.1(c) further states that the margin requirements apply only to swap and security-based swap transactions that are entered into on or after the relevant compliance date set forth in § __.1(d). This section also provides that nothing in this proposal is intended to prevent, and nothing in this proposal is intended to require, a covered swap entity from independently collecting margin in amounts greater than are required under this proposed rule.

1. Treatment of Swaps With Commercial End User Counterparties

Following passage of the Dodd-Frank Act, various parties expressed concerns regarding whether sections 731 and 764 of the Dodd-Frank Act authorize or require the CFTC, SEC, and Agencies to establish margin requirements with respect to transactions between a covered swap entity and a ''commercial end user'' (*i.e.,* a nonfinancial counterparty that is neither a swap entity nor a financial end user and engages in swaps to hedge commercial risk).[58] Pursuant to other provisions of the Dodd-Frank Act, nonfinancial end users that engage in swaps to hedge their commercial risks are exempt from the requirement that all swaps designated for clearing by the CFTC or SEC be cleared by a CCP, and, therefore they are exempt from the requirement to post initial margin and variation margin to the CCP. Commenters to the 2011 proposal argued that swaps with commercial end users should also be excluded from the scope of margin requirements imposed for non-cleared swaps under sections 731 and 764, asserting that commercial firms engaged in hedging activities pose a reduced risk to their counterparties and the stability of the U.S. financial system and that including these types of counterparties in the scope of the proposal would undermine the goals of excluding these firms from the clearing requirements.[59]

[57] The proposed rule defines material swaps exposure as an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps with all counterparties for June, July, and August of the previous calendar year that exceeds $3 billion, where such amount is calculated only for business days.

[58] Although the term ''commercial end user'' is not defined in the Dodd-Frank Act, it is generally understood to mean a company that is eligible for the exception to the mandatory clearing requirement for swaps under section 2(h)(7) of the Commodity Exchange Act and section 3C(g) of the Securities Exchange Act, respectively. This exception is generally available to a person that (i) is not a financial entity, (ii) is using the swap to hedge or mitigate commercial risk, and (iii) has notified the CFTC or SEC how it generally meets its financial obligations with respect to non-cleared swaps or security-based swaps, respectively. *See* 7 U.S.C. 2(h)(7) and 15 U.S.C. 78c–3(g).

[59] Statements in the legislative history of sections 731 and 764 suggest that at least some members of Congress did not intend, in enacting these sections, to impose margin requirements on nonfinancial end users engaged in hedging activities, even in cases where they entered into swaps with swap entities.

Continued

In formulating the proposed rule, the Agencies have carefully considered these concerns and statements. The plain language of sections 731 and 764 provides that the Agencies adopt rules for covered swap entities imposing margin requirements on *all non-cleared swaps.* Those sections do not, by their terms, exclude a swap with a counterparty that is a commercial end user. Importantly, sections 731 and 764 also direct the Agencies to adopt margin requirements that (i) help ensure the safety and soundness of the covered swap entity and (ii) are appropriate for the risk associated with the non-cleared swaps. Thus, the statute requires the Agencies to take a risk-based approach to establishing margin requirements. Further, the Dodd-Frank Act does not contain an express exemption for commercial end users from the margin requirements of sections 731 and 764 of the Dodd-Frank Act. The Agencies note that the application of margin requirements to non-cleared swaps with nonfinancial end users could be viewed as lessening the effectiveness of the clearing requirement exemption for these nonfinancial end users.

The 2011 proposal permitted a covered swap entity to adopt, where appropriate, initial and variation margin thresholds below which the covered swap entity would not be required to collect initial or variation margin from nonfinancial end users. The proposal noted the lesser risk posed by these types of counterparties to covered swap entities and financial stability with respect to exposures below these thresholds. The Agencies received many comments on this aspect of the 2011 proposal. In particular, commenters requested that swap transactions with nonfinancial end users and a number of other counterparties, including sovereigns and multilateral development banks, be explicitly excluded from the margin requirements.

The proposal takes a different approach to nonfinancial end users than the 2011 proposal. Like the 2011 proposal, this proposal follows the statutory framework and proposes a risk-based approach to imposing margin requirements. Unlike the 2011 proposal, this proposal does not require that the covered swap entity determine a specific, numerical threshold for each nonfinancial end user counterparty. Rather, the proposed rule does not require a covered swap entity to collect initial margin and variation margin from nonfinancial end users and certain other counterparties as a matter of course, but instead requires it to collect initial and variation margin at such times and in such forms and amounts (if any) as the covered swap entity determines would appropriately address the credit risk posed by swaps entered into with ''other counterparties.'' [60] The Agencies believe that this approach is consistent with current market practice as well as with well-established internal credit processes and standards of swap entities, based on safety and soundness, that require covered swap entities to use an integrated approach in evaluating the risk of their counterparties in extending credit, including in the form of a swap, and manage the overall credit exposure to the counterparty.

The proposal takes a similar approach to margin requirements for transactions between covered swap entities and sovereign entities; multilateral development banks; the Bank for International Settlements; captive finance companies exempt from clearing pursuant to the Dodd-Frank Act; and Treasury affiliates exempt from clearing pursuant to the Dodd-Frank Act.[61] The Agencies believe that this approach is consistent with the statute, which requires the margin requirements to be risk-based, and is appropriate in light of the lower risks that these types of counterparties generally pose to the safety and soundness of covered swap entities and U.S. financial stability.

2. Compliance Dates

Section __.1(d) of the proposal includes a set of compliance dates by which covered swap entities must comply with the minimum margin requirements for non-cleared swaps. The compliance dates of the proposal are consistent with the 2013 international framework. The proposed rule would be effective with respect to any swap to which a covered swap entity becomes a party on or after the relevant compliance date and would continue to apply regardless of future changes in the measured swaps exposure of the covered swap entity and its affiliates or the counterparty and its affiliates.

For variation margin, the compliance date is December 1, 2015 for all covered swap entities with respect to covered swaps with any counterparty. The Agencies believe that the collection of daily variation margin is currently a best practice and, as such, current swaps business operations for covered swap entities of all sizes will be able to achieve compliance with the proposed rule by December 1, 2015. Therefore, there is no phase-in for the variation margin requirements.

As reflected in the table below, for initial margin, the compliance dates range from December 1, 2015 to December 1, 2019 depending on the average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps (''covered swaps'') of the covered swap entity and its counterparty for June, July and August of that year.[62]

COMPLIANCE DATE SCHEDULE FOR INITIAL MARGIN

Compliance date	Initial margin requirements
December 1, 2015	Initial margin where both the covered swap entity combined with its affiliates and the counterparty combined with its affiliates have an average daily aggregate notional amount of covered swaps for June, July and August of 2015 that exceeds $4 trillion.
December 1, 2016	Initial margin where both the covered swap entity combined with its affiliates and the counterparty combined with its affiliates have an average daily aggregate notional amount of covered swaps for June, July and August of 2016 that exceeds $3 trillion.
December 1, 2017	Initial margin where both the covered swap entity combined with its affiliates and the counterparty combined with its affiliates have an average daily aggregate notional amount of covered swaps for June, July and August of 2017 that exceeds $2 trillion.

See, e.g., 156 Cong. Rec. S5904 (daily ed. July 15, 2010) (statement of Sen. Lincoln).

[60] In the case of a nonfinancial end user with a strong credit profile, under current market practices, a swap dealer would likely not require margin—in essence, it would extend unsecured credit to the end user with respect to the underlying exposure. For counterparties with a weak credit profile, a swap dealer would likely make a different credit decision and require the counterparty to post margin.

[61] *See* 7 U.S.C. 2(h)(7)(C)(iii), 7 U.S.C. 2(h)(7)(D) and 15 U.S.C. 78c–3(g)(4).

[62] ''Foreign exchange forward and foreign exchange swap'' is defined to mean any foreign exchange forward, as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)), and foreign exchange swap, as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25)).

COMPLIANCE DATE SCHEDULE FOR INITIAL MARGIN—Continued

Compliance date	Initial margin requirements
December 1, 2018	Initial margin where both the covered swap entity combined with its affiliates and the counterparty combined with its affiliates have an average daily aggregate notional amount of covered swaps for June, July and August of 2018 that exceeds $1 trillion.
December 1, 2019	Initial margin for any other covered swap entity with respect to covered swaps with any other counterparty.

The Agencies expect that covered swap entities likely will need to make a number of operational and legal changes to their current swaps business operations in order to achieve compliance with the proposed rule, including potential changes to internal risk management and other systems, trading documentation, collateral arrangements, and operational technology and infrastructure. In addition, the Agencies expect that covered swap entities that wish to calculate initial margin using an initial margin model will need sufficient time to develop such models and obtain regulatory approval for their use. Accordingly, the compliance dates have been structured to ensure that the largest and most sophisticated covered swap entities and counterparties that present the greatest potential risk to the financial system comply with the requirements first. These swap market participants should be able to make the required operational and legal changes more rapidly and easily than smaller entities that engage in swaps less frequently and pose less risk to the financial system.

Section __.1(e) provides that once a covered swap entity and its counterparty must comply with the margin requirements for non-cleared swaps based on the compliance dates in § __.1(d), the covered swap entity and its counterparty shall remain subject to the margin requirements from that point forward. As an example, December 1, 2016 is the relevant compliance date where both the covered swap entity combined with its affiliates and its counterparty combined with its affiliates have an average aggregate daily notional amount of covered swaps that exceeds $3 trillion. If the notional amount of the swap activity for the covered swap entity or the counterparty drops below that threshold amount of covered swaps in subsequent years, their swaps would nonetheless remain subject to the margin requirements. On December 1, 2019, any covered swap entity that did not have an earlier compliance date becomes subject to the margin requirements with respect to non-cleared swaps entered into with any counterparty.

3. Treatment of Swaps Executed Prior to the Applicable Compliance Date under a Netting Agreement

The Agencies note that a covered swap entity may enter into swaps on or after the proposed rule's compliance date pursuant to the same master netting agreement that governs existing swaps entered into with a counterparty prior to the compliance date. As discussed below, the proposed rule permits a covered swap entity to (i) calculate initial margin requirements for swaps under an eligible master netting agreement (''EMNA'') with the counterparty on a portfolio basis in certain circumstances, if it does so using an initial margin model; and (ii) calculate variation margin requirements under the proposed rule on an aggregate, net basis under an EMNA with the counterparty. Applying the proposed rule in such a way would, in some cases, have the effect of applying it retroactively to swaps entered into prior to the compliance date under the EMNA. The Agencies expect that the covered swap entity will comply with the margin requirements with respect to all swaps governed by an EMNA, regardless of the date on which they were entered into, consistent with current industry practice.[63] A covered swap entity would need to enter into a separate master netting agreement for swaps entered into after the proposed rule's compliance date in order to exclude swaps entered into with a counterparty prior to the compliance date.

4. Non-Cleared Swaps Between Covered Swap Entities and Their Affiliates

The proposed rule prescribes margin requirements on all non-cleared swaps between a covered swap entity and its counterparties. In particular, the proposal generally would cover swaps between banks that are covered swap entities and their affiliates that are financial end users, including affiliates that are subsidiaries of a bank, such as operating subsidiaries, Edge Act subsidiaries, agreement corporation subsidiaries, financial subsidiaries, and lower-tier subsidiaries of such subsidiaries. The Agencies note that other applicable laws require transactions between banks and their affiliates to be on an arm's length basis. In particular, section 23B of the Federal Reserve Act provides that many transactions between a bank and its affiliates must be on terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to the bank as those prevailing at the time for comparable transactions with or involving nonaffiliated companies.[64] The requirements of section 23B generally would mean that a bank engaging in a swap with an affiliate should do so on the same terms (including the posting and collecting of margin) that would prevail in a swap between the bank and a nonaffiliated company. Since the proposed rule will apply to a swap between a bank and a nonaffiliated company, it will also apply to a swap between a bank and an affiliate.

While section 23B applies to transactions between a bank and its financial subsidiary, it does not apply to transactions between a bank and other subsidiaries, such as an operating subsidiary, an Edge Act subsidiary, or an agreement corporation subsidiary. The proposed rule does not exempt a bank's swaps with these affiliates and would therefore impose margin requirements on all swaps between a bank and a subsidiary, including a subsidiary that is not covered by section 23B.

B. Section __.2: Definitions

Section __.2 of the 2011 proposal defined its key terms. In particular, the 2011 proposal defined the four types of swap counterparties that formed the basis of the 2011 proposal's risk-based approach to margin requirements. Section ___.2 also provided other key operative terms needed to calculate the amount of initial and variation margin required under other sections of the 2011 proposal.

[63] *See* proposed rule §§ __.4(d) and __.8(b).

[64] 12 U.S.C. 371c–1(a).

1. Overview of 2011 Proposal and Comments on Swap Counterparty Definitions

The four types of counterparties defined in the 2011 proposal were (in order of highest to lowest risk): (i) Swap entities; (ii) high-risk financial end users; (iii) low-risk financial end users; and (iv) nonfinancial end users. The 2011 proposal defined ''swap entity'' as any entity that is required to register as a swap dealer, major swap participant, security-based swap dealer or major security-based swap participant.[65]

Section __.2 of the 2011 proposal defined a financial end user largely based on the definition of a ''financial entity'' that is ineligible for the exemption from the mandatory clearing requirements of sections 723 and 763 of the Dodd-Frank Act, and also included foreign governments.[66] As noted above, the 2011 proposal also distinguished between margin requirements for high-risk and low-risk financial end users. Section __.2 of the 2011 proposal defined a financial end user counterparty as a low-risk financial end user only if (i) its swaps fall below a specified ''significant swaps exposure'' threshold; (ii) it predominantly uses swaps to hedge or mitigate the risks of its business activities; and (iii) it is subject to capital requirements established by a prudential regulator or state insurance regulator. The 2011 proposal defined a nonfinancial end user as any counterparty that is an end user but is not a financial end user.[67]

The Agencies requested comment on whether the 2011 proposal's categorization of various types of counterparties by risk, and the key definitions used to implement this risk-based approach, were appropriate, or whether alternative approaches or definitions would better reflect the purposes of sections 731 and 764 of the Dodd-Frank Act. As discussed above, many commenters argued that nonfinancial end users should not be subject to the margin requirements and urged that the language and intent of the statute did not require the imposition of margin on nonfinancial end users.

Many commenters also argued that particular types of entities should either be excluded from the term financial end user or be classified as a low-risk financial end user instead of a high-risk financial end user.[68] In particular, commenters argued that the following entities should be excluded from the definition of financial end user: (i) Foreign sovereigns; (ii) states and municipalities; (iii) multilateral development banks; (iv) captive finance companies; (v) Treasury affiliates; (vi) cooperatives exempt from clearing; (vii) pension plans; (viii) payment card networks; and (ix) special purpose vehicles. A few commenters contended that small financial end users should be treated as nonfinancial end users because these entities use swaps mostly to hedge risk.

2. 2014 Proposal for Swap Counterparty Definitions

Section __.2 of the proposal defines key terms used in the proposed rule, including the types of counterparties that form the basis of the proposal's risk-based approach to margin requirements and other key terms needed to calculate the required amount of initial margin and variation margin.[69] As noted above, this proposal distinguishes among four separate types of counterparties: [70] (i) Counterparties that are themselves swap entities; (ii) counterparties that are financial end users with a material swaps exposure; (iii) counterparties that are financial end users without a material swaps exposure; and (iv) other counterparties, including nonfinancial end users, sovereigns, and multilateral development banks. Below is a general description of the significant terms defined in § __.2.[71]

a. Swap Entity

Similar to the 2011 proposal, this proposal defines ''swap entity'' by reference to the Securities Exchange Act and the Commodity Exchange Act to mean a security-based swap dealer, a major security-based swap participant, a swap dealer, or a major swap participant.

b. Financial End User

The proposal's definition of financial end user takes a different approach than the 2011 proposal, which, as noted above, was based on the definition of a ''financial entity'' that is ineligible for the exemption from mandatory clearing requirements of sections 723 and 763 of the Dodd-Frank Act. In order to provide certainty and clarity to counterparties as to whether they would be financial end users for purposes of this proposal, the financial end user definition provides a list of entities that would be financial end users as well as a list of entities excluded from the definition. This approach would mean that covered swap entities would not need to make a determination regarding whether their counterparties are predominantly engaged in activities that are financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956, as amended (the ''BHC Act'').[72] In contrast to the 2011 proposal, the Agencies now are proposing to rely, to the greatest extent possible, on the counterparty's legal status as a regulated financial entity.

Under the proposal, financial end user includes a counterparty that is not a swap entity but is:

- A bank holding company or an affiliate thereof; a savings and loan holding company; a nonbank financial institution supervised by the Board of Governors of the Federal Reserve System under Title I of the Dodd-Frank

[65] *See* 2011 proposal § __.2(y) (2011).

[66] *See* 7 U.S.C. 2(h)(7); 15 U.S.C. 78c–3(g).

[67] *See* 2011 proposal § __.2(r) (2011).

[68] As described further below, the proposal does not distinguish between high-risk and low-risk financial end users in this manner.

[69] Initial margin means the collateral as calculated in accordance with § __.8 that is posted or collected in connection with a non-cleared swap. *See* proposed rule § __.2; *see also* proposed rule § __.3 (describing initial margin requirements). Variation margin means a payment by one party to its counterparty to meet performance of its obligations under one or more non-cleared swaps between the parties as a result of a change in value of such obligations since the last time such payment was made. *See* proposed rule § __.2; *see also* proposed rule § __.4 (describing variation margin requirements).

[70] Counterparty is defined to mean, with respect to any non-cleared swap or non-cleared security-based swap to which a covered swap entity is a party, each other party to such non-cleared swap or non-cleared security-based swap. Non-cleared swap means a swap that is not a cleared swap, as that term is defined in section 1a(7) of the Commodity Exchange Act (7 U.S.C. 1a(7)) and non-cleared security-based swap means a security-based swap that is not, directly or indirectly, submitted to and cleared by a clearing agency registered with the SEC. Clearing agency is defined to have the meaning specified in section 3(a)(2) of the Securities Exchange Act (15 U.S.C. 78c(a)(23)) and derivatives clearing organization is defined to have the meaning specified in section 1a(15) of the Commodity Exchange Act (7 U.S.C. 1a(15)). *See* proposed rule § __.2.

[71] The term ''nonfinancial end user'' is not used in the proposal. Nonfinancial end users would be treated as ''other counterparties'' in the proposal. *See* proposed rule § __.3(d) & __.4(c).

[72] The financial entity definition in the 2011 proposal includes a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature, as defined in section 4(k) of the BHC Act. *See* 7 U.S.C. 2(h)(7); 15 U.S.C. 78c–3(g). The Agencies requested comment on how covered swap entities should make this determination, and whether they should use an approach similar to that developed by the Board for purposes of Title I of the Dodd-Frank Act. *See* 68 FR 20756 (April 5, 2013). Section 4(k) of the BHC Act includes conditions that do not define whether an activity is itself financial but were imposed on bank holding companies to ensure that the activity is conducted by bank holding companies in a safe and sound manner or to comply with another provision of law. Staff of the Agencies recognize that by simply choosing not to comply with the conditions imposed on the manner in which those activities must be conducted by bank holding companies, a firm could avoid being considered to be engaged in activities that are financial in nature.

Wall Street Reform and Consumer Protection Act (12 U.S.C. 5323);

• A depository institution; a foreign bank; a Federal credit union, State credit union as defined in section 2 of the Federal Credit Union Act (12 U.S.C. 1752(1) & (6)); an institution that functions solely in a trust or fiduciary capacity as described in section 2(c)(2)(D) of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)(D)); an industrial loan company, an industrial bank, or other similar institution described in section 2(c)(2)(H) of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)(H));

• An entity that is state-licensed or registered as a credit or lending entity, including a finance company; money lender; installment lender; consumer lender or lending company; mortgage lender, broker, or bank; motor vehicle title pledge lender; payday or deferred deposit lender; premium finance company; commercial finance or lending company; or commercial mortgage company; but excluding entities registered or licensed solely on account of financing the entity's direct sales of goods or services to customers;

• A money services business, including a check casher; money transmitter; currency dealer or exchange; or money order or traveler's check issuer;

• A regulated entity as defined in section 1303(20) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4502(20)) and any entity for which the Federal Housing Finance Agency or its successor is the primary federal regulator;

• Any institution chartered and regulated by the Farm Credit Administration in accordance with the Farm Credit Act of 1971, as amended, 12 U.S.C. 2001 et seq.;

• A securities holding company; a broker or dealer; an investment adviser as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)); an investment company registered with the SEC under the Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.); or a company that has elected to be regulated as a business development company pursuant to section 54(a) of the Investment Company (15 U.S.C. 80a–53);

• A private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80–b–2(a)); an entity that would be an investment company under section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3) but for section 3(c)(5)(C); or an entity that is deemed not to be an investment company under section 3 of the Investment Company Act of 1940 pursuant to Investment Company Act Rule 3a–7 of the Securities and Exchange Commission (17 CFR 270.3a–7);

• A commodity pool, a commodity pool operator, or a commodity trading advisor as defined in, respectively, sections 1a(10), 1a(11), and 1a(12) of the Commodity Exchange Act (7 U.S.C. 1a(10), 7 U.S.C. 1a(11), 7 U.S.C. 1a(12)); or a futures commission merchant;

• An employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002);

• An entity that is organized as an insurance company, primarily engaged in writing insurance or reinsuring risks underwritten by insurance companies, or is subject to supervision as such by a State insurance regulator or foreign insurance regulator;

• An entity that is, or holds itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in loans, securities, swaps, funds or other assets for resale or other disposition or otherwise trading in loans, securities, swaps, funds or other assets;

• An entity that would be a financial end user as described above or a swap entity, if it were organized under the laws of the United States or any State thereof; or

• Notwithstanding the specified exclusions described below, any other entity that [Agency] has determined should be treated as a financial end user.

In developing this definition of financial end user, the Agencies sought to provide certainty and clarity to covered swap entities and their counterparties regarding whether particular counterparties would qualify as financial end users and be subject to the margin requirements of the proposed rule. The Agencies tried to strike a balance between the desire to capture all financial counterparties, without being overly broad and capturing commercial firms and sovereigns. Financial firms present a higher level of risk than other types of counterparties because the profitability and viability of financial firms is more tightly linked to the health of the financial system than other types of counterparties. Because financial counterparties are more likely to default during a period of financial stress, they pose greater systemic risk and risk to the safety and soundness of the covered swap entity. In case the list of financial end users in the proposal does not capture a particular entity, the last part of this definition would allow an Agency to require a covered swap entity to treat a counterparty as a financial end user for margin purposes, where appropriate for safety and soundness purposes or to address systemic risk.

In developing the list of financial entities, the Agencies sought to include entities subject to Federal statutes that impose registration or chartering requirements on entities that engage in specified financial activities, such as deposit taking and lending, securities and swaps dealing, or investment advisory activities; as well as asset management and securitization entities. For example, certain securities investment funds as well as securitization vehicles are covered, to the extent those entities would qualify as private funds defined in section 202(a) of the Investment Advisers Act of 1940, as amended (the ''Advisers Act''). In addition, certain real estate investment companies would be included as financial end users as entities that would be investment companies under section 3 of the Investment Company Act of 1940, as amended (the ''Investment Company Act''), but for section 3(c)(5)(C), and certain other securitization vehicles would be included as entities deemed not to be investment companies pursuant to Rule 3a–7 of the Investment Company Act.

Because Federal law largely looks to the States for the regulation of the business of insurance, the proposed definition broadly includes entities organized as insurance companies or supervised as such by a State insurance regulator. This element of the proposed definition would extend to reinsurance and monoline insurance firms, as well as insurance firms supervised by a foreign insurance regulator.

The Agencies are also proposing to cover, as financial end users, the broad variety and number of nonbank lending and retail payment firms that operate in the market. To this end, the Agencies are proposing to include State-licensed or registered credit or lending entities and money services businesses, under proposed regulatory language incorporating an inclusive list of the types of firms subject to State law.[73] However, the Agencies recognize that the licensing of nonbank lenders in some states extends to commercial firms

[73] The Agencies expect that state-chartered financial cooperatives that provide financial services to their members, such as lending to their members and entering into swaps in connection with those loans, would be treated as financial end users, pursuant to this aspect of the proposed rule's coverage of credit or lending entities.

that provide credit to the firm's customers in the ordinary course of business. Accordingly, the Agencies are proposing to exclude an entity registered or licensed solely on account of financing the entity's direct sales of goods or services to customers. The Agencies request comment on whether this aspect of the proposed rule adequately maintains a distinction between financial end users and commercial end users.

Under the proposed rule, those cooperatives that are financial institutions, such as credit unions, FCS banks and associations, and other financial cooperatives [74] are financial end users because their sole business is lending and providing other financial services to their members, including engaging in swaps in connection with such loans.[75] Cooperatives that are financial end users may qualify for an exemption from clearing,[76] and therefore, they may enter into non-cleared swaps with covered swap entities that are subject to the proposed rule.

The Agencies remain concerned, however, that now or in the future, one or more types of financial entities might escape classification under the specific Federal or State regulatory regimes included in the proposed definition of a financial end user. The Agencies have accordingly included two additional prongs in the definition. First, the Agencies have included language that would cover an entity that is, or holds itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in loans, securities, swaps, funds or other assets for resale or other disposition or otherwise trading in loans, securities, swaps, funds or other assets. The Agencies request comment on the extent to which there are (or may be in the future) pooled investment vehicles that are not captured by the other prongs of the definition (such as the provisions covering private funds under the Advisers Act or commodity pools under the Commodity Exchange Act). The Agencies also request comment on whether this aspect of the definition of financial end user provides sufficiently clear guidance to covered swap entities and market participants as to its intended scope, and whether it adequately maintains a distinction between financial end users and commercial end users.

Second, as previously explained, the proposed rule would allow an Agency to require a covered swap entity to treat an entity as a financial end user for margin purposes, as appropriate for safety and soundness purposes, or to mitigate systemic risks. In such case, consistent with the Agency's supervisory procedures, the Agency that is the covered swap entity's prudential regulator would notify the covered swap entity in writing of the regulator's intention to require treatment of the counterparty as a financial end user, and the date by which such treatment is to be implemented.[77]

To address the classification of foreign entities as financial end users, the Agencies are proposing to require the covered swap entity to determine whether a foreign counterparty would fall within another prong of the financial end user definition if the foreign entity was organized under the laws of the United States or any State. The Agencies recognize that this approach would impose upon covered swap entities the difficulties associated with analyzing a foreign counterparty's business activities in light of a broad array of U.S. regulatory requirements. The alternative, however, would require covered swap entities to gather a foreign counterparty's financial reporting data and determine the relative amount of enumerated financial activities in which the counterparty is engaged over a rolling period.[78] The Agencies request comment on whether some other method or approach would adequately assure that the rule's objectives with respect to covered swap entity safety and soundness and reductions of systemic risk can be achieved, in a fashion that can be more readily operationalized by covered swap entities.

Unlike the 2011 proposal, the proposal excludes certain types of counterparties from the definition of financial end user. In particular, the proposal states that the term ''financial end user'' does not generally include any counterparty that is:

- A sovereign entity; [79]
- A multilateral development bank; [80]
- The Bank for International Settlements;
- A captive finance company that qualifies for the exemption from clearing under section 2(h)(7)(C)(iii) of the Commodity Exchange Act and implementing regulations; or
- A person that qualifies for the affiliate exemption from clearing pursuant to section 2(h)(7)(D) of the Commodity Exchange Act or section 3C(g)(4) of the Securities Exchange Act and implementing regulations.

The Agencies note the exclusion for sovereign entities, multilateral development banks and the Bank for International Settlements is generally consistent with the 2013 international framework which recommended that margin requirements not apply to sovereigns, central banks, multilateral development banks or the Bank for International Settlements. The last two categories that are excluded from the financial end user definition were excluded by Title VII of the Dodd-Frank Act from the definition of financial entity subject to mandatory clearing. The Agencies also believe that this approach is appropriate as these entities generally pose less systemic risk to the financial system in addition to posing less counterparty risk to a swap entity. Thus, the Agencies believe that application of the margin requirements

[74] The National Rural Utility Cooperative Finance Cooperation is an example of another financial cooperative.

[75] Most cooperatives are producer, consumer, or supply cooperatives and, therefore, they are not financial end users. However, many of these cooperatives have financing subsidiaries and affiliates. These financing subsidiaries and affiliates would not be financial end users under this proposal if they qualify for an exemption under sections 2(h)(7)(C)(iii) or 2(h)(7)(D) of the Commodity Exchange Act or section 3C(g)(4) of the Securities Exchange Act of 1934.

[76] Section 2(h)(7)(c)(ii) of the Commodity Exchange Act and section 3C(g)(4) of the Securities Exchange Act of 1934 authorize the CFTC and the SEC, respectively, to exempt small depository institutions, small Farm Credit System institutions, and small credit unions with total assets of $10 billion or less from the mandatory clearing requirements for swaps and security-based swaps. *See* 7 U.S.C. 2(h)(7) and 15 U.S.C. 78c–3(g). Additionally, the CFTC, pursuant to its authority under section 2(h)(1)(A) of the Commodity Exchange Act, enacted 17 CFR part 50, subpart C, section 50.51, which allows cooperative financial entities, including those with total assets in excess of $10 billion, to elect an exemption from mandatory clearing of swaps that: (1) They enter into in connection with originating loans for their members; or (2) hedge or mitigate commercial risk related to loans or swaps with their members.

[77] The Agencies' procedures would generally provide an adequate opportunity for the covered swap entity to raise objections to the Agency's proposed action and for the Agency to respond.

[78] *See, e.g.,* 68 FR 20756 (April 5, 2013).

[79] Sovereign entity is defined to mean a central government (including the U.S. government) or an agency, department, or central bank of a central government. *See* proposed rule § __.2. A sovereign entity would include the European Central Bank for purposes of this exclusion.

[80] Multilateral development bank is defined to mean the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and any other entity that provides financing for national or regional development in which the U.S. government is a shareholder or contributing member or which the [AGENCY] determines poses comparable credit risk. *See* proposed rule § __.2.

to swaps with these counterparties is not necessary to achieve the objectives of this rule.

The Agencies note that States would not be excluded from the definition of financial end user, as the term ''sovereign entity'' includes only central governments. The categorization of a State or particular part of a State as a financial end user depends on whether that part of the State is otherwise captured by the definition of financial end user. For example, a State entity that is a ''governmental plan'' under the Employment Retirement Income Security Act of 1974, as amended, would meet the definition of financial end user.

The Agencies believe that the proposal addresses many of the commenters' concerns about the definition of ''financial end user'' contained in the 2011 proposal. Entities that are neither financial end users nor swap entities are treated as ''other counterparties'' in this proposal.[81] The Agencies seek comment on all aspects of the financial end user definition including whether the definition has succeeded in capturing all entities that should be treated as financial end users. The Agencies request comment on whether there are additional entities that should be included as financial end users and, if so, how those entities should be defined. Further, the Agencies also request comment on whether there are additional entities that should be excluded from the definition of financial end user and why those particular entities should be excluded. The Agencies also request comment on whether another approach to defining financial end user (*e.g.,* basing the financial end user definition on the financial entity definition as in the 2011 proposal) would provide more appropriate coverage and clarity, and whether covered swap entities could operationalize such an approach as part of their regular procedures for taking on new counterparties.

c. Material Swaps Exposure

The proposal differs from the 2011 proposal by distinguishing between swaps with financial end user counterparties that have a material swaps exposure and swaps with financial end user counterparties that do not have a material swaps exposure. ''Material swaps exposure'' for an entity is defined to mean that the entity and its affiliates have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps with all counterparties for June, July and August of the previous year that exceeds $3 billion, where such amount is calculated only for business days. The Agencies believe that using the average daily aggregate notional amount during June, July, and August of the previous year, instead of a single as-of date, is appropriate to gather a more comprehensive assessment of the financial end user's participation in the swaps market, and address the possibility that a market participant might ''window dress'' its exposure on an as-of date such as year-end, in order to avoid the Agencies' margin requirements. Material swaps exposure would be calculated based on the previous year. For example, on January 1, 2015, an entity would determine whether it had a material swaps exposure in June, July and August of 2014 that exceeded $3 billion.[82]

d. Other Definitions

The proposal also defines a number of other terms that were not defined in the 2011 proposal. The Agencies believe that these definitions will help provide additional clarity regarding the application of the margin requirements contained in the proposed rule.

i. Affiliate

The proposal defines ''affiliate'' to mean any company that controls, is controlled by, or is under common control with another company. This definition of affiliate is the same as that in the BHC Act and consequently should be familiar to market participants.[83] The proposal also defines subsidiary to mean a company that is controlled by another company, which is similar to the definition in the BHC Act and the Board's Regulation Y.[84]

The term affiliate is used in the definition of initial margin threshold amount which means a credit exposure of $65 million that is applicable to non-cleared swaps between a covered swap entity and its affiliates with a counterparty and its affiliates. The inclusion of affiliates in this definition is meant to make clear that the initial margin threshold amount applies to an entity and its affiliates. Similarly, the term ''affiliate'' is also used in the definition of ''material swaps exposure,'' as material swaps exposure takes into account the exposures of an entity and its affiliates.

ii. Control

The definitions of ''affiliate'' and ''subsidiary'' use the term ''control,'' which is also a defined term in the proposal.[85] The proposal provides that control of another company means: (i) Ownership, control, or power to vote 25 percent or more of a class of voting securities of the company, directly or indirectly or acting through one or more other persons; (ii) ownership or control of 25 percent or more of the total equity of the company, directly or indirectly or acting through one or more other persons; or (iii) control in any manner of the election of a majority of the directors or trustees of the company. This definition of control is similar to the definition under the BHC Act and consequently should be familiar to many market participants.[86]

The Agencies seek comment on the definition of control in this proposal. In particular, the Agencies request comment on this definition of control as it relates to advised and sponsored funds and sponsored securitization vehicles. The Agencies believe that advised and sponsored funds and sponsored securitization vehicles would not be affiliates of the investment adviser or sponsor unless the adviser or sponsor meets the definition of control (*e.g.,* owning 25 percent or more of the voting securities or total equity or controlling the election of the majority

[81] As is further discussed below, these entities excluded from the definition of ''financial end users,'' as well as nonfinancial counterparties, are treated as ''other counterparties'' with respect to the proposed variation margin requirements. With respect to the proposed initial margin requirements, the ''other counterparties'' category also includes financial end users that do not have a material swaps exposure.

[82] As a specific example of the calculation for material swaps exposure, consider a financial end user (together with its affiliates) with a portfolio consisting of two non-cleared swaps (e.g., an equity swap, an interest rate swap) and one non-cleared security-based credit swap. Suppose that the notional value of each swap is exactly $10 billion on each business day of June, July, and August of 2015. Furthermore, suppose that a foreign exchange forward is added to the entity's portfolio at the end of the day on July 31, 2015, and that its notional value is $10 billion on every business day of August 2015. On each business day of June and July 2015, the aggregate notional amount of non-cleared swaps, security-based swaps and foreign exchange forwards and swaps is $30 billion. Beginning on August 1, 2015 the aggregate notional amount of non-cleared swaps, security-based swaps and foreign exchange forwards and swaps is $40 billion. The daily average aggregate notional value for June, July and August of 2015 is then (22 × $30 billion +23 × $30 billion + 21 × $40 billion)/(22 + 23 + 21) = $33.18 billion, in which case this entity would be considered to have a material swaps exposure for every date in 2016.

[83] *See* section 2(k) of the Bank Holding Company Act, 12 U.S.C. 1841(k).

[84] *See* section 2(d) of the Bank Holding Company Act, 12 U.S.C. 1841(d); 12 CFR 225.2(o).

[85] The term subsidiary is used in § __.9 to describe certain entities that are eligible for substituted compliance.

[86] *See, e.g.,* section 2(a)(2) of the Bank Holding Company Act, 12 U.S.C. 1841(a)(2).

of the directors or trustees). The 2013 international framework states that investment funds that are managed by an investment adviser are considered distinct entities that are treated separately when applying the threshold as long as the funds are distinct legal entities that are not collateralized by or otherwise guaranteed or supported by other investment funds or the investment adviser in the event of fund insolvency or bankruptcy. The intent of the Agencies is to follow the approach of the 2013 international framework for investment funds and securitization vehicles, including with respect to guarantees and other collateral support arrangements. The Agencies request comment on whether the proposal's definition of control would allow investment funds and securitization vehicles to be treated separately in the manner described in the 2013 international framework.

iii. Cross-Currency Swap

The proposal defines a cross-currency swap as a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs upon the inception of the swap, with a reversal of the exchange at a later date that is agreed upon at the inception of the swap. As explained in greater detail below, the proposal provides that the proposed initial margin requirements for cross-currency swaps do not apply to the portion of the swap that is the fixed exchange of principal. This treatment of cross-currency swaps is consistent with the treatment recommended in the 2013 international framework. This treatment of cross-currency swaps also aligns with the determination by the Secretary of the Treasury to exempt foreign exchange swaps from the definition of swap as explained further below. Non-deliverable forwards would not be treated as cross-currency swaps for purposes of the proposal, and thus would be subject to the margin requirements set forth under the proposed rule.

iv. Major Currencies

Major currencies is defined to mean: (i) United States Dollar (USD); (ii) Canadian Dollar (CAD); (iii) Euro (EUR); (iv) United Kingdom Pound (GBP); (v) Japanese Yen (JPY); (vi) Swiss Franc (CHF); (vii) New Zealand Dollar (NZD); (viii) Australian Dollar (AUD); (ix) Swedish Kronor (SEK); (x) Danish Kroner (DKK); (xi) Norwegian Krone (NOK); and (xii) any other currency as determined by the relevant Agency.[87] Major currencies are eligible collateral for initial margin as described further in § __.6.

v. Prudential Regulator

The proposal defines prudential regulator to have the meaning specified in section 1a(39) of the Commodity Exchange Act.[88] Section 1a(39) of the Commodity Exchange Act defines the term ''prudential regulator'' for purposes of the capital and margin requirements applicable to swap dealers, major swap participants, security-based swap dealers and major security-based swap participants. The entities for which each of the Agencies is the prudential regulator is set out in § __.1 of each Agency's rule text.

vi. Eligible Master Netting Agreement

Qualifying master netting agreement (''QMNA'') was defined in the 2011 proposal, based on the definition of the term in the Federal banking agencies' risk-based capital rules applicable to derivatives positions held by insured depository institutions and bank holding companies.[89] A few commenters expressed concern with the 2011 proposal's definition of QMNA. These commenters argued that a requirement providing that any exercise of rights under the agreement will not be stayed or avoided under applicable law and would not allow for rights to be stayed as required under certain bankruptcy, receivership or liquidation regimes.

Since the 2011 proposal, the Federal banking agencies have modified the definition of QMNA used in their risk-based capital rules.[90] The proposal contains a revised definition based on the new QMNA definition in the risk-based capital rules. However, the proposal uses the term ''eligible master netting agreement'' (''EMNA'') to avoid confusion with and distinguish from the term used under the capital rules. The Agencies believe that the modifications to the definition address the concerns raised by commenters.

The proposal defines EMNA as any written, legally enforceable netting agreement that creates a single legal obligation for all individual transactions covered by the agreement upon an event of default (including receivership, insolvency, liquidation, or similar proceeding) provided that certain conditions are met. These conditions include requirements with respect to the covered swap entity's right to terminate the contract and liquidate collateral and certain standards with respect to legal review of the agreement to ensure it meets the criteria in the definition. The legal review must be sufficient so that the covered swap entity may conclude with a well-founded basis that, among other things, the contract would be found legal, binding, and enforceable under the law of the relevant jurisdiction and that the contract meets the other requirements of the definition.

The Agencies believe that the revised EMNA definition addresses commenters' concerns regarding certain insolvency regimes where rights can be stayed. In particular, the second criteria has been modified to provide that any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than (i) in receivership, conservatorship, or resolution by an Agency exercising its statutory authority, or similar laws in foreign jurisdictions that provide for limited stays to facilitate the orderly resolution of financial institutions, or (ii) in a contractual agreement subject by its terms to any of the foregoing laws.[91]

The Agencies request comment on whether the proposed definition of EMNA provides sufficient clarity regarding the laws of foreign jurisdictions that provide for limited stays to facilitate the orderly resolution of financial institutions or whether additional specificity should be provided regarding additional factors required in order for a foreign law to qualify under the EMNA definition. For example, should the definition include a limitation of the duration of the limited stay? If so, what should such limitation be (*e.g.,* one or two-business days)? The Agencies also seek comment regarding whether the provision for a contractual agreement made subject by its terms to limited stays under resolution regimes adequately encompasses potential contractual agreements of this nature or whether this provision needs to be broadened, limited, clarified or modified in some manner.

vii. State

State is defined in the proposal to mean any State, commonwealth, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana

[87] *See* the CFTC's regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries for this list of major currencies, 75 FR 55410 at 55412 (September 10, 2010).

[88] *See* 7 U.S.C. 1a(39).

[89] *See* 76 FR 27564 at 27576 (May 11, 2011).

[90] *See* 12 CFR part 3.2, 12 CFR part 217.2, and 12 CFR part 324.2.

[91] *See* proposed rule § __.2.

Islands, American Samoa, Guam, or the United States Virgin Islands. The purpose of this definition is to make clear these regions would be included as States for purposes of § __.9 that addresses the cross-border application of margin requirements.

viii. U.S. Government-Sponsored Enterprises

The 2011 proposal did not specifically define U.S. Government-sponsored enterprises, although it allowed the securities of these entities to be pledged as eligible collateral. Under the 2014 proposal, U.S. Government-sponsored enterprise means an entity established or chartered by the U.S. government to serve public purposes specified by Federal statute, but whose debt obligations are not explicitly guaranteed by the full faith and credit of the United States. U.S. Government-sponsored enterprises currently include Farm Credit System banks, associations, and service corporations, Farmer Mac, the Federal Home Loan Banks, Fannie Mae, Freddie Mac, the Financing Corporation, and the Resolution Funding Corporation. In the future, Congress may create new U.S Government-sponsored enterprises, or terminate the status of existing U.S. Government-sponsored entities. This term is used in the definition of eligible collateral as described further in § __.6.

ix. Entity Definitions

The Agencies are including a number of other definitions including ''bank holding company,'' ''broker,'' ''dealer,'' ''depository institution,'' ''foreign bank,'' ''futures commission merchant,'' ''savings and loan holding company,'' and ''securities holding company'' that are defined by cross-reference to the relevant statute. Many of these terms are also used in the definition of ''financial end user'' or ''market intermediary,'' which is defined to mean a securities holding company, a broker, a dealer, a futures commission merchant, a swap dealer, or a security-based swap dealer.

C. Section __.3: Initial Margin

1. Overview of 2011 Proposal and Public Comments

Section __.3 of the 2011 proposal set out the initial margin amounts for a covered swap entity to collect from its counterparty for its non-cleared swaps. The 2011 proposal specified, among other things, the manner in which a covered swap entity must calculate the initial margin requirements applicable to its non-cleared swaps. These initial margin requirements applied only to the amount of initial margin that a covered swap entity would be required to *collect* from its counterparties. In general, these requirements did not address whether, or in what amounts, a covered swap entity must *post* initial margin to a counterparty.[92]

The 2011 proposal requested comment on whether the rule should incorporate two-way margining. A number of commenters stated that the Agencies should require covered swap entities to post margin. Commenters raised a number of concerns regarding the lack of any requirement for covered swap entities to post both initial margin and variation margin to their counterparties. For example, one commenter argued that covered swap entities that do not post collateral present a risk to the system in the event that such covered swap entities experience financial distress. Commenters also said that by requiring two-way margining, overall leverage exposure would be reduced to an appropriate level.

Under the 2011 proposal, a covered swap entity would have been permitted to select from two alternatives to calculate its initial margin requirements. A covered swap entity could calculate its initial margin requirements using a standardized ''look-up'' table that specified the minimum initial margin that was required to be collected. Alternatively, a covered swap entity could calculate its minimum initial margin requirements using an internal margin model that met certain criteria and that had been approved by the relevant prudential regulator.

In the 2011 proposal, the Agencies proposed initial margin threshold amounts, which varied based on the relative risk posed by the counterparty; high-risk financial end users were subject to lower threshold amounts than low-risk financial end users; and nonfinancial end users were subject to thresholds that were set according to the covered swap entity's internal credit policies. Commenters expressed varying views on the proposed thresholds. For example, one commenter stated that establishing thresholds by counterparty type was too broad and did not appropriately reflect risk. Another commenter suggested that low-risk financial end users should not be subject to a threshold, while a third commenter stated that dollar threshold amounts were arbitrary and should be eliminated altogether.

Under the 2011 proposal, a covered swap entity was required to collect initial margin on or before the date it entered into a swap. Some commenters indicated that this requirement was operationally infeasible due to timing cutoffs and time differences between time zones, and for this reason, commenters requested that the Agencies permit covered swap entities to collect initial margin one to three days after entering into the transaction.

2. 2014 Proposal

a. Collecting and Posting Initial Margin

Consistent with the 2013 international framework and comments received relating to the 2011 proposal, the Agencies are proposing that swap entities that are transacting in non-cleared swaps with one another or with financial end users with material swaps exposure collect *and* post initial margin with respect to those non-cleared swaps. Assuming all swap entities will be subject to an Agency, CFTC, or SEC margin rule that requires collection of initial margin, the proposed rule will result in a collect-and-post system for all non-cleared swaps between swap entities. Under this proposal, a covered swap entity transacting with a financial end user with material swaps exposure must (i) calculate its initial margin collection amount using an approved internal model or the standardized look-up table, (ii) collect an amount of initial margin that is at least as large as the initial margin collection amount less any permitted initial margin threshold amount (which is discussed in more detail below), and (iii) post at least as much initial margin to the financial end user with material swaps exposure as the covered swap entity would be required to collect if it were in the place of the financial end user with material swaps exposure.

b. Calculation Alternatives

Similar to the 2011 proposal, the proposed rule permits a covered swap entity to select from two methods (the standardized look-up table or the internal margin model) for calculating its initial margin requirements. In all cases, the initial margin amount required under the proposed rule is a minimum requirement; covered swap entities are not precluded from collecting additional initial margin (whether by contract or subsequent agreement with the counterparty) in such forms and amounts as the covered swap entity believes is appropriate. These methods are discussed further below under Appendix A and § __.8,

[92] As previously discussed, § __.11 of the FHFA and FCA versions of the 2011 proposal required all institutions supervised by FHFA and the FCA to collect initial and variation margin from their swap entity counterparties.

respectively. Section __.8 also addresses the use of EMNAs for initial margin.

c. Initial Margin Thresholds

As part of the proposed rule's initial margin requirements and consistent with the 2013 international framework, a covered swap entity using either calculation method may adopt an initial margin threshold amount of up to $65 million, below which the covered swap entity need not collect or post initial margin from and to a swap entity or financial end user with a material swaps exposure.[93] This feature of the proposed threshold serves two purposes. First, covered swap entities would be able to make greater use of their own internal credit assessments when making a threshold determination as to the credit and other risks presented by a specific counterparty. Covered swap entities dealing with counterparties that are judged to be of high credit quality may determine a counterparty-specific threshold (of up to $65 million) so credit extensions made by covered swap entities can be more flexible and better informed by granular, internal credit determinations. Second, allowing the use of initial margin thresholds, to the extent prudently applied by covered swap entities, may reduce the potential liquidity burden of the proposed margin requirements. A number of commenters on the 2011 proposal indicated that the liquidity costs of the proposed requirements were inappropriately high. Unlike the 2011 proposal, the current proposal requires both collection and posting of initial margin. Moreover, the Agencies anticipate that allowing for the use of initial margin thresholds of up to $65 million will provide relief to smaller and less systemically risky counterparties while ensuring that initial margin is collected from those counterparties that pose the greatest systemic risk to the financial system.

The proposed initial margin threshold of $65 million would be applied on a consolidated entity level, and therefore, would apply across all non-cleared swaps between a covered swap entity and its affiliates and the counterparty and its affiliates. For example, suppose that a firm engages in separate swap transactions, executed under separate legally enforceable EMNAs, with three counterparties, all belonging to the same larger consolidated group, such as a bank holding company. Suppose further that the initial margin requirement is $100 million for each of the firm's netting sets with each of the three counterparties. The firm dealing with these three affiliates must collect at least $235 million (235 = $100 + $100 + $100 − $65) from the consolidated group. Exactly how the firm allocates the $65 million threshold among the three netting sets is subject to agreement between the firm and its counterparties. The firm may not extend the $65 million threshold to each netting set so that the total amount of initial margin collected is only $105 million (105 = 100 − 65 + 100 − 65 + 100 − 65). The requirement to apply the threshold on a fully consolidated basis applies to both the counterparty to which the threshold is being extended and the counterparty that is extending the threshold.[94] Applying this threshold on a consolidated entity level precludes the possibility that covered swap entities and their counterparties would create legal entities and netting sets that have no economic basis and are constructed solely for the purpose of applying additional thresholds to evade margin requirements.

The Agencies' preliminary view is that the proposed initial margin threshold of $65 million is appropriate and reflects a risk-based approach to the margin requirements. However, the Agencies seek comment on the use of such a threshold in the margin requirements and the proposed size of $65 million. Importantly, the Agencies recognize that allowing for a significant initial margin threshold subjects covered swap entities and their counterparties to credit risk that may materialize quickly in the event of a significant period of financial stress. Is the proposed use of an initial margin threshold appropriate in light of the risks associated with its use? Does the proposed level of the threshold appropriately balance the need to limit the liquidity impact of the requirements with the need to limit credit exposures in non-cleared swaps markets? Are there other approaches that could be taken in this regard that would be more effective than the proposed initial margin threshold approach?

d. Material Swaps Exposure

Under the proposed rule and consistent with the 2013 international framework, covered swap entities are required to collect and post initial margin only with financial end user counterparties that have a material swaps exposure. The Agencies do not propose to require the exchange of initial margin with financial end users with small exposures, as it is assumed that these entities, in most circumstances, would have an initial margin requirement that is significantly less than the proposed $65 million threshold amount.[95] Requiring covered swap entities to subject financial end users with exposures that would generally result in initial margin requirements substantially below $65 million could create significant operational burdens, as the initial margin collection amounts would need to be calculated on a daily basis even though no initial margin would be expected to be collected given that these amounts would be below the permitted initial margin threshold of $65 million.

Under the proposed rule and consistent with the 2013 international framework, the Agencies have adopted a simple and transparent approach to defining material swaps exposure that depends on a counterparty's gross notional derivative exposure for non-cleared swaps. The Agencies' preliminary view is that this approach is appropriate as gross notional derivative exposure is broadly related to a counterparty's overall size and risk exposure and provides for a simple and transparent measurement of exposure that presents only a modest operational burden. Under the proposed rule, a covered swap entity would not be required to collect or post initial margin to or from a financial end user counterparty without a material swaps exposure, that is, if its average daily aggregate notional amount of covered swaps over a defined period exceeds $3 billion.[96] This amount differs from that set forth in the 2013 international framework, which defines smaller financial end users as those counterparties that have a gross aggregate amount of covered swaps below €8 billion, which, at current exchange rates, is approximately equal to $11 billion.

The Agencies' preliminary view is that defining material swaps exposure

[93] This credit exposure limit is defined in the proposed rule as the initial margin threshold amount. *See* proposed rule §§ __.2, __.3(a). A covered swap entity that has established an initial margin threshold amount for a counterparty need only collect initial margin if the required amount exceeds the initial margin threshold amount, and in such cases is only required to collect the excess amount.

[94] Suppose that in the example set out above, the firm is organized into three subsidiaries (A, B, and C) and each of these subsidiaries engages in non-centrally cleared swaps with the counterparties. In this case, the extension of the $65 million threshold by the firm to the counterparties is considered across the entirety of the firm, including the affiliates A, B and C, so that all affiliates of the firm extend in the aggregate no more than $65 million in an initial margin threshold to all of the counterparties.

[95] To be consistent, both ''initial margin threshold'' and ''material swaps exposure'' are defined to include the counterparty and its affiliates.

[96] The definition of ''material swaps exposure'' can be found in § __.2 of the proposed rule.

as a gross notional exposure of $3 billion, rather than $11 billion, is appropriate because it reduces systemic risk without imposing undue burdens on covered swap entities, and therefore, is consistent with the objectives of the Dodd-Frank Act. This view is based on data and analyses that have been conducted since the publication of the 2013 international framework.

Specifically, the Agencies have reviewed actual initial margin requirements for a sample of cleared swaps. These analyses indicate that there are a significant number of cases in which a financial end user counterparty would have a material swaps exposure level below $11 billion but would have a swap portfolio with an initial margin collection amount that significantly exceeds the proposed permitted initial margin threshold amount of $65 million. The intent of both the Agencies and the 2013 international framework is that the initial margin threshold provide smaller counterparties with relief from the operational burden of measuring and tracking initial margin collection amounts that are expected to be below $65 million. Setting the material swaps exposure threshold at $11 billion appears to be inconsistent with this intent, based on the recent analyses.

The table below summarizes actual initial margin requirements for 4,686 counterparties engaged in cleared interest rate swaps. Each counterparty represents a particular portfolio of cleared interest rate swaps. Each counterparty had a swap portfolio with a total gross notional amount less than $11 billion and each is a customer of a CCP's clearing member (*no customer* is itself a CCP clearing member). Column (1) displays the initial margin amount as a percentage of the gross notional amount. Column (2) reports the initial margin, in millions of dollars that would be required on a portfolio with a gross notional amount of $11 billion.

INITIAL MARGIN AMOUNTS ON 4,686 CLEARED INTEREST RATE SWAP PORTFOLIOS

	Column (1) Initial margin amount as percentage of gross notional amount (%)	Column (2) Initial margin amount on an $11 billion gross notional portfolio ($MM)
Average	2.1	231
25th Percentile	0.6	66
50th Percentile	1.4	154
75th Percentile	2.7	297

As shown in the table above, the average initial margin rate across all 4,686 counterparties, reported in Column (1), is 2.1 percent, which would equate to an initial margin collection amount, reported in Column (2), of $231 million on an interest rate swap portfolio with a gross notional amount of $11 billion. This average initial margin collection amount significantly exceeds the proposed permitted threshold amount of $65 million. Seventy-five percent of the 4,686 cleared interest rate swap portfolios exhibit an initial margin rate in excess of 0.6 percent, which equates to an initial margin amount on a cleared interest rate swap portfolio of $66 million (approximately equal to the proposed permitted threshold amount).

The data above represent actual margin requirements on a sample of interest rate swap portfolios that are cleared by a single CCP. Some CCPs also provide information on the initial margin requirements on specific and representative swaps that they clear. The Chicago Mercantile Exchange (''CME''), for example, provides information on the initial margin requirements for cleared interest rate swaps and credit default swaps that it clears. This information does not represent actual margin requirements on actual swap portfolios that are cleared by the CME but does represent the initial margin that would be required on specific swaps if they were cleared at the CME. The table below presents the initial margin requirements for two swaps that are cleared by the CME.

INITIAL MARGIN AMOUNTS ON CME CLEARED INTEREST RATE AND CREDIT DEFAULT SWAPS

	Column (1) Initial margin amount as percentage of gross notional amount (%)	Column (2) Initial margin amount on an $11 billion gross notional portfolio ($MM)
5 year, receive fixed and pay floating rate interest rate swap	2.0	216
5 year, sold CDS protection on the CDX IG Series 20 Version 22 Index	1.9	213

According to the CME, the initial margin requirement on the interest rate swap and the credit default swap are both roughly two percent of the gross notional amount. This initial margin rate translates to an initial margin amount of roughly $216 million on a swap portfolio with a gross notional amount of $11 billion. Accordingly, this data also indicates that the initial margin collection amount on a swap portfolio with a gross notional size of $11 billion could be significantly larger than the proposed permitted initial margin threshold of $65 million.

In addition to the information provided in the tables above, the Agencies' preliminary view is that additional considerations suggest that the initial margin collection amounts associated with non-cleared swaps could be even greater than those reported in the tables above. The tables above represent initial margin requirements on cleared interest rate and credit default index swaps. Non-cleared swaps in other asset classes, such as single name equity or single name credit default swaps, are likely to be riskier and hence would require even more initial margin. In addition, non-cleared swaps often contain complex features, such as nonlinearities, that

make them even riskier and would hence require more initial margin. Finally, non-cleared swaps are generally expected to be less liquid than cleared swaps and must be margined, under the proposed rule, according to a ten-day close-out period rather than the five-day period required for cleared swaps. The data presented above pertains to cleared swaps that are margined according to a five-day and not a ten-day close-out period. The requirement to use a ten-day close-out period would further increase the initial margin requirements of non-cleared versus cleared swaps.

In light of the data and considerations noted above, the Agencies' preliminary view is that it is appropriate and consistent with the intent of the 2013 international framework to identify a material swaps exposure with a gross notional amount of $3 billion rather than $11 billion (€8 billion) as is suggested by the 2013 international framework. Identifying a material swaps exposure with a gross notional amount of $3 billion is more likely to result in an outcome in which entities with a gross notional exposure below the material swaps exposure amount would be likely to have an initial margin collection amount below the proposed permitted initial margin threshold of $65 million. The Agencies do recognize, however, that even at the lower amount of $3 billion, there are likely to be some cases in which the initial margin collection amount of a portfolio that is below the material swaps exposure amount will exceed the proposed permitted initial margin threshold amount of $65 million. The Agencies' preliminary view is that such instances should be relatively rare and that the operational benefits of using a simple and transparent gross notional measure to define the material swaps exposure amount are substantial.

The Agencies seek comment on the use and definition of material swaps exposure. In particular, is the proposed $3 billion level of the material swaps exposure appropriate? Should the amount be higher or lower and if so, why? Are there alternative measurement methodologies that do not rely on gross notional amounts that should be used? Does the proposed rule's use and definition of the material swaps exposure raise any competitive equity issues that should be considered? Are there any other aspects of the material swaps exposure that should be considered by the Agencies?

d. Timing

The proposed rule establishes the timing under which a covered swap entity must comply with the initial margin requirements set out in §§ __.3(a) and (b). Under the proposed rule, a covered swap entity, with respect to any non-cleared swap to which it is a party, must, on a daily basis, comply with the initial margin requirements for a period beginning on or before the business day following the day it enters into the transaction and ending on the date the non-cleared swap is terminated or expires. This requirement will cause covered swap entities to recalculate their initial margin requirements per their internal margin models or the standardized look-up table each business day. As a result, covered swap entities may need to adjust the amount of initial margin they collect or post on a daily basis.

Under the 2011 proposal, a covered swap entity was required to collect initial margin on or before the date it entered into a non-cleared swap. In the proposed rule, the Agencies have changed the timing provision in § __.3 to require a covered swap entity to comply with the initial margin requirements beginning on or before the business day following the day it enters into the swap. Providing an additional day is intended to address the operational concerns raised by the commenters to the 2011 proposal.

e. Other Counterparties

Under the proposed rule, a covered swap entity is not required as a matter of course to collect initial margin with respect to any non-cleared swap with a counterparty other than a financial end user with material swaps exposure or a swap entity, but shall collect initial margin at such times and in such forms and amounts (if any) that the covered swap entity determines appropriately address the credit risk posed by the counterparty and the risks of such swaps. Thus, the specific provisions of the Agencies' rules on initial margin requirements, documentation, and eligible collateral would not apply to non-cleared swaps between covered swap entities and these ''other counterparties.'' These ''other counterparties'' would include nonfinancial end users, entities that are excluded from the definition of financial end user, and financial end users without material swaps exposure. The Agencies' preliminary view is that this treatment of ''other counterparties'' is consistent with the Dodd-Frank Act's risk-based approach to establishing margin requirements. In particular, the Agencies intend for the proposed requirements with respect to ''other counterparties'' to be consistent with current market practice and understand that in many cases a covered swap entity would exchange little or no margin with these counterparty types. There may be circumstances, however, in which a covered swap entity finds it prudent to collect initial margin from these counterparty types, for example, if a covered swap entity chose to incorporate margin to mitigate the safety and soundness effects of its credit exposures to these counterparty types.

D. Section __.4: Variation Margin

1. Overview of 2011 Proposal and Public Comments

Section __.4 of the 2011 proposal specified the variation margin requirements applicable to non-cleared swaps. Consistent with the treatment of initial margin in the 2011 proposal, the variation margin requirements applied only to the collection of variation margin by covered swap entities from their counterparties, and not to the posting of variation margin to their counterparties. Under the 2011 proposal, covered swap entities and their counterparties were free to negotiate the extent to which a covered swap entity could have been required to post variation margin to a counterparty (other than a swap entity that is itself subject to margin requirements). In the 2011 proposal, the Agencies requested comment on whether the margin rules should impose a separate, additional requirement that a covered swap entity post variation margin to financial end users and nonfinancial end users. Consistent with the comments received relating to initial margin, many commenters recommended two-way posting of variation margin for transactions between covered swap entities and financial end users. Specifically, commenters argued that the bilateral exchange of variation margin would reduce systemic risk, increase transparency, and facilitate central clearing.

The 2011 proposal also established a minimum amount of variation margin that must be collected, leaving covered swap entities free to collect larger amounts if they elected to do so. Under the 2011 proposal, a covered swap entity would have been permitted to establish, for certain counterparties that are end users, a credit exposure limit that acts as a threshold below which the covered swap entity need not collect variation margin. Specifically, the variation margin threshold amount that a covered swap entity could establish for a low-risk financial end user counterparty could be calculated in the same way as the proposed initial margin threshold amounts for such counterparties. The 2011 proposal

would not have allowed a variation margin threshold amount for swap entity or high-risk financial end user counterparties. The 2011 proposal permitted a covered swap entity to calculate variation margin requirements on an aggregate basis across all non-cleared swaps with a counterparty that were executed under the same QMNA. The Agencies requested comment regarding whether permitting the aggregate calculation of variation margin requirements was appropriate and, if so, whether the 2011 proposal's definition of ''QMNA'' raised practical or implementation difficulties or was inconsistent with market practices. Commenters generally supported netting and argued that netting diversification should be allowed across asset classes.

The 2011 proposal also specified that covered swap entities calculate and collect variation margin from counterparties that were themselves swap entities or financial end users at least once per business day, and from counterparties that are nonfinancial end users at least once per week once the relevant credit threshold was exceeded.

2. 2014 Proposal

a. Collecting and Paying Variation Margin

Consistent with the initial margin requirements of this proposal, the Agencies are proposing that swap entities transacting with one another and with financial end users be required to collect and pay variation margin with respect to non-cleared swaps. As with initial margin, the Agencies believe that requiring covered swap entities both to collect and pay margin with these counterparties effectively reduces systemic risk by protecting both the covered swap entity and its counterparty from the effects of a counterparty default.

In response to the comments received and consistent with the 2013 international framework, the proposed rule would require a covered swap entity to collect variation margin from all swap entities and from financial end users regardless of whether the financial end user has a material swaps exposure. The proposed rule generally requires a covered swap entity to collect and pay variation margin on non-cleared swaps in an amount that is at least equal to the increase or decrease (as applicable) in the value of such swaps since the previous exchange of variation margin. Unlike the 2011 proposal, and the initial margin requirements set out in §§ __.3(a) and (b) of this proposal, a covered swap entity may not adopt a threshold amount below which it need not collect or pay variation margin on swaps with a swap entity or financial end user counterparty (although transfers below a minimum transfer amount would not be required, as discussed in § __.5, below).

The terms ''pay'' and ''paid'' are used when referring to variation margin. This terminology is being proposed based on a preliminary understanding that market participants view the economic substance of variation margin as settling the daily exposure of non-cleared swaps between counterparties. This perception is reinforced by the current market practice among swap participants of requiring that variation margin, where required under the parties' negotiated agreements, be provided in cash. As noted below, § __.6 of the proposed rule would limit eligible collateral for variation margin to cash.

The market perception that variation margin essentially settles the current exposure may not always align with the underlying legal requirement or with contracts that document the parties' rights and obligations with respect to swaps. On the one hand, for cleared swaps, derivatives clearing organizations are required by law to settle the exposure with counterparties at least daily, and thus the legal requirement is aligned with market participants' perceptions about the underlying economic substance of such transfers.[97] On the other hand, for non-cleared swaps, there is currently no statutory requirement that counterparties settle their exposures daily, leaving parties to negotiate such settlement.

It is the Agencies' understanding that standard swap documentation may treat variation margin differently depending on the underlying legal structure. For example, swap agreements under New York law might refer to variation margin as being ''posted'' pursuant to a security interest. Swap documentation referencing English law, however, may be aligned with a title transfer regime under which variation margin is *not* furnished pursuant to a security interest.

By proposing to use ''pay'' and ''paid'' terminology with respect to variation margin, the Agencies do not intend to propose to mandate, as a legal matter, to alter current practices under which variation margin is characterized as being ''posted'' pursuant to an agreement that establishes a security interest. Also, the Agencies, by proposing ''pay'' and ''paid'' terminology, do not intend to alter the characterization of such transfer of variation margin funds for accounting, tax, or other purposes. The Agencies invite comment on the appropriateness of the proposed terminology and whether other terminology may better address the underlying purpose of the legal requirements for the Agencies to establish requirements related variation margin requirements.

b. Frequency

Section __.4(b) of the proposed rule establishes the frequency at which a covered swap entity must comply with the variation margin requirements set out in § __.4(a). Under the proposed rule, a covered swap entity must collect or pay variation margin with swap entities and financial end user counterparties no less frequently than once per business day.

c. Other Counterparties

Like the proposed initial margin requirements set out in § __.3, the proposed rule permits a covered swap entity to collect variation margin from counterparties other than swap entities and financial end users at such times and in such forms and amounts (if any) that the covered swap entity determines appropriately address the credit risk posed by the counterparty and the risks of such non-cleared swaps. The specific provisions of the Agencies' rules on variation margin requirements, documentation, eligible collateral, segregation, and rehypothecation would not apply to swaps between covered swap entities and these ''other counterparties.'' As with initial margin, the Agencies intend for the proposed requirements to be consistent with current market practice and understand that, in many cases, a covered swap entity would exchange little or no margin with these counterparty types.

An important difference between the treatment of ''other counterparties'' in the cases of initial margin and of variation margin is that the scope of ''other counterparties'' for variation margin requirements is narrower than for the initial margin requirements. Specifically, under the proposed rule, financial end users without material swaps exposures are treated similarly as ''other counterparties'' in the context of the initial margin requirements but not the variation margin requirements.

[97] Section 5b(c)(2)(E) of the Commodity Exchange Act requires derivatives clearing organizations to ''complete money settlements on a timely basis (but not less frequently than once each business day).'' CFTC regulations define ''settlement'' as, among other things, ''payment and receipt of variation margin for futures, options, and swaps.'' 17 CFR 39.14(a)(1). Further, CFTC regulations require that ''except as otherwise provided by Commission order, derivatives clearing organizations shall effect a settlement with each clearing member at least once each business day.'' 17 CFR 39.14(b).

In other words, all financial end user counterparties are subject to the variation margin requirements, while only financial end user counterparties with material swaps exposure are subject to initial margin requirements. The different composition of ''other counterparties'' between the proposed initial and variation margin requirements reflects the Agencies' view that variation margin is an important risk mitigant that (i) reduces the build-up of risk that may ultimately pose systemic risk; (ii) imposes a lesser liquidity burden than does initial margin; and (iii) reflects current market practice and a risk management best practice by providing for the regular exchange of variation margin between covered swap entities and financial end users.

e. Netting Arrangements

Similar to the 2011 proposal, the proposed rule permits a covered swap entity to calculate variation margin requirements on an aggregate net basis across all non-cleared swap transactions with a counterparty that are executed under a single EMNA. If an EMNA covers non-cleared swaps that were entered into before the applicable compliance date, those swaps must be included in the aggregate for purposes of calculating the required variation margin. As discussed previously, under the proposed rule, the margin requirements would not be applied retroactively, and therefore, no new initial margin or variation margin requirements would be imposed on non-cleared swaps entered into prior to the relevant compliance date until those transactions are rolled-over or renewed. The only requirements that would apply to a pre-compliance date transaction would be the initial margin and variation margin requirements to which the parties to the transaction had previously agreed by contract. However, if non-cleared swaps that were entered into prior to the applicable compliance date were included in the EMNA, those swaps would be subject to the proposed variation margin requirements. A covered swap entity would need to establish a new EMNA to cover only swaps entered into after the compliance date in order to not include pre-compliance date swaps. Like the 2011 proposal, the proposed rule defines an EMNA as a legally enforceable agreement to offset positive and negative mark-to-market values of one or more swaps that meet a number of specific criteria designed to ensure that these offset rights are fully enforceable, documented and monitored by the covered swap entity.[98]

E. Section __.5: Minimum Transfer Amount and Satisfaction of Collecting and Posting Requirements

1. Minimum Transfer Amount

The 2011 proposal included a minimum transfer amount for the collection of initial and variation margin by covered swap entities. Under the 2011 proposal, a covered swap entity was not required to collect margin from any individual counterparty otherwise required under the rule until the required cumulative amount was $100,000 or more.

The proposed rule also provides for a minimum transfer amount for the collection and posting of margin by covered swap entities. Under the proposal, a covered swap entity need not collect or post initial or variation margin from or to any individual counterparty otherwise required unless and until the required cumulative amount of initial and variation margin is greater than $650,000.[99] This minimum transfer amount is consistent with the 2013 international framework and addresses a number of comments received on the 2011 proposal indicating that the $100,000 minimum transfer amount was too low and inconsistent with market practice. The Agencies' preliminary view is that the higher minimum transfer amount is consistent with the mandate to mitigate risk to swap entities and to the financial system.

2. Satisfaction of Collecting and Posting Requirements

The 2011 proposal addressed the situation where a counterparty refused or otherwise failed to make variation margin payments to a covered swap entity. The 2011 proposal provided that the covered swap entity would not be in violation of the rule in this situation so long as it took certain steps to collect the margin or commenced termination of the swap.

This proposal includes similar provisions with respect to both initial and variation margin. Specifically, under § .__5(b), a covered swap entity shall not be deemed to have violated its obligation to collect or post initial or variation margin from or to a counterparty if: (1) The counterparty has refused or otherwise failed to provide or accept the required margin to or from the covered swap entity; and (2) the covered swap entity has (i) made the necessary efforts to collect or post the required margin, or has otherwise demonstrated upon request to the satisfaction of the appropriate Agency that it has made appropriate efforts to collect the required margin, or (ii) commenced termination of the non-cleared swap with the counterparty promptly following the applicable cure period and notification requirements.

F. Section __.6: Eligible Collateral

1. Overview of 2011 Proposal and Public Comments

The 2011 proposal placed strict limits on the collateral that covered swap entities could collect to meet their minimum margin requirements. For minimum variation margin requirements, the Agencies proposed to recognize only immediately available cash (denominated either in U.S. dollars or in the currency in which payment obligations under the swap contract would be settled) and obligations issued by or fully guaranteed by the U.S. government. For minimum initial margin requirements, the Agencies proposed to recognize the aforementioned assets plus senior debt obligations issued by Fannie Mae, Freddie Mac, the Federal Home Loan Banks, or Farmer Mac, and ''insured obligations'' of the Farm Credit Banks.[100]

Most commenters that addressed the eligible collateral section of the 2011 proposal, including industry groups and members of Congress, stated that the Agencies should expand the list of eligible collateral to include a broader range of high-quality, liquid and readily marketable assets. These commenters stated that a more expansive list of eligible collateral would be consistent with market practice, legislative intent, and international standards. Many commenters suggested that the minimum margin requirements included in the 2011 proposal could disrupt financial markets by significantly increasing the demand for certain liquid assets, inadvertently

[98] EMNAs are discussed in more detail in § __.2 of the proposed rule.

[99] *See* proposed rule § __.5(a). The minimum transfer amount only affects the timing of margin collection; it does not change the amount of margin that must be collected once the $650,000 threshold is crossed. For example, if the margin requirement were to increase from $500,000 to $800,000, the covered swap entity would be required to collect the entire $800,000 (subject to application of any applicable initial margin threshold amount).

[100] ''Insured obligations'' of FCS banks are consolidated and System-wide obligations issued by FCS banks. These obligations are insured by the Farm Credit System Insurance Corporation out of funds in the Farm Credit Insurance Fund. Should the Farm Credit Insurance Fund ever be exhausted, Farm Credit System banks are jointly and severally liable for payment on insured obligations. *See* 12 U.S.C. 2277a–3.

restrict liquidity and, in turn, slow economic growth. Additionally, commenters suggested that increased demand for ''eligible'' assets could inappropriately distort the market for those assets relative to other high-quality, liquid, and readily marketable assets.

2. 2014 Proposal

a. Variation Margin Collateral

Under the proposal, the Agencies are proposing to require the collection or payment of immediately available cash funds to satisfy the minimum variation margin requirements. Such payment must be denominated either in U.S. dollars or in the currency in which payment obligations under the swap are required to be settled. When determining the currency in which payment obligations under the swap are required to be settled, a covered swap entity must consider the entirety of the contractual obligation. As an example, in cases where a number of swaps, each potentially denominated in a different currency, are subject to a single master agreement that requires all swap cash flows to be settled in a single currency, such as the Euro, then that currency (Euro) may be considered the currency in which payment obligations are required to be settled. The Agencies request comment on whether there are current market practices that would raise difficulties or concerns about identifying the appropriate settlement currency in applying this aspect of the proposed rule, from a contractual or other operational standpoint.

Limiting variation margin to cash should sharply reduce the potential for disputes over the value of variation margin collateral. Additionally, this proposed change is consistent with regulatory and industry initiatives to improve standardization and efficiency in the OTC swaps market. For example, in June 2013, ISDA published the 2013 Standard Credit Support Annex (SCSA), which provides for the sole use of cash for variation margin. Additionally, the Agencies note that central counterparties generally require variation margin to be paid in cash.

Under this proposed rule, the value of cash paid to satisfy variation margin requirements is not subject to a haircut. Variation margin payments reflect gains and losses on a swap transaction, and payment or receipt of variation margin generally represents a transfer of ownership in the collateral. Therefore, haircuts are not a necessary component of the regulatory requirements for cash variation margin.

The Agencies seek comment on the appropriateness of limiting variation margin to cash, and on any other revisions that commenters believe would be appropriate to better align the variation margin requirements applicable with arrangements that are currently observed in the OTC swap market.

b. Initial Margin Collateral

The Agencies are proposing to expand the list of eligible collateral with respect to the collection and posting of initial margin. The standards for eligible initial margin collateral in the 2014 proposal pertain to collateral collected or posted in connection with the proposed minimum requirements. This proposal in no way restricts the types of collateral that may be collected or posted to satisfy margin terms that are bilaterally negotiated and not required under the proposal. For example, under the proposal a covered swap entity may extend an initial margin threshold of up to $65 million on an aggregate basis to each swap entity or financial end user counterparty and its affiliates. If a covered swap entity extended such an initial margin threshold to a counterparty and the resulting minimum initial margin requirement was zero, but the covered swap entity decided to collect initial margin collateral to protect itself against counterparty credit risk, then the covered swap entity could choose to collect that initial margin in any form of collateral, including forms other than the types of collateral specified in the rule.

Relatedly, under the 2014 proposal, covered swap entities need to collect initial margin for non-cleared swaps with certain entities (''other counterparties'') in such forms and amounts (if any) and at such times that the covered swap entity determines appropriately address the credit risk posed by the counterparty and the risks of such transactions. For such a transaction, a covered swap entity is responsible for determining the amount, the form, and the time for the margin to be collected. Accordingly, margin collected by a covered swap entity in connection with a non-cleared swap with an ''other counterparty'' can be in any form of collateral, including in forms other than the types of collateral specified in the rule.

Although the list of eligible collateral in the 2014 proposal for initial margin is more expansive than the 2011 proposal, the Agencies continue to believe that it is necessary to impose limits on the types of assets eligible to satisfy the minimum margin requirements. Therefore, the Agencies are limiting the recognition of collateral to certain assets deemed to be highly liquid, particularly during a period of financial stress as suggested by the 2013 international framework. To support this approach, the Agencies note that to protect a covered swap entity during periods of financial stress, collateral eligible to satisfy the proposed minimum margin requirements should not have excessive exposures to credit, market, or foreign exchange risk.

The Agencies are proposing to permit a broader range of collateral to be pledged to satisfy the minimum initial margin requirements, which includes cash collateral (subject to the same requirements applicable to variation margin) and any of the following:

(1) A security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury;

(2) A security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, a U.S. government agency (other than the U.S. Department of the Treasury) whose obligations are fully guaranteed by the full faith and credit of the United States government;

(3) A publicly traded debt security issued by, or an asset-backed security fully guaranteed as to the timely payment of principal and interest by, a U.S. Government-sponsored enterprise that is operating with capital support or another form of direct financial assistance received from the U.S. government that enables the repayments of the U.S. Government-sponsored enterprise's eligible securities;

(4) Any major currency, regardless of whether it is the currency in which payment obligations under the swap are required to be settled;

(5) A security that is issued by the European Central Bank or by a sovereign entity that receives no higher than a 20 percent risk weight under subpart D of the Federal banking agencies' risk-based capital rules; [101]

(6) A security that is issued by or unconditionally guaranteed as to the timely payment of principal and interest by the Bank for International Settlements, the International Monetary Fund, or a multilateral development bank;

(7) A publicly traded debt security for which the issuer has adequate capacity to meet financial commitments (as defined by the appropriate Federal

[101] *See* 12 CFR part 3, subpart D, 12 CFR part 217, subpart D, and 12 CFR part 324, subpart D.

agency),[102] including such a security issued by a U.S. Government-sponsored enterprise not covered in (3), above;

(8) A publicly traded common equity security that is included in the Standard and Poor's Composite 1500 Index, an index that a covered swap entity's supervisor in a foreign jurisdiction recognizes for the purposes of including publicly traded common equity as initial margin, or any other index for which the covered swap entity can demonstrate that the equities represented are as liquid and readily marketable as those included in the Standard and Poor's Composite 1500 Index; and

(9) Gold.

Notably, any debt security issued by a U.S. Government-sponsored enterprise that is not operating with capital support or another form of direct financial assistance from the U.S. government would be eligible collateral only if the security met the requirements for debt securities discussed above. The Agencies seek comment on how the likelihood of financial assistance from the United States not authorized under current law (that is, the perceived ''implicit guarantee'') influences the determination that a U.S. Government-sponsored enterprise has ''adequate capacity to meet financial commitments'' when its debt securities are considered for acceptance as collateral for initial margin. The Agencies also request comment on whether the final rule should state that debt securities of a U.S. Government-sponsored enterprise that is not operating with capital support or other financial assistance from the U.S. government are eligible collateral for initial margin only if: (1) The U.S. Government-sponsored enterprise has adequate capacity to meet financial commitments (as defined in each agency's rule) *and* (2) the determination of ''adequate capacity'' is not reliant on financial assistance from the U.S. Government.

In the context of corporate securities, initial margin collateral is further restricted to exclude any corporate securities (equity or debt) issued by the counterparty or any of its affiliates, a bank holding company, a savings and loan 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 one of the foregoing institutions. These restrictions reflect the Agencies' view that securities issued by the foregoing entities are very likely to come under significant pressure during a period of financial stress when a covered swap entity may be resolving a counterparty's defaulted swap position and present a general source of wrong-way risk. Accordingly, the Agencies believe that it is prudent to restrict initial margin collateral in this manner and that these restrictions will not unduly reduce the scope of collateral that is eligible to satisfy the minimum initial margin requirements.

The Agencies request comment on the securities subject to this restriction, and, in particular, on whether securities issued by other entities, such as non-bank systemically important financial institutions designated by the Financial Stability Oversight Council, also should be excluded from the list of eligible collateral.

For the purpose of the initial margin requirements, the recognized value of assets posted as initial margin collateral, except U.S. dollars and the currency in which the payment obligations of the swap is required, is subject to haircuts. These collateral haircuts reduce the value of the initial margin to an amount that is equal to the market value of the initial margin collateral multiplied by one minus the specific collateral haircut. Collateral haircuts guard against the possibility that the value of initial margin collateral could decline during the period that a defaulted swap position has to be closed out by a covered swap entity. The proposed collateral haircuts, which appear in Appendix B, have been calibrated to be broadly consistent with valuation changes observed during periods of financial stress.

The Agencies request comment on whether the proposed rule's list of eligible collateral for minimum initial and variation margin requirements, and the haircuts applied to initial margin, are appropriate.

The approach taken to initial margin collateral in the proposal, which is consistent with the 2013 international framework, recognizes a broad array of financial collateral ranging from high quality sovereign bonds to corporate securities and commodities. The Agencies believe that broadening the scope of eligible collateral addresses concerns about collateral availability and market impact without exposing covered swap entities to undue risk. In particular, the Agencies believe that this proposal appropriately restricts eligible collateral to liquid and high-quality assets with limited market and credit risk. In addition, initial margin collateral is subject to robust collateral haircuts that will further reduce risk.

Because the value of collateral may change, a covered swap entity must monitor the value and quality of collateral previously collected to satisfy minimum initial margin requirements. If the value of such collateral has decreased, or if the quality of the collateral has deteriorated so that it no longer qualifies as eligible collateral, the covered swap entity must collect additional collateral of sufficient value and quality to ensure that all applicable minimum margin requirements remain satisfied on a daily basis.

The proposal does not allow a covered swap entity to fulfill the minimum margin requirements with any forms of non-cash collateral not included in the list of liquid and readily marketable assets described above. The use of alternative types of collateral to fulfill regulatory margin requirements is complicated by pro-cyclical considerations (for example, the changes in the liquidity, price volatility, or wrong-way risk of collateral during a period of financial stress could exacerbate that stress) and the need to ensure that the collateral is subject to low credit, market, and liquidity risk. Therefore, this proposed rule limits the recognition of collateral to the aforementioned list of assets.

However, counterparties that wish to rely on assets that do not qualify as eligible collateral under the proposed rule still would be able to pledge those assets with a lender in a separate arrangement, using the cash or other eligible collateral received from that separate arrangement to meet the minimum margin requirements.

G. Section __.7: Segregation of Collateral

1. 2011 Proposal and Public Comment

The 2011 proposal established minimum safekeeping standards for collateral posted by covered swap entities to assure that collateral is available to support the swaps and not housed in a jurisdiction where it is not available if defaults occur. The 2011 proposal required the covered swap entity to require a counterparty that is a swap entity to hold funds or other property posted as initial margin at an independent third-party custodian. The 2011 proposal also required that the independent third-party custodian be prohibited by contract from: (i) Rehypothecating or otherwise transferring any initial margin it holds for the covered swap entity; and (ii) reinvesting any initial margin held by the custodian in any asset that would

[102] The FCA is proposing a new definition of ''investment grade'' only for FCS institutions in § __.2 that is identical to 12 CFR 1.2(d).

not qualify as eligible collateral for initial margin under the 2011 proposal. Further, the 2011 proposal required that the custodian be located in a jurisdiction that applies the same insolvency regime to the custodian as would apply to the covered swap entity. These custodian and related requirements applied only to initial margin, not variation margin, and did not apply to transactions with a counterparty that was not a swap entity. Collateral collected from counterparties that were not swap entities could be segregated at the discretion of the counterparties.

The third-party custodian requirement in the 2011 proposal was based on a preliminary view by the Agencies that requiring a covered swap entity's initial margin to be segregated at a third-party custodian was necessary to offset the greater risk to the covered swap entity and the financial system arising from the use of non-cleared swaps, and protect the safety and soundness of the covered swap entity.

Commenters generally supported the protections described in the 2011 proposal as reasonable to protect the pledged or transferred collateral but several commenters noted that these types of protections would be costly and have large liquidity impacts and may increase systemic risk, given that much of the collateral would likely be held by a relatively few large custodians. In addition, concerns were expressed by some commenters with the ability of custodians to meet the requirement that the jurisdiction of insolvency of the custodian be the same as the covered swap entity.

2. 2014 Proposal

The proposal retains and expands on most of the collateral safekeeping requirements of the 2011 proposal and revises requirements related to the custodial agreement.

Section __.7(a) of the proposal addresses requirements for when a covered swap entity posts any collateral other than variation margin. Posting collateral to a counterparty exposes a covered swap entity to risks in recovering such collateral in the event of its counterparty's insolvency. To address this risk and to protect the safety and soundness of the covered swap entity, § __.7(a) requires a covered swap entity that posts any collateral other than variation margin with respect to a non-cleared swap to require that such collateral be held by one or more custodians that are not affiliates of the covered swap entity or the counterparty. This requirement would apply to initial margin posted by a covered swap entity pursuant to § __.3(b), as well as initial margin that is not required by this rule but is posted by a covered swap entity as a result of negotiations with its counterparty, such as initial margin posted to a financial end user that does not have material swaps exposure or initial margin posted to another covered swap entity even though the amount was less than the $65 million initial margin threshold amount.

Section __.7(b) of the proposal addresses requirements for when a covered swap entity collects initial margin required by § __.3(a). Under § __.7(b), the covered swap entity shall require that initial margin collateral collected pursuant to § __.3(a) be held at one or more custodians that are not affiliates of either party. Because the collection of initial margin does not expose the covered swap entity to the same risk of counterparty default as is created when a covered swap entity posts collateral, the scope of the requirements for initial margin that a covered swap entity collects is narrower than the scope for requirements for posting collateral. As a result, § __.7(b) applies only to initial margin that a covered swap entity collects as required by § __.3(a), rather than all collateral collected.

For collateral subject to § __.7(a) or § __.7(b), § __.7(c) requires the custodian to act pursuant to a custodial agreement that is legal, valid, binding, and enforceable under the laws of all relevant jurisdictions including in the event of bankruptcy, insolvency, or similar proceedings. Such a custodian agreement must prohibit the custodian from rehypothecating, repledging, reusing or otherwise transferring (through securities lending, repurchase agreement, reverse repurchase agreement, or other means) the funds or other property held by the custodian. Section __.7(d) provides that, notwithstanding this prohibition on rehypothecating, repledging, reusing or otherwise transferring the funds or property held by the custodian, the posting party may substitute or direct any reinvestment of collateral, including, under certain conditions, collateral collected pursuant to § __.3(a) or posted pursuant to § __.3(b).

In particular, for initial margin collected pursuant to § __.3(a) or posted pursuant to § __.3(b), the posting party may substitute only funds or other property that meet the requirements for initial margin under § __.6 and where the amount net of applicable discounts described in Appendix B would be sufficient to meet the requirements of § __.3. The posting party also may direct the custodian to reinvest funds only in assets that would qualify as eligible collateral under § __.6 and ensure that the amount net of applicable discounts described in Appendix B would be sufficient to meet the requirements of § __.3. In the cases of both substitution and reinvestment, the proposed rule requires the posting party to ensure that the value of eligible collateral net of haircuts remains equal to or above the minimum requirements contained in § __.3. In addition, the restrictions on the substitution of collateral described above do not apply to cases where a covered swap entity has posted or collected more initial margin than is required under § __.3. In such cases the initial margin that has been posted or collected in satisfaction of § __.3 is subject to the restrictions on collateral substitution but any additional collateral that has been posted is not subject to the restrictions on collateral substitution and, as noted above, any additional collateral that has been collected by the covered swap entity is not subject to any of the requirements of § __.7.

The segregation limits on rehypothecation, repledge, or reuse contained in § __.7 apply only with respect to the initial margin requirement and not with respect to variation margin.[103] The Agencies' preliminary view is that requiring covered swap entities to segregate and limit the rehypothecation, repledge, or reuse of funds and other property held in satisfaction of the initial margin requirement is necessary to (i) offset the greater risk to the covered swap entity and the financial system arising from the use of swaps that are not cleared and (ii) protect the safety and soundness of the covered swap entity. In developing this proposal, the Agencies have considered that the failure of a covered swap entity could pose significant systemic risks to the financial system, and losses borne by the financial system in such a failure could have significant consequences. The consequences could be magnified if funds or other property received by the failing covered swap entity to satisfy the initial margin requirement cannot be quickly recovered by nondefaulting counterparties during a period of financial stress. To the extent that initial margin requirements are intended to constrain risk-taking, a lack of

[103] The proposed rule does not apply the segregation requirement to variation margin because variation margin is generally used to offset the current exposure arising from *actual* changes in the market value of derivative swap transaction rather than to secure potential exposure arising from *future* changes in the market value of the swap transaction during the closeout of the exposure.

restrictions on rehypothecation, repledging, and reusing initial margin and a lack of segregation at an unaffiliated custodian will weaken their effect.

The Agencies are concerned that not requiring funds or other property held to satisfy the initial margin requirement to be held at an unaffiliated custodian and limiting its rehypothecation, repledging, or reuse at the outset may cause an entity that incurs a severe loss, due to credit or market events, to face liquidity challenges during periods of stress. Requiring the protection of pledged initial margin bilaterally between the counterparties provides assurance that the pledging counterparty is much less likely to face additional losses (due to the loss of its transferred or pledged initial margin) above the replacement cost of the non-cleared swaps portfolio. During a period of stress, the custodian will provide assurance that the counterparties' initial margin is indeed only available to meet incremental losses during the closeout of the defaulting counterparty's non-cleared swaps and has not been used to secure other obligations. As such, this reduces the incentive for the nondefaulting counterparty to become concerned with meeting its obligations to other nondefaulting counterparties, reducing the interconnected risk associated with non-cleared swaps.

As discussed above, the limitations on rehypothecation, repledging, or reusing pledged collateral will likely increase funding costs for some market participants required to post initial margin, including some covered swap entities. Moreover, when a covered swap entity intermediates non-cleared swaps between two financial end users with material swaps exposure the proposed rule would require that the covered swap entity post initial margin to each financial end user and that the covered swap entity collect initial margin from each financial end user and that these funds or other property be held at a third-party custodian that will not rehypothecate, repledge, or reuse such assets. These proposed requirements will result in a significant amount of initial margin collateral that will be held and segregated to guard against the risk of counterparty default.

The 2013 international framework sets out parameters for member countries to permit a limited degree of rehypothecation, repledging, and reuse of initial margin collateral when a covered swap entity is dealing with a financial end user if certain safeguards for protecting the financial end user's rights in such collateral are available under applicable law. If such protections exist, under the 2013 international framework, a member country may allow a swap entity to rehypothecate, repledge, or reuse initial margin provided by a non-dealer financial end user one time to hedge the covered swap entities exposure to the financial end user.[104] The Agencies seek comment on the circumstances under which one-time rehypothecation, repledge, or reuse of initial margin posted by a non-dealer financial end user would be permitted under the 2013 international framework and whether this would be a commercially viable option for market participants.

H. Section __.8: Initial Margin Models and Standardized Amounts

1. Overview of 2011 Proposal and Public Comments

Section __.8 of the 2011 proposal set out modeling standards that an initial margin model must meet for a covered swap entity to calculate initial margin under such a model. In situations where these requirements would not be met, initial margin would be calculated according to a standardized look-up table (Appendix A of the 2011 proposal). Under the 2011 proposal, all initial margin models had to calculate the potential future exposure of the swap consistent with a one-tailed 99 percent confidence level over a 10-day close-out period. In addition, the initial margin model had to be calibrated to be consistent with a period of financial stress. Initial margin models were permitted to recognize portfolio effects and offsets within a portfolio of swaps with a counterparty if they were conducted under the same QMNA. The recognition of portfolio effects and offsets was limited, however, to swaps within the following broad asset classes: Commodity, credit, equity, and interest rates and foreign exchange (considered as a single asset class). No portfolio effects or offsets were recognized across transactions in different asset classes.

The 2011 proposal requested comment on the requirements for initial margin models as well as the standardized look-up table based initial margin requirements. A number of commenters indicated that the assumption of a 10-day close-out period was too long and that many non-cleared swaps could effectively be replaced in less than 10 days. More specifically, a number of commenters agreed that the close-out period applied to non-cleared swaps should be longer than that applied to listed futures (1 day) and cleared swaps (5 days) but suggested that 10 days was too long. Other commenters indicated that the appropriate close-out period varied significantly across transactions and that a single close-out period would not be appropriate. One commenter suggested that covered swap entities should be allowed to use self-determined close-out period assumptions based on their specific knowledge of the transaction and its market characteristics. A number of commenters suggested that the standardized look-up table did not appropriately recognize the kind of portfolio risk offsets that are allowed in the context of initial margin models.

2. 2014 Proposal

a. Internal Initial Margin Models

As in the 2011 proposal, the Agencies are now proposing an approach whereby covered swap entities may calculate initial margin requirements using an approved initial margin model. As in the case of the 2011 proposal, the proposed rule also requires that the initial margin amount be set equal to a model's calculation of the potential future exposure of the non-cleared swap consistent with a one-tailed 99 percent confidence level over a 10-day close-out period. Generally, the modeling standards for the initial margin model are consistent with current regulatory rules and best practices for such models in the context of risk-based capital rules applicable to insured depository institutions and bank holding companies, are no less conservative than those generally used by CCPs, and are also consistent with the standards of the 2013 international framework.[105] More specifically, under the proposed rule initial margin models must capture all of the material risks that affect the non-cleared swap including material non-linear price characteristics of the swap.[106] For example, the initial margin calculation for a swap that is an option on an underlying asset, such as a credit default swap contract, would be

[104] The prudential regulators note that on April 14, 2014, the European Supervisory Authorities (''ESA'') issued for comment a proposal to implement the 2013 international framework. Like the prudential regulators, the ESA did not propose to allow the rehypothecation, repledge, or reuse of initial margin. *See* ''Draft Regulatory Technical Standards on Risk-mitigation Techniques for OTC-derivative Contracts Not Cleared by a CCP under Article 11(15) of Regulation (EU) No. 648/2012'', pp 11, 42–43 (April 14, 2014), *https://www.eba.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf.*

[105] This conservative approach also incorporates the practices associated with model validation, independent review and other qualitative requirements associated with the use of internal models for regulatory capital purposes.

[106] *See* proposed rule § __.8(d)(9).

required to capture material non-linearities arising from changes in the price of the underlying asset or changes in its volatility. Accordingly, the Agencies' preliminary view is that these modeling standards should ensure that a non-cleared swap does not pose a greater systemic risk than a cleared swap.

All initial margin models must be approved by a covered swap entity's prudential regulator before being used for margin calculation purposes. In the event that a model is not approved, initial margin calculations would have to be performed according to the standardized initial margin approach that is detailed in Appendix A and discussed below.

In addition to the requirement that the models appropriately capture all material sources of risk, as discussed above, the proposed rule contains a number of standards and criteria that must be satisfied by initial margin models. These standards relate to the technical aspects of the model as well as broader oversight and governance standards. These standards are broadly similar to modeling standards that are already required for internal regulatory capital models.

Initial margin models will be reviewed for approval by the appropriate Agency upon the request of a covered swap entity. Models that are reviewed for approval will be analyzed and subjected to a number of tests to ensure that the model complies with the requirements of the proposed rule. Given that covered swap entities may engage in highly specialized business lines with varying degrees of intensity, it is expected that specific initial margin models will vary across covered swap entities. Accordingly, the specific analyses that will be undertaken in the context of any single model review will have to be tailored to the specific uses for which the model is intended. The nature and scope of initial margin model reviews are expected to be generally similar to reviews that are conducted in the context of other model review processes such as those relating to the approval of internal models for regulatory capital purposes. Initial margin models will also undergo periodic supervisory reviews to ensure that they remain compliant with the requirements of the proposed rule and are consistent with existing best practices over time.

i. Ten-Day Close-Out Period Assumption

Since non-cleared swaps are expected to be less liquid than cleared swaps, the proposed rule specifies a minimum close-out period for the initial margin model of 10 business days, compared with a typical requirement of 3 to 5 business days used by CCPs.[107] Moreover, the required 10-day close-out period assumption is consistent with counterparty credit risk capital requirements for banks. Accordingly, to the extent that non-cleared swaps are expected to be less liquid than cleared swaps and to the extent that related capital rules which also mitigate counterparty credit risk similarly require a 10-day close-out period assumption, the Agencies' preliminary view is that a 10-day close-out period assumption for margin purposes is appropriate.[108]

Under the proposed rule, the initial margin model calculation must be performed directly over a 10-day close out period. In the context of bank regulatory capital rules, a long horizon calculation (such as 10 days) may, under certain circumstances, be indirectly computed by making a calculation over a shorter horizon (such as 1 day) and then scaling the result of the shorter horizon calculation to be consistent with the longer horizon. The proposed rule does not provide this option to covered swap entities using an approved initial margin model. The Agencies' preliminary view is that the rationale for allowing such indirect calculations that rely on scaling shorter horizon calculations has largely been based on computational and cost considerations that were material in the past but are much less so in light of advances in computational speeds and reduced computing costs. The Agencies seek comment on whether the option to make use of such indirect calculations has a material effect on the burden of complying with the proposed rule, and whether such indirect methods are appropriate in light of current computing methods and costs.

ii. Recognition of Portfolio Risk Offsets

The proposed rule permits a covered swap entity to use an internal initial margin model that reflects offsetting exposures, diversification, and other hedging benefits within seven broad risk categories: Agricultural commodities, energy commodities, metal commodities, other commodities, credit, equity, and foreign exchange and interest rates (as a single asset class) when calculating initial margin for a particular counterparty if the swaps are executed under the same EMNA.[109] The proposed rule does *not* permit an initial margin model to reflect offsetting exposures, diversification, or other hedging benefits *across* broad risk categories.[110] As a specific example, if a covered swap entity entered into two credit swaps and two energy commodity swaps with a single counterparty under an EMNA then the covered swap entity could use an approved initial margin model to perform two separate calculations: The initial margin collection amount calculation for the credit swaps and the initial margin collection amount calculation for the energy commodity swaps. Each calculation could recognize offsetting and diversification within the credit swaps and within the energy commodity swaps. The result of the two separate calculations would then be summed together to arrive at the total initial margin collection amount for the four swaps (two credit swaps and two energy commodity swaps).

It is the preliminary view of the Agencies that the correlations of exposures across unrelated risk categories, such as credit and energy commodity, are not stable enough over time, and, importantly, during periods of financial stress, to be recognized in a regulatory margin model requirement. The Agencies note that in the case of commodities the number of distinct asset classes has been increased from one to four since the 2011 proposal. The Agencies' preliminary view is that a single commodity asset class is too broad and that the relationship between disparate commodity types, such as aluminum and corn, are not stable enough to warrant hedging benefits within the initial margin model. The Agencies seek comment on this specific treatment of commodities for initial margin purposes and whether greater or fewer distinctions should be made.

Also, the Agencies are aware that some swaps may be difficult to classify into one and only one asset class as some swaps may have characteristics that relate to more than one asset class. Under the proposal, the Agencies expect that the covered swap entity would make a determination as to which asset class best represents the swap based on a holistic view of the underlying swap. As a specific example, many swaps may have some sensitivity to interest rates even though the majority of the swap's sensitivity relates to another asset class such as equity or credit. The Agencies seek comment on whether or not this approach is reasonable and whether or

[107] *See* proposed rule § __.8(d)(1).

[108] In cases where a swap has a remaining maturity of less than 10 days, the remaining maturity of the swap, rather than 10 days, may be used as the close-out period in the margin model calculation.

[109] *See* proposed rule § __.8(d)(3).

[110] *Id.*

not instances in which the classification of a swap into one of the broad asset classes described above is problematic and material. If such instances are material, the Agencies seek comment on alternative approaches to dealing with such swaps. Should the Agencies, for example, identify an additional asset class of ''unclassified swaps'' that would not be classified into one or another broad asset class and then require that swaps in this ''unclassified swaps'' category be margined separately from all other swaps? Are there other approaches to handling such swaps that should be considered by the Agencies?

iii. Stress Calibration

In addition to a time horizon of 10 trading days and a one-tailed confidence level of 99 percent, the proposed rule requires the initial margin model to be calibrated to a period of financial stress.[111] In particular, the initial margin model must employ a stress period calibration for each broad asset class (agricultural commodity, energy commodity, metal commodity, other commodity, credit, equity, and interest rate and foreign exchange). The stress period calibration employed for each broad asset class must be appropriate to the specific asset class in question. While a common stress period calibration may be appropriate for some asset classes, a common stress period calibration for all asset classes would only be considered appropriate if it is appropriate for each specific underlying asset class. Also, the time period used to inform the stress period calibration must include at least one year, but no more than five years of equally-weighted historical data. This proposed requirement is intended to balance the tradeoff between shorter and longer data spans. Shorter data spans are sensitive to evolving market conditions but may also overreact to short-term and idiosyncratic spikes in volatility, resulting in procyclical margin requirements. Longer data spans are less sensitive to short-term market developments but may also place too little emphasis on periods of financial stress, resulting in less robust initial margins. Also, the requirement that the data be equally weighted is intended to establish a degree of consistency in model calibration while also ensuring that particular weighting schemes do not result in procyclical margin requirements during short-term bouts of heightened volatility.

Calibration to a stress period ensures that the resulting initial margin requirement is robust to a period of financial stress during which swap entities and financial end user counterparties are more likely to default, and counterparties handling a default are more likely to be under pressure. The stress calibration requirement also reduces the systemic risk associated with any increase in margin requirements that might occur in response to an abrupt increase in volatility during a period of financial stress as initial margin requirements will already reflect a historical stress event.

iv. Cross-Currency Swaps

As discussed above, an approved initial margin model must generally account for all of the material risks that affect the non-cleared swap. An exception to this requirement has been made in the specific case of cross-currency swaps. In a cross-currency swap, one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs upon the inception of the swap, with a reversal of the exchange of principal at a later date that is agreed upon at the inception of the swap.

An initial margin model need not recognize any risks or risk factors associated with the foreign exchange transactions associated with the fixed exchange of principal embedded in the cross-currency swap. The initial margin model must recognize all risks and risk factors associated with all other payments and cash flows that occur during the life of the cross-currency swap. In the context of the standardized margin approach, described in Appendix A and further below, the gross initial margin rates have been set equal to those for interest rate swaps. This treatment recognizes that cross-currency swaps are subject to risks arising from fluctuations in interest rates but does not recognize any risks associated with the fixed exchange of principal since principal is typically not exchanged on interest rate swaps.

The foreign exchange transactions associated with the fixed exchange of principal in a cross-currency swap are closely related to the exchange of principal that occurs in the context of a foreign exchange forward or swap. In 2012, the U.S. Treasury made a determination that foreign exchange forwards and swaps are not to be considered swaps under the Dodd-Frank Act, in part, because of their low risk profile.[112] As a result, foreign exchange forwards and swaps are not subject to the proposed rule's margin requirements. Accordingly, the Agencies' preliminary view is that it is appropriate to treat that portion of a cross-currency swap that is a fixed exchange of principal in a manner that is consistent with the treatment of foreign exchange forwards and swaps. This treatment of cross-currency swaps is limited to *only* cross-currency swaps and does not extend to any other swaps such as non-deliverable currency forwards. The Agencies note that this treatment is consistent with the 2013 international framework and seek comment on (i) whether or not this treatment of cross-currency swaps is appropriate and (ii) whether the proposed treatment of cross-currency swaps creates any additional burdens or complexities that should be considered.

v. Frequency of Margin Calculation

The proposed rule requires that an approved initial margin model be used to calculate the required initial margin collection amount on a *daily* basis. In cases where the initial margin collection amount increases, this new amount must be used as the basis for determining the amount of initial margin that must be *collected* from a financial end user with material swaps exposure or a swap entity counterparty. In addition, when a covered swap entity faces a financial end user with material swaps exposure, the covered swap entity must also calculate the initial margin collection amount from the perspective of its counterparty on a *daily* basis. In the event that this amount increases, the covered swap entity must use this new amount as the basis for determining the amount of initial margin that it must *post* to its counterparty.

The use of an approved initial margin model may result in changes to the initial margin collection amount on a *daily* basis for a number of reasons. First, the characteristics of the swaps that have a material effect on their risk may change over time. As an example, the credit quality of a corporate reference entity upon which a credit default swap contract is written may undergo a measurable decline. A decline in the credit quality of the reference entity would be expected to have a material impact on the initial margin model's risk assessment and the resulting initial margin collection amount. More generally, as characteristics that are relevant to the risk of the swap change, so too will the initial margin collection amount. Importantly, any change to the composition of the swap portfolio that results in the addition or deletion of

[111] *See* proposed rule § __.8(d)(13).

[112] 77 FR 69694 (November 20, 2012).

swaps from the portfolio would result in a change in the initial margin collection amount. Second, the underlying parameters and data that are used in the model may change over time as underlying conditions change. As an example, in the event that a new period of financial stress is encountered in one or more asset classes, the initial margin model's risk assessment of a swap's overall risk may change as a result. While the stress period calibration is intended to reduce the extent to which small or moderate changes in the risk environment influence the initial margin model's risk assessment, a significant change in the risk environment that affects the required stress period calibration could influence the margin model's overall assessment of the risk of a swap. Third, quantitative initial margin models are expected to be maintained and refined on a continuous basis to reflect the most accurate risk assessment possible with available best practices and methods. As best practice risk management models and methods change, so too may the risk assessments of initial margin models.

vi. Benchmarking

The proposed rule requires that an initial margin model used for calculating initial margin requirements be benchmarked periodically against observable margin standards to ensure that the initial margin required is not less than what a CCP would require for similar transactions.[113] This benchmarking requirement is intended to ensure that any initial margin amount produced by an initial margin model is subject to a readily observable minimum. It will also have the effect of limiting the extent to which the use of initial margin models might disadvantage the movement of certain types of swaps to CCPs by setting lower initial margin amounts for non-cleared transactions than for similar cleared transactions.

b. Standardized Initial Margins

Covered swap entities that are either unable or unwilling to make the technology and related infrastructure investments necessary to maintain an initial margin model may elect to use standardized initial margins. The standardized initial margins are detailed in Appendix A of the proposed rule.

i. Gross Initial Margins and Recognition of Offsets Through the Application of the Net-to-Gross Ratio

The Agencies have proposed standardized initial margins that depend on the asset class (agricultural commodity, energy commodity, metal commodity, other commodity, equity, credit, foreign exchange and interest rate) and, in the case of credit and interest rate asset classes, further depend on the duration of the underlying non-cleared swap.

In addition, the proposed standardized initial margin requirement allows for the recognition of risk offsets through the use of a net-to-gross ratio in cases where a portfolio of non-cleared swaps is executed under an EMNA. The net-to-gross ratio compares the net current replacement cost of the non-cleared portfolio (in the numerator) with the gross current replacement cost of the non-cleared portfolio (in the denominator). The net current replacement cost is the cost of replacing the entire portfolio of swaps that are covered under the EMNA. The gross current replacement cost is the cost of replacing those swaps that have a strictly positive replacement cost under the EMNA. As an example, consider a portfolio that consists of two non-cleared swaps under an EMNA in which the mark-to-market value of the first swap is $10 (i.e., the covered swap entity is owed $10 from its counterparty) and the mark-to-market value of the second swap is −$5 (i.e., the covered swap entity owes $5 to its counterparty). Then the net current replacement cost is $5 ($10 − $5), the gross current replacement cost is $10, and the net-to-gross ratio would be 5/10 or 0.5.[114]

The net-to-gross ratio and gross standardized initial margin amounts (provided in Appendix A) are used in conjunction with the notional amount of the transactions in the underlying swap portfolio to arrive at the total initial margin requirement as follows:

Standardized Initial Margin = 0.4 × Gross Initial Margin + 0.6 × NGR × Gross Initial Margin

Where:

Gross Initial Margin = the sum of the notional value multiplied by the appropriate initial margin requirement percentage from Appendix A of each non-cleared swap under the EMNA; and

NGR = net-to-gross ratio

As a specific example, consider the two-swap portfolio discussed above. Suppose further that the swap with the mark-to-market value of $10 is a sold 5-year credit default swap with a notional value of $100 and the swap with the mark-to-market value of −$5 is an equity swap with a notional value of $100. The standardized initial margin requirement would then be:

$$[0.4 \times (100 \times 0.05 + 100 \times 0.15) + 0.6 \times 0.5 \times (100 \times 0.05 + 100 \times 0.15)] = 8 + 6 = 14.$$

The Agencies further note that the calculation of the net-to-gross ratio for margin purposes must be applied only to swaps subject to the same EMNA and that the calculation is performed *across* transactions in disparate asset classes within a single EMNA such as credit and equity in the above example (i.e., all non-cleared swaps subject to the same EMNA can net against each other in the calculation of the net-to-gross ratio, as opposed to the modeling approach that allows netting only within each asset class). This approach is consistent with the standardized counterparty credit risk capital requirements. Also, the equations are designed such that benefits provided by the net-to-gross ratio calculation are limited by the standardized initial margin term that is independent of the net-to-gross ratio, *i.e.,* the first term of the standardized initial margin equation which is 0.4 × Gross Initial Margin. Finally, if a counterparty maintains multiple swap portfolios under multiple EMNAs, the standardized initial margin amounts would be calculated separately for each portfolio with each calculation using the gross initial margin and net-to-gross ratio that is relevant to each portfolio. The total standardized initial margin would be the sum of the standardized initial margin amounts for each portfolio.

The Agencies also note that the BCBS has recently adopted a new method for the purpose of capitalizing counterparty credit risk.[115] While this alternative approach for recognizing risk offsets in a standardized framework may also be appropriate in a standardized margin context, the Agencies have preliminarily decided to adopt the net-to-gross ratio approach described here to recognize risk offsets. The Agencies seek comment on whether the BCBS's recently adopted standardized approach would represent a material improvement relative to the

[113] *See* proposed rule § __.8(f)(2)(ii).

[114] Note that in this example, whether or not the counterparties have agreed to exchange variation margin has no effect on the net-to-gross ratio calculation, i.e., the calculation is performed without considering any variation margin payments. This is intended to ensure that the net-to-gross ratio calculation reflects the extent to which the non-cleared swaps generally offset each other and not whether the counterparties have agreed to exchange variation margin. As an example, if a swap dealer engaged in a single sold credit derivative with a counterparty, then the net-to-gross calculation would be 1.0 whether or not the dealer received variation margin from its counterparty.

[115] *See* BCBS, ''The Standardised Approach for Measuring Counterparty Credit Risk Exposures,'' (March 2014, revised April 2014), *available at: http://www.bis.org/press/p140331.htm.*

proposed method that employs the net-to-gross ratio.

ii. Calculation of the Net-to-Gross Ratio for Initial Margin Purposes

The proposed standardized approach to initial margin depends on the calculation of a net-to-gross ratio. In the context of performing margin calculations, it must be recognized that at the time non-cleared swaps are entered into it is often the case that both the net and gross current replacement cost is zero. This precludes the calculation of the net-to-gross ratio. In cases where a new swap is being added to an existing portfolio that is being executed under an existing EMNA, the net-to-gross ratio may be calculated with respect to the existing portfolio of swaps. In cases where an entirely new swap portfolio is being established, the initial value of the net-to-gross ratio should be set to 1.0. After the first day's mark-to-market valuation has been recorded for the portfolio, the net-to-gross ratio may be re-calculated and the initial margin amount may be adjusted based on the revised net-to-gross ratio.

iii. Frequency of Margin Calculation

The proposed rule requires that the standardized initial margin collection amount be calculated on a *daily* basis. In cases where the initial margin collection amount increases, this new amount must be used as the basis for determining the amount of initial margin that must be *collected* from a financial end user with material swaps exposure or a swap entity. In addition, when a covered swap entity faces a financial end user with material swaps exposure, the covered swap entity must also calculate the initial margin collection amount from the perspective of its counterparty on a *daily* basis. In the event that this amount increases, the covered swap entity must use this new amount as the basis for determining the amount of initial margin that it must *post* to its counterparty.

c. Daily Calculation

As in the case of internal-model-generated initial margins, the margin calculation under the standardized approach must also be performed on a *daily* basis. Since the standardized initial margin calculation depends on a standardized look-up table (presented in Appendix A), there is somewhat less scope for the initial margin collection amounts to vary on a daily basis. At the same time, however, there are some factors that may result in daily changes in the initial margin collection amount resulting from standardized margin calculations. First, any changes to the notional size of the swap portfolio that arise from any addition or deletion of swaps from the portfolio would result in a change in the standardized margin amount. As an example, if the notional amount of the swap portfolio increases as a result of adding a new swap to the portfolio then the standardized initial margin collection amount would increase. Second, changes in the net-to-gross ratio that result from changes in the mark-to-market valuation of the underlying swaps would result in a change in the standardized initial margin collection amount. Third, changes to characteristics of the swap that determine the gross initial margin (presented in Appendix A) would result in a change in the standardized initial margin collection amount. As an example, the gross initial margin applied to interest rate swaps depends on the duration of the swap. An interest rate swap with a duration between zero and two years has a gross initial margin of one percent while an interest rate swap with duration of greater than two years and less than five years has a gross initial margin of two percent. Accordingly, if an interest rate swap's duration declines from above two years to below two years, the gross initial margin applied to it would decline from two to one percent. Accordingly, the standardized initial margin collection amount will need to be computed on a *daily* basis to reflect all of the factors described above.

d. Combined Use of Internal Model Based and Standardized Initial Margins

The Agencies expect that some covered swap entities may choose to adopt a mix of internal models and standardized approaches to calculating initial margin requirements. As a specific example, it may be the case that a covered swap entity engages in some swap transactions on an infrequent basis to meet client demands but the level of activity does not warrant all of the costs associated with building, maintaining and overseeing a quantitative initial margin model. Further, some covered swap entity clients may value the transparency and simplicity of the standardized approach. In such cases, the Agencies expect that it would be acceptable to use the standardized approach to margin such swaps.

As discussed in the 2013 international framework, under certain circumstances it is appropriate to employ both a model based and standardized approach to calculating initial margins. At the same time, and as discussed in the 2013 international framework, the Agencies are aware that differences between the standardized approach and internal model based margins across different types of swaps could be used to ''cherry pick'' the method that results in the lowest margin requirement. The Agencies would not view such an approach to choosing between a standardized and model based margin method as being appropriate and would raise safety and soundness concerns regarding the swap activities themselves. Rather, the choice to use one method over the other should be based on fundamental considerations apart from which method produces the most favorable margin results. Similarly, the Agencies do not anticipate there should be a need for covered swap entities to switch between the standardized or model-based margin method for a particular counterparty, absent a significant change in the nature of the entity's swap activities. The Agencies expect covered swap entities to provide a rationale for changing methodologies to their supervisory Agency if requested.

I. Section __.9: Cross-Border Application of Margin Requirements

In global markets, counterparties organized in different jurisdictions often transact in non-cleared swaps. Section 9 addresses the cross-border applicability of the proposed margin rules to covered swap entities.

1. Overview of 2011 Proposal and Public Comments

The 2011 proposal provided an exclusion from the margin requirements for certain covered swap entities that operate in foreign jurisdictions.[116] The 2011 proposal excluded any ''foreign non-cleared swap or foreign non-cleared security-based swap'' of a ''foreign covered swap entity,'' as those terms were defined in the 2011 proposal, from application of the margin requirements. With this approach, the Agencies intended to limit the extraterritorial application of the margin requirements while preserving, to the extent possible, competitive equality among U.S. and foreign firms in the United States.

The 2011 proposal defined a ''foreign covered swap entity'' as a covered swap entity that: (i) Is not a company organized under the laws of the United States or any State; (ii) is not a branch or office of a company organized under the laws of the United States or any

[116] When the prudential regulators proposed their margin requirements in 2011, neither the CFTC nor the SEC had yet adopted policies addressing various issues raised by cross-border swaps, including which swaps a U.S. entity and a foreign entity should count toward the *de minimis* thresholds for registration as a swap dealer or major swap participant.

State; (iii) is not a U.S. branch, agency or subsidiary of a foreign bank; and (iv) is not controlled, directly or indirectly, by a company that is organized under the laws of the United States or any State. Accordingly, only a covered swap entity that is organized under foreign law and not controlled, directly or indirectly, by a U.S. company (such as a foreign bank) would have been eligible for treatment as a foreign covered swap entity; neither a foreign branch of a U.S. bank nor a foreign subsidiary of a U.S. company would have been considered a foreign covered swap entity under the 2011 proposal. This treatment reflected the potential that legal, contractual, or reputational factors could expose the U.S. bank, or U.S. parent of the foreign subsidiary, to the risks of the foreign branch's or subsidiary's swap activities. Transactions of a foreign branch or subsidiary of a U.S. company could also have direct and significant connection with activities in, and effect on, commerce of the United States and therefore affect systemic risk in the United States. Similarly, neither a U.S. branch of a foreign bank nor a U.S. subsidiary of a foreign company would have been considered a foreign covered swap entity under the 2011 proposal.

Under the 2011 proposal, foreign swaps would generally have included only swaps where the foreign covered swap entity's counterparty is not organized under U.S. law or otherwise located in the United States, and no U.S. affiliate of the counterparty has guaranteed the counterparty's obligations under the swap.[117] Specifically, the 2011 proposal defined a ''foreign non-cleared swap or foreign non-cleared security-based swap'' as a non-cleared swap or non-cleared security-based swap with respect to which (i) the counterparty is not an entity, nor a branch or office of an entity, organized under the laws of the United States or any State and not a person resident in the United States and (ii) performance of the counterparty's obligations under the swap or security-based swap has not been guaranteed by an affiliate of the counterparty that is an entity, or a branch of an entity, organized under the laws of the United States or any State, or a person resident in the United States.

The requirement that no U.S. affiliate may guarantee the counterparty's obligation was intended to prevent instances where such an affiliate, through a guarantee, effectively assumes ultimate responsibility for the performance of the counterparty's obligations under the swap. In particular, the Agencies were concerned that, without such a requirement, swaps with a U.S. counterparty could be structured, through the use of an overseas affiliate, in a manner that would evade application of the proposed margin requirements to U.S. swaps. Swaps guaranteed by a U.S. entity would also have a direct and significant connection with activities in, and an effect on, commerce of the U. S. and thus affect systemic risk in the United States.

A number of commenters argued that the 2011 proposal would put U.S. firms that do business globally at a competitive disadvantage by applying U.S. rules to U.S. firms regardless of where their operations are conducted. These commenters suggested that U.S. firms operating abroad should be subject to the same margin requirements as other foreign firms to establish competitive equity. Other commenters argued that the 2011 proposal could create situations in which a U.S. firm operating abroad could be subjected to two different and potentially conflicting margin requirements, as the foreign jurisdiction could also impose margin requirements on the foreign operations of U.S. firms.

2. 2014 Proposal

Excluded swaps. The 2014 proposal retains a slightly modified version of the exclusion proposed in 2011. Section __.9 of the proposed rule would exclude from coverage of the rule's margin requirements any foreign non-cleared swap of a foreign covered swap entity.[118] Similar to the 2011 proposal, a ''foreign covered swap entity'' is any covered swap entity that is *not* (i) an entity organized under U.S. or State law, including a U.S. branch, agency, or subsidiary of a foreign bank; (ii) a branch or office of an entity organized under U.S. or State law; or (iii) an entity controlled by an entity organized under U.S. or State law.

The proposed rule's definition of ''foreign non-cleared swap or foreign non-cleared security-based swap'' would cover any non-cleared swap of a foreign covered swap entity to which neither the counterparty nor any guarantor (on either side) is (i) an entity organized under U.S. or State law, including a U.S. branch, agency, or subsidiary of a foreign bank; (ii) a branch or office of an entity organized under U.S. or State law; or (iii) a covered swap entity controlled by an entity organized under U.S. or State law. Under this definition, foreign swaps could include swaps with a foreign bank or with a foreign subsidiary of a U.S. bank or bank holding company, so long as that subsidiary is not itself a covered swap entity. A foreign swap would not include a swap with a foreign branch of a U.S. bank or a U.S. branch or subsidiary of a foreign bank.

Comparability determinations. In addition to the exclusion for certain swaps described above, the proposed rule would permit certain covered swap entities to comply with a foreign regulatory framework for non-cleared swaps if the Agencies determine that such foreign regulatory framework is comparable to the requirements of the proposed rule. At the time of the 2011 proposal it was unclear what margin requirements would be applied in foreign jurisdictions, making it difficult to rely on foreign regulatory regimes. However, the development of the 2013 international framework makes it more likely that regulators in multiple jurisdictions will adopt margin rules for non-cleared swaps that are comparable. In light of the 2013 international framework, the Agencies are requesting comment on a proposal to allow certain non-U.S. covered swap entities to comply with the margin requirements of the proposed rule by complying with a foreign jurisdiction's margin requirements, subject to the Agencies' determination that the foreign rule is comparable to this proposed rule. These determinations would be made on a jurisdiction-by-jurisdiction basis. Furthermore, the Agencies' determination may be conditional or unconditional. The Agencies could, for example, determine that certain provisions of the foreign regulatory framework are comparable to the requirements of the proposed rule but that other aspects are not comparable for purposes of substituted compliance.

Under the proposed rule, certain types of covered swap entities operating in foreign jurisdictions would be able to meet the requirement of the proposed rule by complying with the foreign requirement in the event that a comparability determination is made by the Agencies, regardless of the location of the counterparty, provided that the covered swap entity's obligations under the swap are not guaranteed by a U.S. entity. If a covered swap entity's

[117] Under the 2011 proposal, swap and security-based swaps with *U.S. counterparties* would have been subject to the rule's margin requirements regardless of whether the covered swap entity is U.S. or foreign.

[118] Section 2(i) of the Commodity Exchange Act, as amended by section 722 of the Dodd-Frank Act, provides that the provisions of the Commodity Exchange Act, as amended by section 722 of the Commodity Exchange Act relating to swaps ''shall not apply to activities outside the United States unless those activities . . . have a direct and significant connection with activities in, or effect on, commerce of the United States.''

obligations under a swap are guaranteed by a U.S. entity, the Agencies propose that the swap be subject to the proposed rule. Foreign covered swap entities (defined as discussed above) and foreign subsidiaries of U.S. entities that are covered swap entities would be eligible to take advantage of a comparability determination. The Agencies seek comment on whether a guarantee by a person organized under the laws of the United States or of any State should affect the availability of substituted compliance.

The Agencies are also interested in commenters' views on whether the rule should clarify and define the concept of ''guarantee'' to better ensure that those swaps that pose risks to U.S. insured depository institutions would be included within the scope of the rule. For example, many swaps agreements contain cross-default provisions that give swaps counterparties legal rights against certain ''specified entities.'' In these arrangements, a swaps counterparty of a foreign subsidiary of a U.S. covered swap entity may have a contractual right to close out and settle its swaps positions with the U.S. entity if the foreign subsidiary of the U.S. entity defaults on its own swaps positions with the counterparty. While not technically a guarantee of the foreign subsidiary's swaps, these provisions may be viewed as reassuring counterparties to foreign subsidiaries that the U.S. bank stands behind its foreign subsidiaries' swaps. Other similar arrangements may include keep well agreements or liquidity puts. Moreover, depending on the magnitudes of the swaps positions involved, such agreements can expose the U.S. bank to the risk of unexpected and disorderly termination of a subset of its own swaps positions based on the swaps activities of its foreign subsidiary.

In addition, U.S. branches and agencies of foreign banks would be permitted to comply with the foreign requirement for which a determination was made, provided their obligations under the swap are not guaranteed by a U.S. entity. While such branches and agencies clearly operate within the U.S., the proposed treatment reflects the principle that branches and agencies are part of the parent organization. Under this approach, foreign branches and agencies of U.S. banks would not be eligible for substituted compliance and would be required to comply with the U.S. requirement for the same reason. The Agencies are aware of concerns regarding potential competitive disadvantages that could arise as U.S. covered swap entities compete with U.S. branches and agencies of foreign banks in the market for non-cleared swaps. The Agencies' preliminary view is that this concern can be addressed through the comparability determination process. A foreign jurisdiction with a substantially different margin requirement that resulted in a demonstrable competitive advantage over U.S. covered swap entities is unlikely to have processes that are comparable to the U.S. compliance requirements. Moreover, a foreign margin requirement that would confer a significant competitive advantage on foreign entities through a lower margin requirement or similar means would likely represent a general increase in systemic risk and weaker incentives for central clearing relative to the U.S. requirement. Accordingly, it is unlikely that such foreign requirements would be determined comparable by the Agencies, in which case the U.S. branch or agency of a foreign bank would be required to comply with the U.S. requirement.

Under the proposed rule, if a foreign counterparty is subject to a foreign regulatory framework that has been determined to be comparable by the Agencies, a covered swap entity's posting requirement would be satisfied by posting (in amount, form, and at such time) as required by the foreign counterparty's margin collection requirement, provided that the counterparty is subject to the foreign regulatory framework. In these cases, the collection requirement of the foreign counterparty would suffice to ensure two-way exchange of margin. For example, if a U.S. bank that is a covered swap entity enters into a swap with a foreign hedge fund that is subject to a foreign regulatory framework for which the Agencies have made a comparability determination, the U.S. bank must collect the amount of margin as required under the U.S. rule, but need post only the amount of margin that the foreign hedge fund is required to collect under the foreign regulatory framework.

The proposed rule provides that the Agencies will jointly make a determination regarding the comparability of a foreign regulatory framework that will focus on the outcomes produced by the foreign framework as compared to the U.S. framework. Moreover, as margin requirements are complex and have a number of related aspects, *e.g.,* margin posting requirements, margin collection requirements, model requirements, eligible collateral, and segregation requirements, the Agencies propose to take a holistic view of the foreign regulatory framework that appropriately considers the outcomes produced by the entire framework. More specifically, the Agencies propose that they generally will not require that every aspect of a foreign regulatory framework be comparable to every aspect of the U.S. framework but will require that the outcomes achieved by both frameworks are comparable. The Agencies propose to consider factors such as the scope, objectives, and specific provisions of the foreign regulatory framework and the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised, by the relevant foreign regulatory authorities.

The Agencies propose to accept requests for a determination from a covered swap entity that it be allowed to comply with the foreign regulatory framework if a comparability determination were made to support such result. Once the Agencies make a favorable comparability determination for a foreign regulatory framework, any covered swap entity that could comply with the foreign framework will be allowed to do so (*i.e.,* they will not have to make a specific request). The Agencies expect to consult with the relevant foreign regulatory authorities before making a determination.

Entities not covered by the rule. The Agencies engage in this rulemaking pursuant to sections 731 and 764 of the Dodd-Frank Act, requiring registered swap dealers and security-based swap dealers for which one of the Agencies is the ''prudential regulator'' for purposes of Title VII, to comply with that Agency's margin rule for non-cleared swaps. Title VII's registration requirements are implemented by the CFTC and SEC, not the Agencies. After the prudential regulators issued their 2011 proposal, the CFTC adopted guidance and the SEC adopted a rule to address cross-border issues in swap regulation, including the circumstances in which foreign firms are required to register as swap entities.[119] This guidance clarifies that foreign subsidiaries of U.S. firms engaging in swaps activities abroad are not required to register with the CFTC or SEC *solely* on account of their parent's presence in the United States. Accordingly, there may be notable circumstances in which, for example, a foreign subsidiary of a U.S. insured depository institution, including foreign subsidiaries of Edge Act Corporations, may engage in non-

[119] 78 FR 45292 (July 26, 2013) (CFTC Interpretive Guidance); 79 FR 39067 (July 9, 2014) (SEC rule). A central aspect of these policies is the definition of ''U.S. person,'' which is used to categorize a swap dealer, its counterparty, or major swap participant as either a person with substantial contacts to the United States or as a foreign person.

cleared swaps activities abroad, without having to register with the CFTC or SEC, and accordingly without being covered by the margin rules being proposed by the Agencies in this **Federal Register** notice.

The Agencies note that a substantial amount of swaps activities are currently conducted through foreign subsidiaries that may not be subject to certain elements of Title VII of the Dodd-Frank Act.[120] If these foreign subsidiaries became fully consolidated with insured depository institutions for accounting purposes, the risks of such foreign activities could be borne by insured depository institutions. As noted above, in cases where the foreign subsidiaries are not registered as swap entities, the margin rules proposed by the Agencies likely would not apply by their own terms. The Agencies seek comment as to whether the proposed margin rules should be applied pursuant to the Agencies' general safety and soundness and other authority to foreign subsidiaries of such entities in all cases, irrespective of whether such subsidiaries are registered as swap entities.

The Agencies seek comment on the proposed cross-border provisions of the proposed rule. In particular, are there any reasons not to recognize foreign regulatory frameworks in the manner that has been proposed? Does the recognition of foreign regulatory frameworks raise any competitive equity or related issues that the Agencies should consider? Are there any additional types of covered swap entities that should be permitted to comply with the U.S. framework by complying with a foreign framework? Are there any other covered swap entities that should not be permitted to comply with the U.S. rule in this manner? Are there any issues or potential negative consequences associated with the comparability determination process as described in the proposal?

J. Section __.10: Documentation of Margin Matters

1. Overview of 2011 Proposal and Public Comments

The 2011 proposal included documentation requirements for covered swap entities. Under the 2011 proposal, a covered swap entity would have had to execute trading documentation with each counterparty that included credit support arrangements that granted the covered swap entity the contractual right to collect initial margin and variation margin in such amounts, in such form, and under such circumstances as would have been necessary to meet the initial margin and variation margin requirements set forth in the rule.[121] The trading documentation also would have had to specify (i) the methods, procedures, rules, and inputs for determining the value of each swap for purposes of calculating variation margin requirements, and (ii) the procedures by which any disputes concerning the valuation of swaps, or the valuation of assets collected or posted as initial margin or variation margin, would be resolved.

A number of commenters suggested that formal documentation should not be required with each of a covered swap entity's counterparties. In particular, some commenters indicated that swaps with counterparties (*e.g.,* nonfinancial end users) that would not generally be expected to post margin to a covered swap entity should not require formal documentation.

2. 2014 Proposal

Section __.10(a) of the proposal would retain the documentation requirements substantially as proposed in the 2011 proposal, except that the requirements would apply only to swaps with counterparties that are swap entities or financial end users. Under the proposal, a covered swap entity must execute trading documentation with each counterparty that is a swap entity or a financial end user that includes a credit support arrangement that grants the covered swap entity the contractual right to collect and post initial and variation margin in such amounts, in such form, and under such circumstances as are required by the rule. The documentation must also specify the methods, procedures, rules, and inputs for determining the value of each non-cleared swap for purposes of calculating variation margin requirements and the procedures by which any disputes concerning the valuation of non-cleared swaps or the valuation of assets collected or posted as initial margin or variation margin may be resolved.

The CFTC and SEC are responsible for specifying swap trading relationship documentation requirements for *all* swap entities. In the case of the CFTC, these requirements have been adopted.[122] In the case of the SEC, these requirements have been proposed.[123] The Agencies request comment on whether the proposal should deem compliance with the applicable CFTC or SEC documentation requirements as compliance with this proposed rule. Allowing compliance with CFTC and SEC documentation requirements to satisfy the proposed rule's requirements in these cases will reduce the burden on covered swap entities and avoid duplicative requirements while ensuring that the goals of the proposed rule's requirements are achieved. Alternatively, the Agencies request comment on whether documentation requirements in this rule are necessary to ensure that appropriate minimum documentation standards are in effect for all covered swap entities.

K. Section __.11: Capital

The 2011 proposal would have required a covered swap entity to comply with any risk-based and leverage capital requirements already applicable to that covered swap entity as part of its prudential regulatory regime. A few commenters urged that capital should not be required with respect to covered swap entities' swaps exposures to nonfinancial end user counterparties. Other commenters argued that capital and collateral requirements for swaps should work together, so there is no need for both capital and margin requirements.

In the period since the 2011 proposal, the banking agencies have strengthened regulatory capital requirements for banking organizations through adoption of the revised capital framework as well as through other rulemakings.[124] The revised capital framework introduced a new common equity tier 1 capital ratio and a supplementary leverage ratio, raised the minimum tier 1 ratio and, for certain banking organizations, raised the leverage ratio, implemented strict eligibility criteria for regulatory capital instruments, and introduced a standardized methodology for calculating risk-weighted assets.

[120] *See* section 722 of the Dodd-Frank Act.

[121] *See* 2011 proposal § __.5.

[122] 17 CFR part 23, subpart I (2014). *See* 77 FR 55903 (September 11, 2012).

[123] 76 FR 3859 (January 21, 2011); 78 FR 30800 (May 23, 2013) (reopening of comment period).

[124] *See* 78 FR 62018 (October 11, 2013) and 79 FR 20754 (April 14, 2014). The revised capital framework also reorganized the banking agencies' capital adequacy guidelines into a harmonized, codified set of rules, located at 12 CFR part 3 (national banks and Federal savings associations); 12 CFR part 217 (state member banks, bank holding companies, and savings and loan holding companies); 12 CFR part 324 (state nonmember banks and state savings associations). The requirements of 12 CFR parts 3, 217 and 324 became effective on January 1, 2014, for banking organizations subject to the advanced approaches capital rules, and as of January 1, 2015 for all other banking organizations.

The proposal similarly would require a covered swap entity to comply with risk-based and leverage capital requirements already applicable to the covered swap entity as follows:

- In the case of covered swap entities that are banking organizations,[125] the elements of the revised capital framework that are applicable to the covered entity and have been adopted by the appropriate Federal banking agency under 12 U.S.C. 3907 and 3909 (International Lending Supervision Act), 12 U.S.C. 1462(s) (Home Owner's Loan Act), and section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o);
- In the case of a foreign bank, any state branch or state agency of a foreign bank, the capital standards that are applicable to such covered entity under the Board's Regulation Y (12 CFR 225.2(r)(3)) or the Board's Regulation YY (12 CFR part 252);
- In the case of an Edge corporation or an Agreement corporation, the capital standards applicable to an Edge corporation engaged in banking pursuant to the Board's Regulation K (12 CFR 211.12(c));
- In the case of any ''regulated entity'' under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (i.e., Fannie Mae and its affiliates, Freddie Mac and its affiliates, and the Federal Home Loan Banks), the risk-based capital level or such other amount applicable to the covered swap entity as required by the Director of FHFA pursuant to 12 U.S.C. 4611;
- In the case of Farmer Mac, the capital adequacy regulations set forth in 12 CFR part 652; and
- In the case of any FCS institution (other than Farmer Mac), the capital regulations set forth in 12 CFR part 615.[126] On May 8, 2014, the FCA proposed revisions to the capital rules for all FCS institutions, except Farmer Mac, that are broadly consistent with Basel III.[127]

The Agencies have determined that compliance with the regulatory capital rules described above is sufficient to offset the greater risk, relative to the risk of centrally cleared swaps, to the swap entity and the financial system arising from the use of non-cleared swaps, and helps ensure the safety and soundness of the covered swap entity. In particular, the Agencies note that the regulatory capital rules incorporated by reference into the proposed rule already address, in a risk-sensitive and comprehensive manner, the safety and soundness risks posed by a covered swap entity's swaps positions.[128] In addition, the Agencies believe that these regulatory capital rules sufficiently take into account and address the risks associated with the swaps positions of a covered swap entity.[129] As a result, the Agencies are not proposing separate capital requirements in the proposal.

In response to commenters that argued that the Agencies should not impose both capital and margin requirements, the Agencies note that the relevant statutory provisions require both capital and margin requirements. Moreover, the revised capital framework adopted by the banking agencies and this proposal are intended to operate as complementary regimes that minimize or eliminate duplication of requirements. To the extent that a covered swap entity collects margin on a non-cleared swap, the revised capital framework would recognize the risk mitigation effects of the margin that the covered swap entity has collected, which would in turn reduce the covered swap entity's risk-based capital requirement.

IV. Quantitative Impact of Margin Requirements

A. Overview

The proposed rule would apply the initial margin and variation margin requirements to non-cleared swaps that are entered into by a covered swap entity over a substantial phase-in period that begins in December 2015. The proposed rule would not require an immediate or retroactive application of initial margin or variation margin for any swap entered into prior to the relevant compliance date of the final rule.

Because the requirements would not be applied retroactively, no new initial margin or variation margin requirements would be imposed on non-cleared swaps entered into prior to the relevant compliance date until those transactions are rolled over or renewed. The only requirements that would apply to a pre-compliance date transaction would be the initial margin and variation margin requirements to which the parties to the transaction had previously agreed by contract.

The new requirements will have an impact on the costs of engaging in new non-cleared swaps after the applicable compliance date. In particular, the proposed rule sets out requirements for initial and variation margin that represent a significant change from current industry practice in many circumstances. Since the 2011 proposal was released, a number of analyses have been conducted that attempt to estimate the total amount of liquidity that will be required by the new margin requirements. Given the complexity of this proposal and its inter-relationship to other rulemakings, these analyses are subject to considerable uncertainty. In particular, these analyses make a number of assumptions regarding: (i) The level of market activity in the future, (ii) the amount of central clearing in the future, and (iii) the level of financial market volatility and risk that will determine initial margin requirements. These studies also make a number of additional assumptions which may have a measurable influence on the analysis. Notwithstanding these uncertainties, the Agencies' preliminary view is that the analysis and data that appear in these studies are useful to gauge the approximate amount of liquidity that will be required by the new requirements for non-cleared swaps.

[125] ''Banking organization'' includes national banks, state member banks, state nonmember banks, Federal savings associations, state savings associations, U.S. intermediate holding companies formed pursuant to the Board's Regulation YY (12 CFR part 252) and top-tier bank holding companies domiciled in the United States not subject to the Board's Small Bank Holding Company Policy Statement (12 CFR part 225, Appendix C), as well as top-tier savings and loan holding companies domiciled in the United States except certain savings and loan holding companies that are substantially engaged in insurance underwriting or commercial activities.

[126] *See* proposed rule § __.11.

[127] The FCA recently proposed revisions to its capital rules for all FCS institutions, except Farmer Mac, that are comparable to the Basel III Framework.

[128] For example, with respect to interest rate, foreign exchange rate, credit, equity and precious metal derivative contracts that are not cleared, banking organizations subject to the revised capital framework are subject to a capital requirement based on the type of contract and remaining maturity, and takes into account counterparty credit risk as well as the credit risk mitigating factors of collateral. Banking organizations subject to the advanced approaches rules may use internal models for calculating capital requirements for non-cleared derivatives. *See* 12 CFR part 3, subparts D and E (OCC); 12 CFR part 217, subparts D and E (Board); 12 CFR 324, subparts D and E (FDIC), each as applicable. The FCA's capital requirements for FCS institutions other than Farmer Mac expressly address derivatives transactions. *See* 12 CFR 615.5201 and 615.5212. The FCA's capital requirements for Farmer Mac indirectly address derivatives transactions in the operational risk component of the statutorily mandated risk-based capital stress test model. *See* 12 CFR part 652, subpart B, Appendix A. The FCA, through the Office of Secondary Market Oversight, closely monitors and supervises all aspects of Farmer Mac's derivatives activities, and the FCA believes existing requirements and supervision are sufficient to ensure safe and sound operations in this area. However, the FCA is considering enhancements to the model and in the future may revise the model to more specifically address derivatives transactions.

[129] *See* footnote 49, *supra,* for a discussion of the basis for FHFA's preliminary view that the reference to existing statutory authority is sufficient to address the risks discussed in the text above as to the Enterprises notwithstanding their current conservatorship status.

Below is a discussion of a selection of studies that have been conducted in the recent past that relate to a margin framework similar to the proposed rule. Specifically, each of these studies uses the 2013 international framework described above in estimating the total amount of initial margin collateral that will be required. While this proposal is largely consistent with the 2013 international framework, the two are not identical. Therefore, the results of these studies are limited by these differences.

B. Initial Margin Requirements

The proposed rule will require an exchange of initial margin by many market participants, which represents a significant change in market practice. The total amount of initial margin that would be required at a point in time is an important input into an estimate of the liquidity costs of the new requirements. The table below presents estimates of the total amount of initial margin that would be required by U.S. swap entities and their counterparties once the requirements are fully implemented, that is, at the end of the phase-in period and after existing swaps are rolled into new swaps.

ESTIMATED INITIAL MARGIN REQUIREMENTS

Source	Initial margin estimate ($BN)
BCBS–IOSCO—Model Based	315
ISDA—Model Based	280
ISDA—Standardized	3,570

The initial margin estimates provided in the table above are taken from two different studies that have examined the impact of the 2013 international framework on overall liquidity needs. The studies were conducted by the BCBS and IOSCO [130] and ISDA.[131] Each of these studies reports an estimate of the *global* impact of margin requirements. In particular, these estimates include the impact of margin requirements on foreign financial institutions and their counterparties, in addition to U.S. financial institutions and their counterparties. In order to better align the studies' estimates with the impact of the proposed U.S. rule, the estimates in Table X have been reduced by 65 percent to reflect the fact that U.S. financial institutions and their counterparties account for roughly 35 percent of the global derivatives market.[132] The estimate reported in the table above from the BCBS–IOSCO study reflects the estimate among those provided in the study that is most consistent with the proposed rule.[133] Two estimates from the ISDA study are presented in the table above reflecting a high and low estimate. Both the ISDA low estimate and the BCBS–IOSCO estimate assume that all initial margin requirements are calculated according to an internal model with parameters consistent with those required by the proposed rule. The ISDA high estimate assumes that all initial margin requirements are calculated according to a standardized margin approach. Further, the standardized approach assumed in the ISDA study does not allow for the recognition of any offsets which would be allowed by the application of the net-to-gross ratio under the proposed rule.[134]

As discussed above, these estimates represent the total amount of initial margin that will be required at a point in time once the requirements have been fully phased in and all existing non-cleared swaps have been rolled over into new non-cleared swaps. Accordingly, the full amount of initial margin amount estimates provided in the table above would not be realized until, at the earliest, 2019.

The amounts reported in the table above reflect estimated amounts of initial margin that will be required under this proposal but do not reflect the cost of providing these amounts by covered swap entities and their counterparties. The cost of providing initial margin collateral depends on the difference between the cost of raising additional funds and the rate of return on the assets that are ultimately pledged as initial margin. In some cases, it may be that some entities providing initial margin, such as pension funds and asset managers, will provide assets as initial margin that they already own and would have owned even if no requirements were in place. In such cases, the economic cost of providing initial margin collateral is expected to be low. In other cases, entities engaging in non-cleared swaps will have to raise additional funds to secure assets that can be pledged as initial margin. The greater the cost of their marginal funding relative to the rate of return on the initial margin collateral, the greater the cost of providing collateral assets. It is difficult, however, to estimate these costs due to differences in marginal funding costs across different types of entities as well as differences in marginal funding costs over time and differences in the rate of return on different collateral assets that may be used to satisfy the initial margin requirements.

C. Variation Margin Requirements

The proposal will also require that variation margin be exchanged between covered swap entities and certain of their counterparties. The Agencies' preliminary view is that the impact of such requirements are low in the aggregate because: (i) regular exchange of variation margin is already a well-established market practice among a large number of market participants, and (ii) exchange of variation margin simply redistributes resources from one entity to another in a manner that imposes no aggregate liquidity costs. An entity that suffers a reduction in liquidity from posting variation margin is offset by an increase in the liquidity enjoyed by the entity receiving the variation margin.

D. Request for Comment

While the Agencies' preliminary view is that the studies referenced above are broadly useful for considering the overall liquidity costs of the new requirements, they do not provide useful estimates of other aspects of cost including, for example, the operational costs of complying with the requirements. Also, commenters may have additional information on the economic and liquidity costs that are not addressed in the studies referenced above. Accordingly, the Agencies request commenters to provide their own detailed quantitative impact analyses. The Agencies encourage commenters to include the following elements in their analyses: (i) The expected costs of, or additional liquidity required by, the initial margin and variation margin requirements, and (ii) the potential benefits of the initial margin and variation margin requirements to covered swap entities, their counterparties, and the financial system as a whole. The analyses should also (i) address operational and other

[130] *See* Basel Committee on Banking Supervision and the International Organization of Securities Commissions (2013), *Margin Requirements for Non-Centrally Cleared Derivatives: Second Consultative Document,* report (Basel, Switzerland: Bank for International Settlements, February).

[131] Documents on initial margin requirements are available on the International Swaps and Derivatives Association Web site.

[132] *See* ISDA Research Notes: Concentration of OTC Derivatives Among Major Dealers, Issue 4, 2010.

[133] The BCBS–IOSCO impact study discusses the impact of several different margin regimes, *e.g.,* regimes with and without an initial margin threshold.

[134] The ISDA study was conducted based on the BCBS–IOSCO February 2013 consultative document which did not include any recognition of offsets in the standardized initial margin regime. Recognition of offsets was included in the final 2013 international framework.

business related costs associated with implementing the proposed rule, and (ii) take into consideration and disclose any expected effects of the likely clearing of certain swaps through central counterparties in the future.

V. Request for Comments

The Agencies are interested in receiving comments on all aspects of the proposed rule.

VI. Solicitation of Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act, Public Law 106–102, sec. 722, 113 Stat. 1338, 1471 (Nov. 12, 1999), requires the OCC, Board and FDIC to use plain language in all proposed and final rules published after January 1, 2000. The OCC, Board and FDIC invite your comments on how to make this proposal easier to understand. For example:

- Have we organized the material to suit your needs? If not, how could this material be better organized?
- Are the requirements in the proposed regulation clearly stated? If not, how could the regulation be more clearly stated?
- Does the proposed regulation contain language or jargon that is not clear? If so, which language requires clarification?
- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes to the format would make the regulation easier to understand?
- What else could we do to make the regulation easier to understand?

VII. Administrative Law Matters

A. Paperwork Reduction Act Analysis

Request for Comment on Proposed Information Collection

Certain provisions of the proposed rule contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501–3521). In accordance with the requirements of the PRA, the Agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The OMB control number for the OCC is 1557–0251. The FDIC will obtain an OMB control number. The OMB control number for the Board is 7100–0361. In addition, as permitted by the PRA, the Board proposes to extend for three years, with revision, the Reporting Requirements Associated with Regulation KK (Margin and Capital Requirements for Covered Swaps Entities) (Reg KK; OMB No. 7100–0361). The information collection requirements contained in this joint notice of proposed rulemaking have been submitted to OMB for review and approval by the OCC and FDIC under section 3507(d) of the PRA and section 1320.11 of OMB's implementing regulations (5 CFR 1320). The Board reviewed the proposed rule under the authority delegated to the Board by OMB. The proposed rule contains requirements subject to the PRA. The reporting requirements are found in §§ __.8(c)(1), __.8(c)(2), __.8(c)(3), __.8(d)(5), __.8(d)(10), __.8(d)(11), __.8(d)(12), __.8(d)(13), and __.9(e). The recordkeeping requirements are found in §§ __.2 definition of ''eligible master netting agreement,'' paragraph (4), __.5(b)(2)(i), __.8(e), __.8(f)(2), __.8(f)(3), __.8(f)(4), __.8(g), __.8(h), and __.10. These information collection requirements would implement sections 731 and 764 of the Dodd-Frank Act, as mentioned in the Abstract below.

Comments are invited on:

(a) Whether the collections of information are necessary for the proper performance of the Agencies' functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the information collections, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Comments on aspects of this notice that may affect reporting or recordkeeping requirements and burden estimates should be sent to the addresses listed in the **ADDRESSES** section of this Supplementary Information. A copy of the comments may also be submitted to the OMB desk officer for the Agencies: By mail to U.S. Office of Management and Budget, 725 17th Street NW., #10235, Washington, DC 20503 or by facsimile to 202–395–5806, Attention, Commission and Federal Banking Agency Desk Officer.

Proposed Information Collection

Title of Information Collection: Reporting and Recordkeeping Requirements Associated with Margin and Capital Requirements for Covered Swap Entities.

Frequency of Response: Event-generated and annual.

Affected Public: The affected public of the OCC, FDIC, and Board is assigned generally in accordance with the entities covered by the scope and authority section of their respective proposed rule. Businesses or other for-profit.

Respondents:

OCC: Any national bank, Federal savings association, or Federal branch or agency of a foreign bank that is registered as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant.

FDIC: Any FDIC-insured state-chartered bank that is not a member of the Federal Reserve System or FDIC-insured state-chartered savings association that is registered as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant.

Board: Any state member bank (as defined in 12 CFR 208.2(g)), bank holding company (as defined in 12 U.S.C. 1841), savings and loan holding company (as defined in 12 U.S.C. 1467a), foreign banking organization (as defined in 12 CF. 211.21(o)), foreign bank that does not operate an insured branch, state branch or state agency of a foreign bank (as defined in 12 U.S.C. 3101(b)(11) and (12)), or Edge or agreement corporation (as defined in 12 CFR 211.1(c)(2) and (3)) that is registered as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant.

FHFA: With respect to any regulated entity as defined in section 1303(2) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4502(2)), the proposed rule does not contain any collection of information that requires the approval of the OMB under the PRA.[135]

[135] For the 2011 proposal, FHFA noted that with respect to any of its regulated entities, the rule would not have contained any collection of information pursuant to the PRA. However, provisions in § __.11(e) of FHFA's 2011 proposal allowing a third party that is not subject to regulation by a prudential regulator to request prior written approval of an initial margin model for use by Fannie Mae, Freddie Mac or the Federal Home Loan Banks would have been a collection of information under the PRA. *See* 76 FR 27564 at 27584. As already noted, FHFA is not re-proposing as part of the proposed rule a provision similar to that found in § ___.11(e) of the 2011 proposal. As a consequence, the provision that triggered a FHFA

FCA: The FCA collects information from Farm Credit System institutions, which are Federal instrumentalities, in the FCA's capacity as their safety and soundness regulator, and, therefore, OMB approval is not required for this collection.

Abstract: Sections 731 and 764 of the Dodd-Frank Act would require the Agencies to adopt rules jointly to establish capital requirements and initial and variation margin requirements for such entities on all non-cleared swaps and non-cleared security-based swaps in order to offset the greater risk to such entities and the financial system arising from the use of swaps and security-based swaps that are not cleared.

Reporting Requirements

Section __.8 establishes standards for initial margin models. These standards include (1) a requirement that the covered swap entity receive prior approval from the relevant Agency based on demonstration that the initial margin model meets specific requirements (§§ __.8(c)(1) and __.8(c)(2)); (2) a requirement that a covered swap entity notify the relevant Agency in writing 60 days before extending use of the model to additional product types, making certain changes to the initial margin model, or making material changes to modeling assumptions (§ __.8(c)(3)); (3) a variety of quantitative requirements, including requirements that the covered swap entity validate and demonstrate the reasonableness of its process for modeling and measuring hedging benefits, demonstrate to the satisfaction of the relevant Agency that the omission of any risk factor from the calculation of its initial margin is appropriate, demonstrate to the satisfaction of the relevant Agency that incorporation of any proxy or approximation used to capture the risks of the covered swap entity's non-cleared swaps or non-cleared security-based swaps is appropriate, periodically review and, as necessary, revise the data used to calibrate the initial margin model to ensure that the data incorporate an appropriate period of significant financial stress (§§ __.8(d)(5), __.8(d)(10), __.8(d)(11), __.8(d)(12), and __.8(d)(13)).

Section __.9(e) allows a covered swap entity to request that the prudential regulators make a substituted compliance determination and must provide the reasons therefore and other required supporting documentation. A request for a substituted compliance determination must include a description of the scope and objectives of the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps; the specific provisions of the foreign regulatory framework for non-cleared swaps and security-based swaps (scope of transactions covered; determination of the amount of initial and variation margin required; timing of margin requirements; documentation requirements; forms of eligible collateral; segregation and rehypothecation requirements; and approval process and standards for models); the supervisory compliance program and enforcement authority exercised by a foreign financial regulatory authority or authorities in such system to support its oversight of the application of the non-cleared swap and security-based swap regulatory framework; and any other descriptions and documentation that the prudential regulators determine are appropriate. A covered swap entity may make a request under this section only if directly supervised by the authorities administering the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps.

Recordkeeping Requirements

Section __.2 defines terms used in the proposed rule, including the definition of ''eligible master netting agreement,'' which provides that a covered swap entity that relies on the agreement for purpose of calculating the required margin must (1) conduct sufficient legal review of the agreement to conclude with a well-founded basis that the agreement meets specified criteria and (2) establish and maintain written procedures for monitoring relevant changes in law and to ensure that the agreement continues to satisfy the requirements of this section. The term ''eligible master netting agreement'' is used elsewhere in the proposed rule to specify instances in which a covered swap entity may (1) calculate variation margin on an aggregate basis across multiple non-cleared swaps and security-based swaps and (2) calculate initial margin requirements under an initial margin model for one or more swaps and security-based swaps.

Section __.5(b)(2)(i) specifies that a covered swap entity shall not be deemed to have violated its obligation to collect or post margin from or to a counterparty if the covered swap entity has made the necessary efforts to collect or post the required margin, including the timely initiation and continued pursuit of formal dispute resolution mechanisms, or has otherwise demonstrated upon request to the satisfaction of the agency that it has made appropriate efforts to collect or post the required margin.

Section __.8 establishes standards for initial margin models. These standards include (1) a requirement that a covered swap entity review its initial margin model annually (§ __.8(e)); (2) a requirement that the covered swap entity validate its initial margin model initially and on an ongoing basis, describe to the relevant Agency any remedial actions being taken, and report internal audit findings regarding the effectiveness of the initial margin model to the covered swap entity's board of directors or a committee thereof (§§ __.8(f)(2), __.8(f)(3), and __.8(f)(4)); (3) a requirement that the covered swap entity adequately document all material aspects of its initial margin model (§ __.8(g)); and (4) that the covered swap entity must adequately document internal authorization procedures, including escalation procedures, that require review and approval of any change to the initial margin calculation under the initial margin model, demonstrable analysis that any basis for any such change is consistent with the requirements of this section, and independent review of such demonstrable analysis and approval (§ __.8(h)).

Section __.10 requires a covered swap entity to execute trading documentation with each counterparty that is either a swap entity or financial end user regarding credit support arrangements that (1) provides the contractual right to collect and post initial margin and variation margin in such amounts, in such form, and under such circumstances as are required; and (2) specifies the methods, procedures, rules, and inputs for determining the value of each non-cleared swap or non-cleared security-based swap for purposes of calculating variation margin requirements, and the procedures for resolving any disputes concerning valuation.

Estimated Burden per Response:

Reporting Burden

§§ __.8(c)(1), __.8(c)(2), __.8(c)(3), __.8(d)(5), __.8(d)(10), __.8(d)(11), __.8(d)(12), and __.8(d)(13): 240 hours.

§ __.9(e): 10 hours.

Recordkeeping Burden

§§ __.2, __.5(b)(2)(i), __.8(e), __.8(f)(2), __.8(f)(3), __.8(f)(4), __.8(g), __.8(h), and __.10: 69 hours.

request for OMB approval of an information collection in 2011 is no longer part of the proposed rule.

OCC

Number of respondents: 20.

Total estimated annual burden: 6,780 hours.

FDIC

Number of respondents: 3.

Total estimated annual burden: 1,017 hours.

Board

Number of respondents: 50.

Proposed revisions only estimated annual burden: 16,950 hours (Subpart A).

Total estimated annual burden: 17,048 hours.

B. Initial Regulatory Flexibility Act Analysis

In accordance with section 3(a) of the Regulatory Flexibility Act, 5 U.S.C. 601 *et. seq.* (RFA), the Agencies are publishing an initial regulatory flexibility analysis for the proposed rule. The RFA requires an agency to provide an initial regulatory flexibility analysis with the proposed rule or to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities. The Agencies welcomes comment on all aspects of the initial regulatory flexibility analysis. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

1. Statement of the objectives of the proposal. As required by section 4s of the Commodity Exchange Act (7 U.S.C. 6(s)) and section 15F of the Securities Exchange Act (15 U.S.C. 78o–10), which were added by sections 731 and 764 of the Dodd-Frank Act, respectively, the Agencies are proposing new regulations to establish rules imposing (i) capital requirements and (ii) initial and variation margin requirements on all non-cleared swaps into which covered swap entities enter. The capital and margin standards for swap entities imposed under sections 731 and 764 of the Dodd-Frank Act are intended to offset the greater risk to the swap entity and the financial system arising from the use of swaps and security-based swaps that are not cleared.[136] Sections 731 and 764 of the Dodd-Frank Act require that the capital and margin requirements imposed on swap entities must, to offset such risk, (i) help ensure the safety and soundness of the swap entity and (ii) be appropriate for the greater risk associated with the non-cleared swaps and non-cleared security-based swaps held as a swap entity. In addition, sections 731 and 764 of the Dodd-Frank Act require the Agencies, in establishing capital requirements for covered swap entities, to take into account the risks associated with other types, classes or categories of swaps or security-based swaps engaged in, and the other activities conducted that are not otherwise subject to regulation by virtue of being a swap entity.[137]

This proposed rule implements the statutory provisions, which require the Agencies to adopt rules jointly to establish capital requirements and initial and variation margin requirements for covered swap entities on all non-cleared swaps and non-cleared security-based swaps in order to offset the greater risk to such entities and the financial system arising from the use of swaps and security-based swaps that are not cleared.

2. Small entities affected by the proposal. This proposal may have an effect predominantly on two types of small entities: (i) Covered swap entities that are subject to the proposed rule's capital and margin requirements; and (ii) counterparties that engage in swap transactions with covered swap entities.

A financial institution generally is considered small if it has assets of $550 million or less.[138] Based on 2014 Call Report data, no covered swap entities had total consolidated domestic assets of $550 million or less. The Agencies do not expect that any small financial institution is likely to be a covered swap entity, because these small financial institutions are unlikely to engage in the level of swap activity that would require them to register as swap dealers or major swap participants.[139]

The initial and variation margin requirements of the proposed rule apply to non-cleared swap transactions entered into by a covered swap entity with counterparties that are swap entities or financial end users. Non-financial or ''commercial'' end users would not be subject to specific requirements under the proposed rule, and a covered swap entity's collection of margin from these types of counterparties is subject to the judgment of the covered swap entity. That is, under the proposed rule, a covered swap entity is not required to collect initial or variation margin with respect to any non-cleared swap or non-cleared security-based swap with a counterparty that is a nonfinancial end user but shall collect initial and variation margin at such times and in such forms and such amounts (if any) that the covered swap entity determines appropriately address the credit risk posed by the counterparty and the risks of such non-cleared swaps and non-cleared security-based swaps. In this respect, the Agencies intend for the proposed requirements to be consistent with current market practice for such end users, with the understanding that in many cases little or no margin is, or will be, exchanged with these counterparties. The documentation requirements of the proposed rule likewise would not apply to these nonfinancial end users. The segregation requirement of the proposed rule could apply in cases where the covered swap entity posts margin to a nonfinancial end user, even though a covered swap entity is not required to post margin to nonfinancial end users under the proposed rule. In particular, under the proposal, a covered swap entity that posts any collateral other than variation margin shall require that all funds or other property other than variation margin provided by the covered swap entity be held by one or more custodians that are not affiliates of the covered swap entity or the counterparty. The Agencies believe that the treatment of nonfinancial end users under the proposal should reduce the burden on nonfinancial end users including those that are small entities.

The rule would require covered swap entities to post margin to and collect margin on non-cleared swaps from counterparties that are swap entities or financial end users. The number of such counterparties and the extent to which certain types of companies are likely to be counterparties are unknown. As noted above, the CFTC has provided a list of provisionally registered swap dealers that includes 102 institutions and provisionally registered major swap participants that includes 2 institutions.[140] Swap entities also would

[136] *See* 7 U.S.C. 6s(e)(3)(A); 15 U.S.C. 78o–10(e)(3)(A).

[137] *See* 7 U.S.C. 6s(e)(2)(C); 15 U.S.C. 78o–10(e)(2)(C). The Agencies are referencing existing capital regulations that covered swap entities are already subject to and, as a consequence, do not expect an incremental impact as a result of these requirements.

[138] *See* 13 CFR 121.201 (effective July 14, 2014); *see also* 13 CFR 121.103(a)(6) (noting factors that the Small Business Administration considers in determining whether an entity qualifies as a small business, including receipts, employees, and other measures of its domestic and foreign affiliates).

[139] The CFTC has published a list of provisionally registered swap dealers as of July 29, 2014 and provisionally registered major swap participants that does not include any small financial institutions. *See http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer* and *http://www.cftc.gov/LawRegulation/DoddFrankAct/registermajorswappart.* The SEC has not yet imposed a registration requirement on entities that meet the definition of security-based swap dealer or major security-based swap participant.

[140] *http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer* and *http://*

include security-based swap dealers and major security-based swap dealers of which the number is unknown.[141] The number of financial end user counterparties is also unknown.

The application of initial margin requirements to swaps with financial end user counterparties is limited, depending on the counterparty's level of swap activity. With respect to financial end user counterparties that engage in swap transactions with swap entities that are subject to the proposed rule's margin requirements, the proposed rule minimizes the burden on small entities by requiring that such counterparties have a material swaps exposure in order to be subject to initial margin requirements. Material swaps exposure for an entity is defined to mean that an entity and its affiliates have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps with all counterparties for June, July and August of the previous calendar year that exceeds $3 billion, where such amount is calculated only for business days. In addition, the proposed rule provides an initial margin threshold resulting in an aggregate credit exposure of $65 million from all non-cleared swaps and non-cleared security-based swaps between a covered swap entity and its affiliates and a counterparty and its affiliates. A covered swap entity would not need to collect initial margin from a counterparty to the extent the amount is below the initial margin threshold. The Agencies expect the initial margin threshold should further reduce the impact of the proposal on small entities.

Under regulations issued by the Small Business Administration, a ''small entity'' includes firms within the ''Securities, Commodity Contracts, and Other Financial Investments and Related Activities'' sector with assets of $38.5 million or less and ''Funds, Trusts and Other Financial Vehicles'' with assets of $32.5 million or less.[142] The Agencies do not expect that there will be a significant number of small entities that will have material swaps exposure or meet the initial margin threshold amount. In particular, according to 2014 Call Report data, banks with $550 million or less in total assets had an average notional derivative exposure of approximately $4 million and a large number of these entities reported no notional derivative exposure.

As noted above, all financial end users would be subject to the variation margin requirements and documentation requirements of the proposed rule. However, the Agencies believe that such treatment is consistent with current market practice and should not represent a significant burden on small financial end users. Consequently, the proposed rule would not appear to have a significant economic impact on a substantial number of small entities.

3. Compliance requirements. With respect to initial and variation margin requirements, the Agencies' proposed rule does not apply directly to counterparties that engage in swap transactions with swap entities. However, the proposed rule requires a covered swap entity to collect and post a minimum amount of initial margin (subject to a threshold) from all counterparties that are swap entities and financial end users with material swaps exposure and to collect and post a minimum amount of variation margin from all swap entity and financial end user counterparties. Certain aspects of the segregation requirement of the proposal would also apply regardless of the size of the counterparty. In particular, the proposal provides that a covered swap entity that posts any collateral other than variation margin with respect to a non-cleared swap or non-cleared security-based swap shall require that all funds or other property other than variation margin provided by the covered swap entity be held by one or more custodians that are not affiliates of the covered swap entity or the counterparty.[143] As a consequence, the margin requirements may affect the amount of margin that counterparties that are small entities are required to collect and post to covered swap entity counterparties when transacting in swaps markets. Accordingly, the Agencies expect any economic impact on counterparties that are small entities to be negative to the extent that swap entities currently do not post or collect initial margin or variation margin from those counterparties but would be required to do so under the proposed rule.

4. Other Federal rules. Sections 731 and 764 of the Dodd-Frank Act require the CFTC and SEC separately to adopt rules imposing capital and margin requirements for swap entities for which there is no prudential regulator.[144] The Dodd-Frank Act requires the CFTC, SEC, and the Agencies to establish and maintain, to the maximum extent practicable, capital and margin requirements that are comparable, and to consult with each other periodically (but no less than annually) regarding these requirements.[145] Assuming all swap entities will be subject to an Agency, CFTC, or SEC margin rule that requires collection of initial margin, this rule will result in a collect-and-post system for all non-cleared swaps between swap entities.

The Agencies acknowledge that both the CFTC and SEC are responsible for specifying swap trading relationship documentation requirements for *all* registered swap dealers, major swap participants, security-based swap dealers and major security-based swap participants. In the case of the CFTC, these requirements have been adopted.[146] In the case of the SEC, these requirements have been proposed.[147] The Agencies request comment on whether the 2014 proposal should deem compliance with the applicable CFTC or SEC documentation requirements as compliance with this rule. Allowing compliance with CFTC and SEC documentation requirements to satisfy the proposed rule's requirements in these cases will reduce the burden on covered swap entities and avoid duplicative requirements while ensuring that the goals of the proposed rule's requirements are achieved. Alternatively, the Agencies request comment on whether documentation requirements in this rule are necessary to ensure that appropriate minimum documentation standards are in effect for all covered swap entities.

Section 7 of the proposal also contains requirements regarding segregation and rehypothecation of initial margin for non-cleared for swaps. Under the Dodd-Frank Act, the CFTC and SEC have authority to separately adopt requirements for swap entities with respect to the treatment of collateral posted by their counterparties

www.cftc.gov/LawRegulation/DoddFrankAct/registermajorswappart.

[141] The number of security-based swap dealers and major security-based swap dealers is unknown because, unlike the CFTC, the SEC has not yet set up their registration system.

[142] 13 CFR 121.201.

[143] By contrast, a covered swap entity is only required to segregate margin collected pursuant to section __.3(a) of the rule from financial end users with material swaps exposure and swap entities.

[144] *See* 7 U.S.C. 6s(e)(2)(B); 15 U.S.C. 78*o*–10(e)(2)(B).

[145] *See* 7 U.S.C. 6s(e)(2)(A); 6s(e)(3)(D); 15 U.S.C. 78*o*–10(e)(2)(A), 78*o*–10(e)(3)(D). Staff of the Agencies have consulted with staff of the CFTC and SEC in developing the proposed rule.

[146] *See* Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 FR 55903 (Sept. 11, 2012), *available at http://www.gpo.gov/fdsys/pkg/FR-2012-09-11/pdf/2012-21414.pdf.*

[147] *See* Trade Acknowledgment and Verification of Security-Based Swap Transactions, 76 FR 3,859 (Jan. 2011).

to margin, guarantee, or secure non-cleared swaps pursuant to sections 724 and 763 of the Dodd-Frank Act. The CFTC has adopted such requirements, and the SEC has proposed such requirements.[148] To the extent that the CFTC and SEC segregation requirements differ from those of this proposal, the covered swap entity would be expected to comply with the stricter segregation rule.

Section 9 of the proposed rule also allows for recognition of other regulatory regimes in certain circumstances. Pursuant to this section, certain types of covered swap entities operating in foreign jurisdictions would be able to meet the U.S. requirement by complying with the foreign requirement in the event that a comparability determination is made by the Agencies, regardless of the location of the counterparty. The Agencies are seeking comment on the proposal's approach to recognizing other regulatory regimes. Allowing compliance with other regulatory regimes to satisfy the proposed rule's requirements in these cases will reduce the burden on covered swap entities and avoid duplicative requirements while ensuring that the goals of the proposed rule's requirements are achieved.

The proposed rule prescribes margin requirements on all non-cleared swap transactions between a covered swap entity and its counterparties including transactions between banks that are covered swap entities and their affiliates that are financial end users including subsidiaries of banks. To the extent that the proposed rule covers interaffiliate swap transactions, sections 23A and 23B of the Federal Reserve Act (''FRA'') might also be applicable. Section 608 of the Dodd-Frank Act amended section 23A of the FRA to include as a covered transaction a derivative transaction with an affiliate, to the extent that the transaction causes a member bank or a subsidiary to have credit exposure to the affiliate. Banks that are swap entities may have collateral requirements as a result of this proposal and section 608 of the Dodd-Frank Act with respect to their swap transactions with affiliates. To the extent there are differences, the stricter rule would apply.

5. Significant alternatives to the proposed rule. As discussed above, the Agencies have mitigated the impact of the margin requirements on nonfinancial end users from which swap entities may be required to collect initial margin and/or variation margin by leaving the collection of margin from these types of counterparties to the judgment of the covered swap entity consistent with current market practice. In addition, the Agencies have proposed to reduce the effect of the proposed rule on counterparties to covered swap entities, including small entities, by requiring a material swaps exposure for a financial end user counterparty to be subject to initial margin requirements and through the implementation of an initial margin threshold amount. The Agencies have also requested comment on a variety of alternative approaches to implementing margin requirements. The Agencies welcome comment on any significant alternatives that would minimize the impact of the proposal on small entities.

FHFA: FHFA believes that the proposed rule, if promulgated as a final rule, would not have a significant economic impact on a substantial number of small entities, since none of FHFA's regulated entities come within the meaning of small entities as defined in the Regulatory Flexibility Act (*see* 5 U.S.C. 601(6)), and the rule would not substantially affect any business that its regulated entities might conduct with such small entities.

FCA: Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 601 et seq., FCA hereby certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the Farm Credit System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities; nor does the Federal Agricultural Mortgage Corporation meet the definition of ''small entity.'' Therefore, System institutions are not ''small entities'' as defined in the Regulatory Flexibility Act.

C. OCC Unfunded Mandates Reform Act of 1995 Determination

The OCC has analyzed the proposed rule under the factors in the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1532). Under this analysis, the OCC considered whether the proposed rule includes a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year (adjusted annually for inflation).

The OCC has determined this proposed rule is likely to result in the expenditure by the private sector of $100 million or more in any one year (adjusted annually for inflation). The OCC has prepared a budgetary impact analysis and identified and considered alternative approaches. When the proposed rule is published in the **Federal Register**, the full text of the OCC's analysis will available at: *http://www.regulations.gov,* Docket ID OCC–2011–0008.

Text of the Proposed Common Rules (All Agencies)

The text of the proposed common rules appears below:

PART/SUBPART [ ]—[RESERVED]

MARGIN AND CAPITAL REQUIREMENTS FOR COVERED SWAP ENTITIES

__.1 Authority, purpose, scope, and compliance dates.
__.2 Definitions.
__.3 Initial margin.
__.4 Variation margin.
__.5 Minimum transfer amount and satisfaction of collecting and posting requirements.
__.6 Eligible collateral.
__.7 Segregation of collateral.
__.8 Initial margin models and standardized amounts.
__.9 Cross-border application of margin requirements.
__.10 Documentation of margin matters.
__.11 Capital.
Appendix A to Part [ ]—Standardized Minimum Initial Margin Requirements for Non-cleared Swaps and Non-cleared Security-based Swaps
Appendix B to Part [ ]—Margin Values for Cash and Noncash Initial Margin Collateral

§ __.1 Authority, purpose, scope, and compliance dates.

(a) [Reserved]

(b) [Reserved]

(c) [Reserved]

(d) *Compliance dates.* Covered swap entities must comply with the minimum margin requirements for non-cleared swaps and non-cleared security-based swaps on or before the following dates for non-cleared swaps and non-cleared security-based swaps entered into on or after the following dates—

(1) December 1, 2015 with respect to the requirements in § __.4 for variation margin for non-cleared swaps and non-cleared security-based swaps.

(2) December 1, 2015 with respect to the requirements in § __.3 for initial margin for any non-cleared swaps and non-cleared security-based swaps, where both:

[148] The CFTC issued a final rule regarding these arrangements and the SEC has proposed a rule. *See* Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy, 78 FR 66621 (Nov. 6, 2013); Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 78 FR 4365 (Jan. 22, 2013).

(i) The covered swap entity combined with all its affiliates; and

(ii) its counterparty combined with all its affiliates, have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps for June, July and August 2015 that exceeds $4 trillion, where such amounts are calculated only for business days.

(3) December 1, 2016 with respect to the requirements in § __.3 for initial margin for any non-cleared swaps and non-cleared security-based swaps, where both:

(i) The covered swap entity combined with all its affiliates; and

(ii) its counterparty combined with all its affiliates, have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps for June, July and August 2016 that exceeds $3 trillion, where such amounts are calculated only for business days.

(4) December 1, 2017 with respect to the requirements in § __.3 for initial margin for any non-cleared swaps and non-cleared security-based swaps, where both:

(i) The covered swap entity combined with all its affiliates; and

(ii) its counterparty combined with all its affiliates, have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps for June, July and August 2017 that exceeds $2 trillion, where such amounts are calculated only for business days.

(5) December 1, 2018 with respect to the requirements in § __.3 for initial margin for any non-cleared swaps and non-cleared security-based swaps, where both:

(i) The covered swap entity combined with all its affiliates; and

(ii) its counterparty combined with all its affiliates, have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps for June, July and August 2018 that exceeds $1 trillion, where such amounts are calculated only for business days.

(6) December 1, 2019 with respect to the requirements in § __.3 for initial margin for any other covered swap entity with respect to non-cleared swaps and non-cleared security-based swaps entered into with any other counterparty.

(e) Once a covered swap entity and its counterparty must comply with the margin requirements for non-cleared swaps and non-cleared security-based swaps based on the compliance dates in paragraph (d), the covered swap entity and its counterparty shall remain subject to the requirements of this [subpart].

§ __.2 Definitions.

Affiliate means any company that controls, is controlled by, or is under common control with another company.

Bank holding company has the meaning specified in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841).

Broker has the meaning specified in section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4)).

Clearing agency has the meaning specified in section 3(a)(23) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(23)).

Control of another company means:

(1) Ownership, control, or power to vote 25 percent or more of a class of voting securities of the company, directly or indirectly or acting through one or more other persons;

(2) Ownership or control of 25 percent or more of the total equity of the company, directly or indirectly or acting through one or more other persons; or

(3) Control in any manner of the election of a majority of the directors or trustees of the company.

Counterparty means, with respect to any non-cleared swap or non-cleared security-based swap to which a covered swap entity is a party, each other party to such non-cleared swap or non-cleared security-based swap.

Cross-currency swap means a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs upon the inception of the swap, with a reversal of the exchange of principal at a later date that is agreed upon at the inception of the swap.

Dealer has the meaning specified in section 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(5)).

Depository institution has the meaning specified in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

Derivatives clearing organization has the meaning specified in section 1a(15) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(15)).

Eligible collateral means collateral described in § __.6.

Eligible master netting agreement means a written, legally enforceable agreement provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default following any stay permitted by paragraph (2) of this definition, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides 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 apply collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(i) In receivership, conservatorship, resolution under the Federal Deposit Insurance Act (12 U.S.C. 1811 *et seq.*), Title II of the Dodd-Frank Act (12 U.S.C. 5381 *et seq.*), the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 as amended (12 U.S.C. 4617), or the Farm Credit Act of 1971 (12 U.S.C. 2183 and 2279cc), or similar laws of foreign jurisdictions that provide for limited stays to facilitate the orderly resolution of financial institutions, or

(ii) In a contractual agreement subject by its terms to any of the laws referenced in paragraph (2)(i) of this definiton;

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, or suspends or conditions payment, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is or otherwise would be, a net creditor under the agreement); and

(4) A covered swap entity that relies on the agreement for purposes of calculating the margin required by this part:

(i) Conducts sufficient legal review (and maintains sufficient written documentation of that legal review) to conclude with a well-founded basis that:

(A) The agreement meets the requirements of paragraphs (1)–(3) of this definition;

(B) In the event of a legal challenge (including one resulting from default or from receivership, insolvency, liquidation, or similar proceeding), the relevant court and administrative authorities would find the agreement to be legal, valid, binding, and enforceable

under the law of the relevant jurisdictions; and

(ii) Establishes and maintains written procedures to monitor possible changes in relevant law and to ensure that the agreement continues to satisfy the requirements of this definition.

Financial end user means

(1) Any counterparty that is not a swap entity and that is:

(i) A bank holding company or an affiliate thereof; a savings and loan holding company; or a nonbank financial institution supervised by the Board of Governors of the Federal Reserve System under Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5323);

(ii) A depository institution; a foreign bank; a Federal credit union or State credit union as defined in section 2 of the Federal Credit Union Act (12 U.S.C. 1752(1) & (6); an institution that functions solely in a trust or fiduciary capacity as described in section 2(c)(2)(D) of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)(D)); an industrial loan company, an industrial bank, or other similar institution described in section 2(c)(2)(H) of the Bank Holding Company Act (12 U.S.C. 1841(c)(2)(H));

(iii) An entity that is state-licensed or registered as—

(A) A credit or lending entity, including a finance company; money lender; installment lender; consumer lender or lending company; mortgage lender, broker, or bank; motor vehicle title pledge lender; payday or deferred deposit lender; premium finance company; commercial finance or lending company; or commercial mortgage company; except entities registered or licensed solely on account of financing the entity's direct sales of goods or services to customers;

(B) A money services business, including a check casher; money transmitter; currency dealer or exchange; or money order or traveler's check issuer;

(iv) A regulated entity as defined in section 1303(20) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4502(20)) and any entity for which the Federal Housing Finance Agency or its successor is the primary federal regulator;

(v) Any institution chartered and regulated by the Farm Credit Administration in accordance with the Farm Credit Act of 1971, as amended, 12 U.S.C. 2001 et. seq.;

(vi) A securities holding company; a broker or dealer; an investment adviser as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)); an investment company registered with the SEC under the Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.); or a company that has elected to be regulated as a business development company pursuant to section 54(a) of the Investment Company (15 U.S.C. 80a–53(a));

(vii) A private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80–b–2(a)); an entity that would be an investment company under section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3) but for section 3(c)(5)(C); or an entity that is deemed not to be an investment company under section 3 of the Investment Company Act of 1940 pursuant to Investment Company Act Rule 3a–7 (17 CFR 270.3a–7) of the U.S. Securities and Exchange Commission;

(viii) A commodity pool, a commodity pool operator, or a commodity trading advisor as defined, respectively, in section 1a(10), 1a(11), and 1a(12) of the Commodity Exchange Act (7 U.S.C. 1a(10), 1a(11), and 1a(12)); or a futures commission merchant;

(ix) An employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002);

(x) An entity that is organized as an insurance company, primarily engaged in writing insurance or reinsuring risks underwritten by insurance companies, or is subject to supervision as such by a State insurance regulator or foreign insurance regulator;

(xi) An entity that is, or holds itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in loans, securities, swaps, funds or other assets for resale or other disposition or otherwise trading in loans, securities, swaps, funds or other assets;

(xii) An entity that would be a financial end user described in paragraph (1) of this section, if it were organized under the laws of the United States or any State thereof; or

(xiii) Notwithstanding paragraph (2) below, any other entity that [Agency] has determined should be treated as a financial end user.

(2) The term ''financial end user'' does not include any counterparty that is:

(i) A sovereign entity;

(ii) A multilateral development bank;

(iii) The Bank for International Settlements;

(iv) An entity that is exempt from the definition of financial entity pursuant to section 2(h)(7)(C)(iii) of the Commodity Exchange Act (7 U.S.C. 2(h)(7)(C)(iii)) and implementing regulations; or

(v) An affiliate that qualifies for the exemption from clearing pursuant to section 2(h)(7)(D) of the Commodity Exchange Act (7 U.S.C. 2(h)(7)(D)) or section 3C(g)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c–3(g)(4)) and implementing regulations.

Foreign bank has the meaning specified in section 1 of the International Banking Act of 1978 (12 U.S.C. 3101).

Foreign exchange forward and foreign exchange swap mean any foreign exchange forward, as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)), and foreign exchange swap, as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25)).

Futures commission merchant has the meaning specified in section 1a(28) of the Commodity Exchange Act (7 U.S.C. 1a(28)).

Initial margin means the collateral as calculated in accordance with § __.8 that is posted or collected in connection with a non-cleared swap or non-cleared security-based swap.

Initial margin collection amount means—

(1) In the case of a covered swap entity that does not use an initial margin model, the amount of initial margin with respect to a non-cleared swap or non-cleared security-based swap that is required under Appendix A of this part; and

(2) In the case of a covered swap entity that uses an initial margin model, the amount of initial margin with respect to a non-cleared swap or non-cleared security-based swap that is required under the initial margin model.

Initial margin model means an internal risk management model that—

(1) Has been developed and designed to identify an appropriate, risk-based amount of initial margin that the covered swap entity must collect with respect to one or more non-cleared swaps or non-cleared security-based swaps to which the covered swap entity is a party; and

(2) Has been approved by [Agency] pursuant to § __.8 of this part.

Initial margin threshold amount means an aggregate credit exposure of $65 million resulting from all non-cleared swaps and non-cleared security-based swaps between a covered swap entity and its affiliates, and a counterparty and its affiliates.

Major currencies means:

(1) United States Dollar (USD);

(2) Canadian Dollar (CAD);

(3) Euro (EUR);
(4) United Kingdom Pound (GBP);
(5) Japanese Yen (JPY);
(6) Swiss Franc (CHF);
(7) New Zealand Dollar (NZD);
(8) Australian Dollar (AUD);
(9) Swedish Kronor (SEK);
(10) Danish Kroner (DKK);
(11) Norwegian Krone (NOK); and
(12) Any other currency as determined by [Agency].

Margin means initial margin and variation margin.

Market intermediary means a securities holding company; a broker or dealer; a futures commission merchant; a swap dealer as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a); or a security-based swap dealer as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c).

Material swaps exposure for an entity means that an entity and its affiliates have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps with all counterparties for June, July and August of the previous calendar year that exceeds $3 billion, where such amount is calculated only for business days.

Multilateral development bank means the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and any other entity that provides financing for national or regional development in which the U.S. government is a shareholder or contributing member or which the [AGENCY] determines poses comparable credit risk.

Non-cleared swap means a swap that is not a cleared swap, as that term is defined in section 1a(7) of the Commodity Exchange Act (7 U.S.C. 1a(7)).

Non-cleared security-based swap means a security-based swap that is not, directly or indirectly, submitted to and cleared by a clearing agency registered with the U.S. Securities and Exchange Commission.

Prudential regulator has the meaning specified in section 1a(39) of the Commodity Exchange Act (7 U.S.C. 1a(39)).

Savings and loan holding company has the meaning specified in section 10(n) of the Home Owners' Loan Act, 12 U.S.C. 1467a(n)).

Securities holding company has the meaning specified in section 618 of the Dodd-Frank Act (12 U.S.C. 1850a).

Security-based swap has the meaning specified in section 3(a)(68) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(68)).

Sovereign entity means a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government.

State means any State, commonwealth, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, or the United States Virgin Islands.

Subsidiary means a company that is controlled by another company.

Swap has the meaning specified in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)).

Swap entity means a security-based swap dealer as defined in section 3(a)(71) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(71)), a major security-based swap participant as defined in section 3(a)(67) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(67)), a swap dealer as defined in section 1a(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)), or a major swap participant as defined in section 1a(33) of the Commodity Exchange Act (7 U.S.C. 1a(33)).

U.S. Government-sponsored enterprise means an entity established or chartered by the U.S. government to serve public purposes specified by federal statute but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. government.

Variation margin means a payment by one party to its counterparty to meet the performance of its obligations under one or more non-cleared swaps or non-cleared security-based swaps between the parties as a result of a change in value of such obligations since the last time such payment was made.

Variation margin amount means the cumulative mark-to-market change in value to a covered swap entity of a non-cleared swap or non-cleared security-based swap, as measured from the date it is entered into (or, in the case of a non-cleared swap or non-cleared security-based swap that has a positive or negative value to a covered swap entity on the date it is entered into, such positive or negative value plus any cumulative mark-to-market change in value to the covered swap entity of a non-cleared swap or non-cleared security-based swap after such date), less the value of all variation margin previously collected, plus the value of all variation margin previously paid with respect to such non-cleared swap or non-cleared security-based swap.

§ __.3 Initial margin.

(a) *Collection of margin.* A covered swap entity shall collect initial margin with respect to any non-cleared swap or non-cleared security-based swap from a counterparty that is a financial end user with material swaps exposure or that is a swap entity in an amount that is no less than the greater of—

(1) Zero; or

(2) The initial margin collection amount for such non-cleared swap or non-cleared security-based swap *less* the initial margin threshold amount (not including any portion of the initial margin threshold amount already applied by the covered swap entity or its affiliates to other non-cleared swaps or non-cleared security-based swaps with the counterparty or its affiliates), as applicable.

(b) *Posting of margin.* A covered swap entity shall post initial margin with respect to any non-cleared swap or non-cleared security-based swap to a counterparty that is a financial end user with material swaps exposure. Such initial margin shall be in an amount at least as large as the covered swap entity would be required to collect under paragraph (a) of this section if it were in the place of the counterparty.

(c) *Timing.* A covered swap entity shall, with respect to any non-cleared swap or non-cleared security-based swap to which it is a party, comply with the initial margin requirements described in paragraph (a) and (b) of this section on a daily basis for a period beginning on or before the business day following the day it enters into such non-cleared swap or non-cleared security-based swap and ending on the date the non-cleared swap or non-cleared security-based swap is terminated or expires.

(d) *Other counterparties.* A covered swap entity is not required to collect initial margin with respect to any non-cleared swap or non-cleared security-based swap with a counterparty that is neither a financial end user with material swaps exposure nor a swap entity but shall collect initial margin at such times and in such forms and such amounts (if any), that the covered swap entity determines appropriately address the credit risk posed by the counterparty

and the risks of such non-cleared swaps and non-cleared security-based swaps.

§ __.4 Variation margin.

(a) *General.* On and after the date on which a covered swap entity enters into a non-cleared swap or non-cleared security-based swap with a swap entity or financial end user, the covered swap entity shall collect the variation margin amount from the counterparty to such non-cleared swap or non-cleared security-based swap when the amount is positive and pay the variation margin amount to the counterparty to such non-cleared swap or non-cleared security-based swap when the amount is negative.

(b) *Frequency.* A covered swap entity shall comply with the variation margin requirements described in paragraph (a) of this section no less frequently than once per business day.

(c) *Other counterparties.* A covered swap entity is not required to collect variation margin with respect to any non-cleared swap or non-cleared security-based swap with a counterparty that is neither a financial end user nor a swap entity but shall collect variation margin at such times and in such forms and such amounts (if any), that the covered swap entity determines appropriately address the credit risk posed by the counterparty and the risks of such non-cleared swaps and non-cleared security-based swaps.

(d) *Netting arrangements.* To the extent that one or more non-cleared swaps or non-cleared security-based swaps are executed pursuant to an eligible master netting agreement between a covered swap entity and its counterparty that is a swap entity or financial end user, a covered swap entity may calculate and comply with the variation margin requirements of this paragraph on an aggregate net basis with respect to all non-cleared swaps and non-cleared security-based swaps governed by such agreement. If the agreement covers non-cleared swaps and non-cleared security-based swaps entered into before the applicable compliance date set forth in § __.1(d), those non-cleared swaps and non-cleared security-based swaps must be included in the aggregate for the purposes of calculating and complying with the variation margin requirements of this paragraph.

§ __.5 Minimum transfer amount and satisfaction of collecting and posting requirements.

(a) *Minimum transfer amount.* Notwithstanding § __.3 or § __.4, a covered swap entity is not required to collect or post margin pursuant to this part with respect to a particular counterparty unless and until the total amount of margin that is required pursuant to this part to be collected or posted and that has not yet been collected or posted with respect to the counterparty is greater than $650,000.

(b) *Satisfaction of Collecting and Posting Requirements.* A covered swap entity shall not be deemed to have violated its obligation to collect or post margin from or to a counterparty under § __.3, __.4 or __.6(d) if—

(1) The counterparty has refused or otherwise failed to provide or accept the required margin to or from the covered swap entity; and

(2) The covered swap entity has—

(i) Made the necessary efforts to collect or post the required margin, including the timely initiation and continued pursuit of formal dispute resolution mechanisms, or has otherwise demonstrated upon request to the satisfaction of [Agency] that it has made appropriate efforts to collect or post the required margin; or

(ii) Commenced termination of the non-cleared swap or non-cleared security-based swap with the counterparty promptly following the applicable cure period and notification requirements.

§ __.6 Eligible collateral.

(a) A covered swap entity shall collect and post initial margin and variation margin required pursuant to this part from or to a swap entity or financial end user solely in the form of one or more of the following types of eligible collateral—

(1) Immediately available cash funds that are denominated in—

(i) U.S. dollars; or

(ii) The currency in which payment obligations under the swap are required to be settled;

(2) With respect to initial margin only—

(i) A security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury;

(ii) A security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, a U.S. government agency (other than the U.S. Department of Treasury) whose obligations are fully guaranteed by the full faith and credit of the United States government;

(iii) A publicly traded debt security issued by, or an asset-backed security fully guaranteed as to the payment of principal and interest by, a U.S. Government-sponsored enterprise that is operating with capital support or another form of direct financial assistance received from the U.S. government that enables the repayments of the U.S. Government-sponsored enterprise's eligible securities;

(iv) A major currency;

(v) A security that is issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to the covered swap entity as set forth in § __.11 of this part;

(vi) A security that is issued by, or fully guaranteed as to the payment of principal and interest by, the Bank for International Settlements, the International Monetary Fund, or a multilateral development bank;

(vii) Subject to paragraph (c) of this section, a security solely in the form of:

(A) Publicly traded debt, including a debt security issued by a U.S. Government-sponsored enterprise (other than one described in § __.6(a)(2)(iii)), that meets the terms of [RESERVED] and is not an asset-backed security;

(B) Publicly traded common equity that is included in:

(*1*) The Standard & Poor's Composite 1500 Index or any other similar index of liquid and readily marketable equity securities as determined by [Agency]; or

(*2*) An index that a covered swap entity's supervisor in a foreign jurisdiction recognizes for purposes of including publicly traded common equity as initial margin under applicable regulatory policy, if held in that foreign jurisdiction; or

(viii) Gold.

(b) The value of any eligible collateral described in paragraph (a)(2) of this section that is collected and held to satisfy initial margin requirements is subject to the discounts described in Appendix B of this part.

(c) Eligible collateral for initial margin required by this part does not include a security issued by—

(1) The counterparty or affiliate of the counterparty pledging such collateral; or

(2) A bank holding company, a savings and loan holding company, a foreign bank, a depository institution, a market intermediary, a company that would be any of the foregoing if it were organized under the laws of the United States or any State, or an affiliate of any of the foregoing institutions.

(d) A covered swap entity shall monitor the market value and eligibility of all collateral collected and held to satisfy its initial margin required by this part. To the extent that the market value of such collateral has declined, the covered swap entity shall promptly collect such additional eligible collateral as is necessary to bring itself

into compliance with the margin requirements of this part. To the extent that the collateral is no longer eligible, the covered swap entity shall promptly obtain sufficient eligible replacement collateral to comply with this part.

(e) A covered swap entity may collect initial margin and variation margin that is not required pursuant to this part in any form of collateral.

§ __.7 Segregation of collateral.

(a) A covered swap entity that posts any collateral other than variation margin with respect to a non-cleared swap or a non-cleared security-based swap shall require that all funds or other property other than variation margin provided by the covered swap entity be held by one or more custodians that are not affiliates of the covered swap entity or the counterparty.

(b) A covered swap entity that collects initial margin amounts required by § __.3(a) with respect to a non-cleared swap or a non-cleared security-based swap shall require that such initial margin collateral be held by one or more custodians that are not affiliates of the covered swap entity or the counterparty.

(c) For purposes of paragraphs (a) and (b) of this section, the custodian must act pursuant to a custody agreement that:

(1) Prohibits the custodian from rehypothecating, repledging, reusing, or otherwise transferring (through securities lending, repurchase agreement, reverse repurchase agreement or other means) the funds or other property held by the custodian; and

(2) Is a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding.

(d) Notwithstanding paragraph (c)(1) of this section, a custody agreement may permit the posting party to substitute or direct any reinvestment of posted collateral held by the custodian, provided that, with respect to collateral collected by a covered swap entity pursuant to § __.3(a) or posted by a covered swap entity pursuant to § __.3(b), the agreement requires the posting party to:

(1) Substitute only funds or other property that would qualify as eligible collateral under § __.6, and for which the amount net of applicable discounts described in Appendix B would be sufficient to meet the requirements of § __.3; and

(2) Direct reinvestment of funds only in assets that would qualify as eligible collateral under § __.6, and for which the amount net of applicable discounts described in Appendix B would be sufficient to meet the requirements of § __.3.

§ __.8 Initial margin models and standardized amounts.

(a) *Standardized amounts.* Unless a covered swap entity's initial margin model conforms to the requirements of this section, the covered swap entity shall calculate all initial margin collection amounts on a daily basis pursuant to Appendix A of this part.

(b) *Use of initial margin models.*

(1) A covered swap entity may calculate the amount of initial margin required to be collected or posted for one or more non-cleared swaps or non-cleared security-based swaps with a given counterparty pursuant to § __.3 on a daily basis using an initial margin model only if the initial margin model meets the requirements of this section.

(2) To the extent that one or more non-cleared swaps or non-cleared security-based swaps are executed pursuant to an eligible master netting agreement between a covered swap entity and its counterparty that is a swap entity or financial end user, a covered swap entity may use its initial margin model to calculate and comply with the initial margin requirements pursuant to § __.3 on an aggregate basis with respect to all non-cleared swaps and non-cleared security-based swaps governed by such agreement. If the agreement covers non-cleared swaps and non-cleared security-based swaps entered into before the applicable compliance date set forth in § ___.1(d), those non-cleared swaps and non-cleared security-based swaps must be included in the aggregate in the initial margin model for the purposes of calculating and complying with the initial margin requirements pursuant to § __.3.

(c) *Requirements for initial margin model.*

(1) A covered swap entity must obtain the prior written approval of [Agency] before using any initial margin model to calculate the initial margin required in this part.

(2) A covered swap entity must demonstrate that the initial margin model satisfies all of the requirements of this section on an ongoing basis.

(3) A covered swap entity must notify [Agency] in writing 60 days prior to:

(i) Extending the use of an initial margin model that [Agency] has approved under this section to an additional product type;

(ii) Making any change to any initial margin model approved by [Agency] under this section that would result in a material change in the covered swap entity's assessment of initial margin requirements; or

(iii) Making any material change to modeling assumptions used by the initial margin model.

(4) [The Agency] may rescind its approval of the use of any initial margin model, in whole or in part, or may impose additional conditions or requirements if [Agency] determines, in its sole discretion, that the initial margin model no longer complies with this section.

(d) *Quantitative requirements.*

(1) The covered swap entity's initial margin model must calculate an amount of initial margin that is equal to the potential future exposure of the non-cleared swap, non-cleared security-based swap or netting set of non-cleared swaps or non-cleared security-based swaps covered by an eligible master netting agreement. Potential future exposure is an estimate of the one-tailed 99 percent confidence interval for an increase in the value of the non-cleared swap, non-cleared security-based swap or netting set of non-cleared swaps or non-cleared security-based swaps due to an instantaneous price shock that is equivalent to a movement in all material underlying risk factors, including prices, rates, and spreads, over a holding period equal to the shorter of ten business days or the maturity of the non-cleared swap or non-cleared security-based swap.

(2) All data used to calibrate the initial margin model must be based on an equally weighted historical observation period of at least one year and not more than five years and must incorporate a period of significant financial stress for each broad asset class that is appropriate to the non-cleared swaps and non-cleared security-based swaps to which the initial margin model is applied.

(3) The covered swap entity's initial margin model must use risk factors sufficient to measure all material price risks inherent in the transactions for which initial margin is being calculated. The risk categories must include, but should not be limited to, foreign exchange or interest rate risk, credit risk, equity risk, agricultural commodity risk, energy commodity risk, metal commodity risk and other commodity risk, as appropriate. For material exposures in significant currencies and markets, modeling techniques must capture spread and basis risk and must incorporate a sufficient number of segments of the yield curve to capture differences in volatility and imperfect correlation of rates along the yield curve.

(4) In the case of a non-cleared cross-currency swap, the covered swap entity's initial margin model need not recognize any risks or risk factors associated with the fixed, physically-settled foreign exchange transactions associated with the exchange of principal embedded in the non-cleared cross-currency swap. The initial margin model must recognize all material risks and risk factors associated with all other payments and cash flows that occur during the life of the non-cleared cross-currency swap.

(5) The initial margin model may calculate initial margin for a non-cleared swap or non-cleared security-based swap or a netting set of non-cleared swaps or non-cleared security-based swaps covered by an eligible master netting agreement. It may reflect offsetting exposures, diversification, and other hedging benefits for swaps and security-based swaps that are governed by the same eligible master netting agreement by incorporating empirical correlations within the following broad risk categories, provided the covered swap entity validates and demonstrates the reasonableness of its process for modeling and measuring hedging benefits: agricultural commodity, energy commodity, metal commodity and other commodity, credit, equity, and foreign exchange or interest rate. Empirical correlations under an eligible master netting agreement may be recognized by the initial margin model within each broad risk category, but not across broad risk categories.

(6) If the initial margin model does not explicitly reflect offsetting exposures, diversification, and hedging benefits between subsets of non-cleared swaps within a broad risk category, the covered swap entity must calculate an amount of initial margin separately for each subset of non-cleared swaps and non-cleared security-based swaps for which offsetting exposures, diversification, and other hedging benefits are explicitly recognized by the initial margin model. The sum of the initial margin amounts calculated for each subset of non-cleared swaps and non-cleared security-based swaps within a broad risk category will be used to determine the aggregate initial margin due from the counterparty for the portfolio of non-cleared swaps and non-cleared security-based swaps within the broad risk category.

(7) The sum of the initial margins calculated for each broad risk category will be used to determine the aggregate initial margin due from the counterparty.

(8) The initial margin model may not permit the calculation of any initial margin collection amount to be offset by, or otherwise take into account, any initial margin that may be owed or otherwise payable by the covered swap entity to the counterparty.

(9) The initial margin model must include all material risks arising from the nonlinear price characteristics of option positions or positions with embedded optionality and the sensitivity of the market value of the positions to changes in the volatility of the underlying rates, prices, or other material risk factors.

(10) The covered swap entity may not omit any risk factor from the calculation of its initial margin that the covered swap entity uses in its initial margin model unless it has first demonstrated to the satisfaction of [Agency] that such omission is appropriate.

(11) The covered swap entity may not incorporate any proxy or approximation used to capture the risks of the covered swap entity's non-cleared swaps or non-cleared security-based swaps unless it has first demonstrated to the satisfaction of [Agency] that such proxy or approximation is appropriate.

(12) The covered swap entity must have a rigorous and well-defined process for re-estimating, re-evaluating, and updating its internal models to ensure continued applicability and relevance.

(13) The covered swap entity must review and, as necessary, revise the data used to calibrate the initial margin model at least monthly, and more frequently as market conditions warrant, to ensure that the data incorporate a period of significant financial stress appropriate to the non-cleared swaps and non-cleared security-based swaps to which the initial margin model is applied.

(14) The level of sophistication of the initial margin model must be commensurate with the complexity of the non-cleared swaps and non-cleared security-based swaps to which it is applied. In calculating an initial margin collection amount, the initial margin model may make use of any of the generally accepted approaches for modeling the risk of a single instrument or portfolio of instruments.

(15) [The Agency] may in its sole discretion require a covered swap entity using an initial margin model to collect a greater amount of initial margin than that determined by the covered swap entity's initial margin model if [the Agency] determines that the additional collateral is appropriate due to the nature, structure, or characteristics of the covered swap entity's transaction(s), or is commensurate with the risks associated with the transaction(s).

(e) *Periodic review.* A covered swap entity must periodically, but no less frequently than annually, review its initial margin model in light of developments in financial markets and modeling technologies, and enhance the initial margin model as appropriate to ensure that the initial margin model continues to meet the requirements for approval in this section.

(f) *Control, oversight, and validation mechanisms.*

(1) The covered swap entity must maintain a risk control unit that reports directly to senior management and is independent from the business trading units.

(2) The covered swap entity's risk control unit must validate its initial margin model prior to implementation and on an ongoing basis. The covered swap entity's validation process must be independent of the development, implementation, and operation of the initial margin model, or the validation process must be subject to an independent review of its adequacy and effectiveness. The validation process must include:

(i) An evaluation of the conceptual soundness of (including developmental evidence supporting) the initial margin model;

(ii) An ongoing monitoring process that includes verification of processes and benchmarking by comparing the covered swap entity's initial margin model outputs (estimation of initial margin) with relevant alternative internal and external data sources or estimation techniques, including benchmarking against observable margin standards to ensure that the initial margin required is not less than what a derivatives clearing organization or a clearing agency would require for similar cleared transactions.

(iii) An outcomes analysis process that includes backtesting the initial margin model.

(3) If the validation process reveals any material problems with the initial margin model, the covered swap entity must notify [Agency] of the problems, describe to [Agency] any remedial actions being taken, and adjust the initial margin model to ensure an appropriately conservative amount of required initial margin is being calculated.

(4) The covered swap entity must have an internal audit function independent of business-line management and the risk control unit that at least annually assesses the effectiveness of the controls supporting the covered swap entity's initial margin model measurement systems, including the activities of the business trading

units and risk control unit, compliance with policies and procedures, and calculation of the covered swap entity's initial margin requirements under this part. At least annually, the internal audit function must report its findings to the covered swap entity's board of directors or a committee thereof.

(g) *Documentation.* The covered swap entity must adequately document all material aspects of its initial margin model, including the management and valuation of the non-cleared swaps and non-cleared security-based swaps to which it applies, the control, oversight, and validation of the initial margin model, any review processes and the results of such processes.

(h) *Escalation procedures.* The covered swap entity must adequately document internal authorization procedures, including escalation procedures, that require review and approval of any change to the initial margin calculation under the initial margin model, demonstrable analysis that any basis for any such change is consistent with the requirements of this section, and independent review of such demonstrable analysis and approval.

§ __.9 Cross-border application of margin requirements.

(a) *Transactions to which this rule does not apply.* The requirements of §§ __.3 through __.8 and __.10 shall not apply to any foreign non-cleared swap or foreign non-cleared security-based swap of a foreign covered swap entity.

(b) For purposes of this section, a *foreign non-cleared swap or foreign non-cleared security-based swap* is any non-cleared swap or non-cleared security-based swap transaction with respect to which neither the counterparty to the foreign covered swap entity nor any guarantor of either party's obligations under the non-cleared swap or non-cleared security-based 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;

(2) A branch or office of an entity organized under the laws of the United States or any State; or

(3) A covered swap entity that is controlled, directly or indirectly, by an entity that is organized under the laws of the United States or any State.

(c) For purposes of this section, a *foreign covered swap entity* is 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 controlled, directly or indirectly, by an entity that is organized under the laws of the United States or any State.

(d) *Transactions for which substituted compliance determination may apply.*

(1) *Determinations and reliance.* For non-cleared swaps and non-cleared security-based swaps described in paragraph (d)(3) of this section, a covered swap entity may satisfy the provisions of this part by complying with the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps that the prudential regulators jointly, conditionally or unconditionally, determine by public order satisfy the corresponding requirements of §§ __.3 through __.8 and __.10.

(2) *Standard.* In determining whether to make a determination under paragraph (d)(1) of this section, the prudential regulators will consider whether the requirements of such foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps applicable to such covered swap entities are comparable to the otherwise applicable requirements of this part and appropriate for the safe and sound operation of the covered swap entity, taking into account the risks associated with non-cleared swaps and non-cleared security-based swaps.

(3) *Covered swap entities eligible for substituted compliance.* A covered swap entity may rely on a determination under paragraph (d)(1) of this section only if the covered swap entity's obligations under the non-cleared swap or non-cleared security-based swap are not guaranteed by an entity organized under the laws of the United States or any State and the covered swap entity is—

(i) A foreign covered swap entity;

(ii) A foreign bank or a U.S. branch or agency of a foreign bank; or

(iii) A foreign subsidiary of a depository institution, Edge corporation, or agreement corporation.

(4) *Compliance with foreign margin collection requirement.* A covered swap entity satisfies its requirement to post initial margin under § __.3(b) of this part by posting initial margin in the form and amount, and at such times, that its counterparty is required to collect pursuant to a foreign regulatory framework, provided that the counterparty is subject to the foreign regulatory framework and the prudential regulators have made a determination under paragraph (d)(1) of this section, unless otherwise stated in that determination.

(e) *Requests for determinations.*

(1) A covered swap entity described in paragraph (d)(3) of this section may request that the prudential regulators make a determination pursuant to this section. A request for a determination must include a description of:

(i) The scope and objectives of the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps;

(ii) The specific provisions of the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps that govern:

(A) The scope of transactions covered;

(B) The determination of the amount of initial and variation margin required and how that amount is calculated;

(C) The timing of margin requirements;

(D) Any documentation requirements;

(E) The forms of eligible collateral;

(F) Any segregation and rehypothecation requirements; and

(G) The approval process and standards for models used in calculating initial and variation margin;

(iii) The supervisory compliance program and enforcement authority exercised by a foreign financial regulatory authority or authorities in such system to support its oversight of the application of the non-cleared swap and non-cleared security-based swap regulatory framework and how that framework applies to the non-cleared swaps and non-cleared security-based swaps of the covered swap entity; and

(iv) Any other descriptions and documentation that the prudential regulators determine are appropriate.

(2) A covered swap entity described in paragraph (d)(3) of this section may make a request under this section only if the non-cleared swap and non-cleared security-based swap activities of the covered swap entity are directly supervised by the authorities administering the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps.

§ __.10 Documentation of margin matters.

(a) A covered swap entity shall execute trading documentation with each counterparty that is either a swap entity or financial end user regarding credit support arrangements that—

(1) Provides the covered swap entity and its counterparty with the contractual right to collect and post initial margin and variation margin in such amounts, in such form, and under such circumstances as are required by this part; and

(2) Specifies—

(i) The methods, procedures, rules, and inputs for determining the value of each non-cleared swap or non-cleared security-based swap for purposes of calculating variation margin requirements; and

(ii) The procedures by which any disputes concerning the valuation of non-cleared swaps or non-cleared security-based swaps, or the valuation of assets collected or posted as initial margin or variation margin, may be resolved.

§ __.11 [Reserved]

Appendix A to Part [ ]—Standardized Minimum Initial Margin Requirements for Non-Cleared Swaps and Non-Cleared Security-Based Swaps

TABLE A—STANDARDIZED MINIMUM GROSS INITIAL MARGIN REQUIREMENTS FOR NON-CLEARED SWAPS AND NON-CLEARED SECURITY-BASED SWAPS [1]

Asset class	Gross initial margin (% of notional exposure)
Credit: 0–2 year duration	2
Credit: 2–5 year duration	5
Credit: 5+ year duration	10
Commodity	15
Equity	15
Foreign Exchange/Currency	6
Cross Currency Swaps: 0–2 year duration	1
Cross-Currency Swaps: 2–5 year duration	2
Cross-Currency Swaps: 5+ year duration	4
Interest Rate: 0–2 year duration	1
Interest Rate: 2–5 year duration	2
Interest Rate: 5+ year duration	4
Other	15

[1] The initial margin amount applicable to multiple non-cleared swaps or non-cleared security-based swaps subject to an eligible master netting agreement that is calculated according to Appendix A will be computed as follows:

Initial Margin = 0.4 × Gross Initial Margin + 0.6 × NGR × Gross Initial Margin where;

Gross Initial Margin = the sum of the product of each non-cleared swap's or non-cleared security-based swap's effective notional amount and the gross initial margin requirement for all non-cleared swaps and non-cleared security-based swaps subject to the eligible master netting agreement;

and

NGR = the net-to-gross ratio (that is, the ratio of the net current replacement cost to the gross current replacement cost). In calculating NGR, the gross current replacement cost equals the sum of the replacement cost for each non-cleared swap and non-cleared security-based swap subject to the eligible master netting agreement for which the cost is positive. The net current replacement cost equals the total replacement cost for all non-cleared swaps and non-cleared security-based swaps subject to the eligible master netting agreement.

Appendix B to Part [ ]—Margin Values for Cash and Noncash Initial Margin Collateral.

TABLE B—MARGIN VALUES FOR CASH AND NONCASH INITIAL MARGIN COLLATERAL [1]

Asset class	Haircut (% of market value)
Cash in same currency as swap obligation	0.0
Eligible government and related (e.g., central bank, multilateral development bank, GSE securities identified in § _ .6(a)(2)(iii)) debt: residual maturity less than one-year	0.5
Eligible government and related (e.g., central bank, multilateral development bank, GSE securities identified in § _ .6(a)(2)(iii)) debt: residual maturity between one and five years	2.0
Eligible government and related (e.g., central bank, multilateral development bank, GSE securities identified in § _ .6(a)(2)(iii)) debt: residual maturity greater than five years	4.0
Eligible corporate (including eligible GSE debt securities not identified in § _.6(a)(2)(iii)) debt: residual maturity less than one-year	1.0
Eligible corporate (including eligible GSE debt securities not identified in § _.6(a)(2)(iii)) debt: residual maturity between one and five years:	4.0
Eligible corporate (including eligible GSE debt securities not identified in § _.6(a)(2)(iii)) 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
	8.0

[1] The value of initial margin collateral that is calculated according to Appendix B will be computed as follows: the value of initial margin collateral for any collateral asset class will be computed as the product of the total value of collateral in any asset class and one minus the applicable haircut expressed in percentage terms. The total value of all initial margin collateral is calculated as the sum of the value of each type of collateral asset.

[END OF COMMON TEXT]

Adoption of the Common Rule Text

The proposed adoption of the common rules by the agencies, as modified by agency-specific text, is set forth below:

Department of the Treasury

Office of the Comptroller of the Currency

12 CFR Chapter I

List of Subjects in 12 CFR Part 45

Administrative practice and procedure, Capital, Margin requirements, National Banks, Federal Savings Associations, Reporting and recordkeeping requirements, Risk.

Authority and issuance

For the reasons stated in the Common Preamble and under the authority of 12 U.S.C. 93a and 5412(b)(2)(B), the Office of the Comptroller of the Currency proposes to amend chapter I of Title 12, Code of Federal Regulations, as follows:

PART 45—MARGIN AND CAPITAL REQUIREMENTS FOR COVERED SWAP ENTITIES

■ 1. Part 45 is added as set forth at the end of the Common Preamble.
■ 2. The authority citation for part 45 is added to read as follows:

Authority: 7 U.S.C. 6s(e), 12 U.S.C. 1 *et seq.,* 12 U.S.C. 93a, 161, 1818, 3907, 3909, 5412(b)(2)(B), and 15 U.S.C. 78o–10(e).

■ 3. Part 45 is amended by:
■ a. Removing ''[Agency]'' wherever it appears and adding in its place ''the OCC'';
■ b. Removing ''[The Agency]'' wherever it appears and adding in its place ''The OCC.''
■ 4. Paragraphs (a), (b), and (c) of § 45.1 are added to read as follows:

§ 45.1 Authority, purpose, scope, and compliance dates.

(a) *Authority.* This part 45 is issued under the authority of 7 U.S.C. 6s(e), 12 U.S.C. 1 *et seq.,* 93a, 161, 1818, 3907, 3909, 5412(b)(2)(B), and 15 U.S.C. 78o–10(e).

(b) *Purpose.* Section 4s of the Commodity Exchange Act (7 U.S.C. 6s) and section 15F of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*–10) require the OCC to establish capital and margin requirements for any national bank, Federal savings association, or Federal branch or agency of a foreign bank that is registered as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant with respect to all non-cleared swaps and non-cleared security-based swaps. This part implements section 4s of the Commodity Exchange Act and section 15F of the Securities Exchange Act of 1934 by defining terms used in the statute and related terms, establishing capital and margin requirements, and explaining the statutes' requirements.

(c) *Scope.* This part establishes minimum capital and margin requirements for each covered swap entity subject to this part with respect to all non-cleared swaps and non-cleared security-based swaps. This part applies to any non-cleared swap or non-cleared security-based swap entered into by a covered swap entity on or after the relevant compliance date set forth in paragraph (d) of this section. Nothing in this part is intended to prevent a covered swap entity from collecting margin in amounts greater than are required under this part.

* * * * *

■ 5. Section 45.2 is amended by adding a definition of ''covered swap entity'' in alphabetical order to read as follows:

§ 45.2 Definitions.

* * * * *

Covered swap entity means any national bank, Federal savings association, or Federal branch or agency of a foreign bank that is a swap entity, or any other entity that the OCC determines.

* * * * *

§ 45.6 [Amended]

■ 6. Section 45.6(a)(2)(vi)(A) is amended by removing ''[RESERVED]'' and adding in its place ''12 CFR Part 1'';
■ 7. Section 45.11 is added to read as follows:

§ 45.11 Capital.

A covered swap entity shall comply with:

(a) In the case of a covered swap entity that is a national bank or Federal savings association, the minimum capital requirements 12 CFR Part 3.

(b) In the case of a covered swap entity that is a Federal branch or agency of a foreign bank, the capital adequacy guidelines applicable as generally provided under 12 CFR 28.14.

Board of Governors of the Federal Reserve System

12 CFR Chapter II

List of Subjects in 12 CFR Part 237

Administrative practice and procedure, Banks and banking, Capital, Foreign banking, Holding companies, Margin requirements, Reporting and recordkeeping requirements, Risk.

Authority and Issuance

For the reasons set forth in the **SUPPLEMENTARY INFORMATION**, the Board of Governors of the Federal Reserve System proposes to add the text of the common rule as set forth at the end of the Supplementary Information as Part 237 to 12 CFR Chapter II as follows:

PART 237—SWAPS MARGIN AND SWAPS PUSH–OUT

Subpart A—Margin and Capital Requirements for Covered Swap Entities (Regulation__)

■ 8. The authority citation for part 237 is added to read as follows:

Authority: 7 U.S.C. 6s(e), 15 U.S.C. 78o–10(e), 12 U.S.C. 221 *et seq.,* 12 U.S.C. 1818, 12 U.S.C. 1841 *et seq.,* 12 U.S.C. 3101 *et seq.* and 12 U.S.C. 1461 *et seq.*

■ 9. Amend part 237 by adding the common text as set forth in the preamble as Subpart A.
■ 10. Revise the heading for Subpart A, as set forth above.
■ 11. Amend subpart A by removing ''[Agency]'' wherever it appears and adding in its place ''the Board'';
■ 12. Amend subpart A removing ''[The Agency]'' wherever it appears and adding in its place ''The Board''; and
■ 13. Amend § 237.1 by adding paragraphs (a) through (c) to read as follows:

§ 237.1 Authority, purpose, scope and compliance dates.

(a) *Authority.* This part (Regulation KK) is issued by the Board of Governors of the Federal Reserve System (Board) under section 4s(e) of the Commodity Exchange Act, as amended (7 U.S.C. 6s(e)) and section 15F(e) of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78o–10(e)), as well as under the Federal Reserve Act, as amended (12 U.S.C. 221 *et seq.*); section 8 of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818); the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 *et seq.*); the International Banking Act of 1978, as amended (12 U.S.C. 3101 *et seq.*), and the Home Owners' Loan Act, as amended1461 *et seq.*).

(b) *Purpose.* Section 4s of the Commodity Exchange Act (7 U.S.C. 6s) and section 15F of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*–10) require the Board to establish capital and margin requirements for any state member bank (as defined in 12 CFR 208.2(g)), bank holding company (as defined in 12 U.S.C. 1841), savings and loan holding company (as defined in 12 U.S.C. 1467a (on or after the transfer established under Section 311 of the

Dodd-Frank Act) (12 U.S.C. 5411)), foreign banking organization (as defined in 12 CFR 211.21(o)), foreign bank that does not operate an insured branch, state branch or state agency of a foreign bank (as defined in 12 U.S.C. 3101(b)(11) and (12)), or Edge or agreement corporation (as defined in 12 CFR 211.1(c)(2) and (3)) that is registered as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant with respect to all non-cleared swaps and non-cleared security-based swaps. This regulation implements section 4s of the Commodity Exchange Act and section 15F of the Securities Exchange Act of 1934 by defining terms used in the statute and related terms, establishing capital and margin requirements, and explaining the statutes' requirements.

(c) *Scope.* This part establishes minimum capital and margin requirements for each covered swap entity subject to this part with respect to all non-cleared swaps and non-cleared security-based swaps. This part applies to any non-cleared swap or non-cleared security-based swap entered into by a covered swap entity on or after the relevant compliance date set forth in § 237.1(d). Nothing in this part is intended to prevent a covered swap entity from collecting margin in amounts greater than are required under this part.

* * * * *

■ 14. In § 237.2, add, in alphabetical order, the definition of ''covered swap entity.''.

§ 237.2 Definitions.

* * * * *

Covered swap entity means any swap entity that is a state member bank (as defined in 12 CFR 208.2(g)), bank holding company (as defined in 12 U.S.C. 1841), savings and loan holding company (as defined in 12 U.S.C. 1467a), foreign banking organization (as defined in 12 CFR 211.21(o)), foreign bank that does not operate an insured branch, state branch or state agency of a foreign bank (as defined in 12 U.S.C. 3101(b)(11) and (12)), Edge or agreement corporation (as defined in 12 CFR 211.1(c)(2) and (3)) or covered swap entity as determined by the Board. Covered swap entity would not include an affiliate of an entity listed in the first sentence of this definition for which the Office of the Comptroller of the Currency or the Federal Deposit Insurance Corporation is the prudential regulator or that is required to be registered with the U.S. Commodity Futures Trading Commission as a swap dealer or major swap participant or with the U.S. Securities and Exchange Commission as a security-based swap dealer or major security-based swap participant.

* * * * *

§ 237.6 [Amended]

■ 15. Section 237.6 is amended by removing [RESERVED] and adding in its place ''12 CFR 1.2(d)''.

■ 16. Section 237.11 is added to read as follows:

§ 237.11 Capital.

A covered swap entity shall comply with:

(a) In the case of a covered swap entity that is a state member bank (as defined in 12 CFR 208.2(g)), the provisions of the Board's Regulation Q (12 CFR 217) applicable to the state member bank;

(b) In the case of a covered swap entity that is a bank holding company (as defined in 12 U.S.C. 1842) or a savings and loan holding company (as defined in 12 U.S.C. 1467a), the provisions of the Board's Regulation Q (12 CFR part 217) applicable to the covered swap entity;

(c) In the case of a covered swap entity that is a foreign banking organization (as defined in 12 CFR 211.21(o)), a U.S. intermediate holding company subsidiary of a foreign banking organization (as defined in 12 CFR 252.3(y)) or any state branch or state agency of a foreign bank (as defined in 12 U.S.C. 3101(b)(11) and (12)), the capital standards that are applicable to such covered swap entity under § 225.2(r)(3) of the Board's Regulation Y (12 CFR 225.2(r)(3)) or the Board's Regulation YY (12 CFR part 252); and

(d) In the case of a covered swap entity that is an Edge or agreement corporation (as defined in 12 CFR 211.1(c)(2) and (3)), the capital standards applicable to an Edge corporation under § 211.12(c) of the Board's Regulation K (12 CFR 211.12(c)) and to an agreement corporation under § 211.5(g) and § 211.12(c) of the Board's Regulation K (12 CFR 211.5(g) and 211.12(c)).

Federal Deposit Insurance Corporation

12 CFR Chapter III

List of Subjects in 12 CFR Part 349

Banks, Holding companies, Reporting and recordkeeping requirements, Savings associations.

Authority and Issuance

For the reasons set forth in the Supplementary Information, the Federal Deposit Insurance Corporation proposes to add the text of the common rule as set forth at the end of the Common Preamble as subpart A of part 349 to chapter III of Title 12, Code of Federal Regulations, modified as follows:

PART 349—DERIVATIVES

■ 17. The part heading is revised to read as set forth above.

■ 18. The authority citation for part 349 is revised to read as follows:

Authority: 7 U.S.C. 6s(e), 15 U.S.C. 78o–10(e), and 12 U.S.C. 1818 and 12 U.S.C. 1819(a)(Tenth), 12 U.S.C. 1813(q), 1818, 1819, and 3108; 7 U.S.C. 2(c)(2)(E), 27 *et seq.*

Subpart B—Retail Foreign Exchange Transactions

■ 19. Redesignate *§§ 349.1 through 349.16 as §§ 349.20 through 349.36*

■ *20. Designate redesignated §§ 349.20 through 349.36 as Subpart B and add a heading to subpart B as set forth above.*

Subpart A—Margin and Capital Requirements for Covered Swap Entities

■ 21. Part 349, subpart A is added as set forth at the end of the Common Preamble.

■ 22. Part 349, subpart A is amended by:

■ a. Removing ''[Agency]'' wherever it appears and adding in its place ''the FDIC''; and

■ b. Removing ''[The Agency]'' wherever it appears and adding in its place ''The FDIC''.

■ 23. Amend § 349.1 by adding paragraphs (a) through (c) to read as follows:

§ 349.1 Authority, purpose, and scope.

(a) *Authority.* This subpart is issued by the Federal Deposit Insurance Corporation (FDIC) under section 4s(e) of the Commodity Exchange Act (7 U.S.C. 6s(e)), section 15F(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–10(e)), and section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818).

(b) *Purpose.* Section 4s of the Commodity Exchange Act (7 U.S.C. 6s) and section 15F of the Securities Exchange Act of 1934 (15 U.S.C. 78o–10) require the FDIC to establish capital and margin requirements for any FDIC-insured state-chartered bank that is not a member of the Federal Reserve System or FDIC-insured state-chartered savings association that is registered as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant with respect to all non-cleared swaps and non-cleared security-based swaps. This part implements section 4s of the Commodity Exchange Act and section 15F of the Securities Exchange Act of

1934 by defining terms used in the statutes and related terms, establishing capital and margin requirements, and explaining the statutes' requirements.

(c) *Scope.* This part establishes minimum capital and margin requirements for each covered swap entity subject to this part with respect to all non-cleared swaps and non-cleared security-based swaps. This part applies to any non-cleared swap or non-cleared security-based swap entered into by a covered swap entity on or after the relevant compliance date set forth in paragraph (d) of this section. Nothing in this part is intended to prevent a covered swap entity from collecting margin in amounts greater than are required under this part.

* * * * *

§ 349.2 [Amended]

■ 24. Amend § 349.2 by adding, in alphabetical order, the definition for ''covered swap entity.''

* * * * *

Covered swap entity means any FDIC-insured state-chartered bank that is not a member of the Federal Reserve System or FDIC-insured state-chartered savings association that is a swap entity, or any other entity that the FDIC determines.

* * * * *

§ 349.6 [Amended]

■ 25. Section 349.6 is amended by removing ''[Reserved]'' wherever it appears and adding in its place ''12 CFR 1.2(d)'';

■ 26. Section 349.11 is revised to read as follows:

§ _349.11 Capital requirement.

A covered swap entity shall comply with the capital requirements that are applicable to the covered swap entity under part 324.

Farm Credit Administration

List of Subjects in 12 CFR Part 624

Accounting, Agriculture, Banks, Banking, Capital, Cooperatives, Credit, Margin requirements, Reporting and recordkeeping requirements, Risk, Rural areas, Swaps.

Authority and Issuance

For the reasons set forth in the Supplementary Information, the Farm Credit Administration proposes to add the text of the common rule as set forth at the end of the Supplementary Information as Part 624 to chapter VI of Title 12, Code of Federal Regulations, modified as follows:

PART 624—MARGIN AND CAPITAL REQUIREMENTS FOR COVERED SWAP ENTITIES

■ 27. The authority citation for part 624 is added to read as follows:

Authority: 7 U.S.C. 6s(e), 15 U.S.C. 78o–10(e), and secs. 4.3, 5.9, 5.17, and 8.32 of the Farm Credit Act (12 U.S.C. 2154, 12 U.S.C. 2243, 12 U.S.C. 2252, and 12 U.S.C. 2279bb–1).

■ 28. Part 624 is added as set forth at the end of the Common Preamble.

■ 29. Part 624 is amended by:

■ a. Removing ''[Agency]'' wherever it appears and adding in its place ''the FCA'';

■ b. Removing ''[The Agency]'' wherever it appears and adding in its place ''The FCA''; and

■ 30. Revise § 624.1 by adding paragraphs (a) through (c) to read as follows:

§ 624.1 Authority, purpose, and scope.

(a) *Authority.* This part is issued by the Farm Credit Administration (FCA) under section 4s(e) of the Commodity Exchange Act (7 U.S.C. 6s(e)), section 15F(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–10(e)), and sections 4.3, 5.9, 5.17, and 8.32 of the Farm Credit Act (12 U.S.C. 2154, 12 U.S.C. 2243, 12 U.S.C. 2252, and 12 U.S.C. 2279bb–1).

(b) *Purpose.* Section 4s of the Commodity Exchange Act (7 U.S.C. 6s) and section 15F of the Securities Exchange Act of 1934 (15 U.S.C. 78o–10) require the FCA to establish capital and margin requirements for any System institution, including the Federal Agricultural Mortgage Corporation, chartered under the Farm Credit Act of 1971, as amended (12 U.S.C. 2001 *et seq.*) that is registered as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant with respect to all non-cleared swaps and non-cleared security-based swaps. This regulation implements section 4s of the Commodity Exchange Act and section 15F of the Securities Exchange Act of 1934 by defining terms used in the statute and related terms, establishing capital and margin requirements, and explaining the statutes' requirements.

(c) *Scope.* This part establishes minimum capital and margin requirements for each covered swap entity subject to this part with respect to all non-cleared swaps and non-cleared security-based swaps. This part applies to any non-cleared swap or non-cleared security-based swap entered into by a covered swap entity on or after the relevant compliance date set forth in § 624.1(d). Nothing in this part is intended to prevent a covered swap entity from collecting margin in amounts greater than are required under this part.

* * * * *

■ 31. Amend *§ 624.2 by adding, in alphabetical order, the definitions for 'Covered swap entity,'' and ''Investment grade'':*

§ 624.2 Definitions.

* * * * *

Covered swap entity means any institution chartered under the Farm Credit Act of 1971, as amended (12 U.S.C. 2001 *et seq.*) that is a swap entity, or any other entity that the FCA determines.

* * * * *

Investment grade means the issuer of a security has an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure. An issuer has an adequate capacity to meet financial commitments if the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected.

* * * * *

§ 624.6 [Amended]

■ 32. Section 624.6 is amended by removing ''[Reserved]'' wherever it appears and adding in its place ''investment grade as defined in § 624.2 of this chapter'';

■ 33. Section 624.11 is added to read as follows:

§ 624.11 Capital.

A covered swap entity shall comply with:

(a) In the case of the Federal Agricultural Mortgage Corporation, the capital adequacy regulations set forth in part 652 of this chapter; and

(b) In the case of any Farm Credit System institution other than the Federal Agricultural Mortgage Corporation, the capital regulations set forth in part 615 of this chapter.

Federal Housing Finance Agency

Lists of Subjects in 12 CFR Part 1221

Government-sponsored enterprises, Mortgages, Securities.

Authority and Issuance

For the reasons set forth in the **SUPPLEMENTARY INFORMATION**, and under the authority of 7 U.S.C. 6s(e), 15 U.S.C. 78o–10(e), 12 U.S.C. 4513 and 12 U.S.C. 4526, the Federal Housing Finance Agency proposes to add the text of the common rule as set forth at the end of the **SUPPLEMENTARY INFORMATION** as Part 1221 of subchapter B of Chapter XII of title 12 of the Code of Federal Regulations, modified as follows:

Chapter XII—Federal Housing Finance Agency

Subchapter B—Entity Regulations

PART 1221—MARGIN AND CAPITAL REQUIREMENTS FOR COVERED SWAP ENTITIES

■ 34. The authority citation for part 1221 is added to read as follows:

Authority: 7 U.S.C. 6s(e), 15 U.S.C. 78o-10(e), 12 U.S.C. 4513 and 12 U.S.C. 4526(a).

■ 35. Part 1221 is amended by:

■ a. Removing ''[Agency]'' wherever it appears and adding in its place ''FHFA''; and

■ b. Removing ''[The Agency]'' wherever it appears and adding in its place ''FHFA''.

■ 36. Section 1221.1 is amended by adding paragraphs (a), (b) and (c) to read as follows:

§ 1221.1 Authority, purpose, scope and compliance dates.

(a) *Authority.* This part is issued by FHFA under section 4s(e) of the Commodity Exchange Act (7 U.S.C. 6s(e)), section 15F(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–10(e)), 12 U.S.C. 4513 and 12 U.S.C. 4526(a).

(b) *Purpose.* Section 4(s) of the Commodity Exchange Act (7 U.S.C. 6s) and section 15F of the Securities Exchange Act of 1934 (15 U.S.C. 78o–10) require FHFA to establish capital and margin requirements for any regulated entity that is registered as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant with respect to all non-cleared swaps and non-cleared security-based swaps. This regulation implements section 4s of the Commodity Exchange Act and section 15F of the Securities Exchange Act of 1934 by defining terms used in the statute and related terms, establishing capital and margin requirements, and explaining the statute's requirements.

(c) *Scope.* This part establishes minimum capital and margin requirements for each covered swap entity subject to this part with respect to all non-cleared swaps and non-cleared security-based swaps. This part applies to any non-cleared swap or non-cleared security-based swap entered into by a covered swap entity on or after the related compliance date set forth in paragraph (d) of this section. Nothing in this part is intended to prevent a covered swap entity from collecting margin in amounts greater than are required under this part.

* * * * *

■ 37. Section 1221.2 is amended by adding in correct alphabetical order the following terms:

§ 1221.2 Definitions.

* * * * *

Covered swap entity means any regulated entity that is a swap entity or any other entity that FHFA determines.

* * * * *

Regulated entity means any regulated entity as defined in section 1303(20) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4502(20)).

* * * * *

§ 1221.6 Eligible Collateral.

■ 38. Section 1221.6 is amended by:

■ a. Removing in paragraph (a)(2)(v) the phrase ''the capital rules applicable to the covered swap entity as set forth in § __.11 of this part'' and adding in its place ''12 CFR part 324''; and

■ b. Removing the words ''terms of [RESERVED]'' where they appear in paragraph (a)(2)(vii)(A) and adding in their place the phrase ''definition of investment quality in § 1267.1 of this chapter''.

■ 39. Section 1221.11 is added to read as follows:

§ 1221.11 Capital.

A covered swap entity shall comply with the capital levels or such other amounts applicable to it as required by the Director of FHFA pursuant to 12 U.S.C. 4611.

Dated: September 3, 2014.

Thomas J. Curry,

Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, September 9, 2014.

Robert deV. Frierson,

Secretary of the Board.

Dated at Washington, DC, this 3rd of September 2014.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

Dated: September 3, 2014.

Dale L. Aultman,

Secretary, Farm Credit Administration Board.

Dated: September 3, 2014.

Melvin L. Watt,

Director, Federal Housing Finance Agency.

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