

CFTC Proposes Cross-Border Application of Margin Requirements for Uncleared Swaps

The CFTC has proposed rules that would define the reach of Dodd-Frank Act margin requirements in cross-border swap transactions.

On June 29, 2015, the US Commodity Futures Trading Commission (CFTC) proposed regulations that would frame the reach of its uncleared swap margin requirements in cross-border swap transactions (the Proposed Rules).¹ The Proposed Rules follow the margin rules the CFTC re-proposed last year, which outlined three different approaches for purposes of applying the margin rules in a cross-border context. The Proposed Rules do not reflect one of the three approaches originally proposed in 2014, but rather take a different (hybrid of sorts) approach to the cross-border application of the CFTC uncleared swap margin rules.

The Proposed Rules would subject all uncleared swap transactions entered into by US swap dealers (SDs) and major swap participants (MSPs) (collectively, covered swap entities (CSEs)) to the CFTC proposed margin requirements, as well as certain uncleared swaps entered into by non-US CSEs where the risk flows back to a US entity. Specifically, in the case of an uncleared swap transaction in which a non-US CSE is facing a counterparty that is (1) a non-US person whose relevant swap obligations are guaranteed by a US person, (2) a US branch of a foreign bank, (3) a foreign branch of a US CSE or (4) a non-US CSE whose financials are consolidated in the annual report of a US ultimate parent, such swap would be subject to the CFTC proposed margin requirements, though substituted compliance would be available in certain instances.

The CFTC has requested comment on the Proposed Rules by September 14, 2015.

Background

The Proposed Rules address the missing cross-border piece of the uncleared swaps margin rules previously proposed by the CFTC in October 2014.

The CFTC proposed (for the second time) margin rules for uncleared swaps in October 2014 in an effort to align the rules with the International Standards (discussed below), but declined to propose a definitive framework specifying the cross-border application of such margin rules. The Proposed Rules would close the loop on the cross-border application of such margin rules.

Margin Requirements for Uncleared Swap Transactions

To put the Proposed Rules into context, a bit of a history lesson on the uncleared swaps margin regime is necessary.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) directs the CFTC, SEC and prudential regulators² to adopt rules establishing minimum initial and variation margin requirements for CSEs on all swaps that are not cleared by a registered derivatives clearing organization (DCO) (as used herein, uncleared swaps).³

CFTC Proposed Margin Requirements

Though the CFTC initially proposed margin rules for public comment on April 28, 2011,⁴ the CFTC re-proposed regulations to implement initial and variation margin requirements for uncleared swaps for CSEs on October 3, 2014 (the CFTC Proposed Margin Rules).⁵ These rules have not yet been finalized. The CFTC Proposed Margin Rules would, *inter alia*:

- Require the posting and collection of initial margin for all swaps entered into between a CSE and (i) another CSE, (ii) a financial end-user⁶ with a material swaps exposure⁷ or (iii) its affiliate
- Require that CSEs segregate, with an independent custodian, all initial margin collected
- Require the posting and collection of variation margin for all swaps entered into between a CSE and either (i) another CSE, (ii) a financial end-user or (iii) its affiliate
- For variation margin, limit eligible collateral to cash

The not-yet-finalized margin requirements are referred to herein as the "CFTC Margin Requirements." The CFTC Proposed Margin Rules also requested comment on the following three potential alternative approaches to the cross-border application of the margin requirements:

- A "transaction-level" approach, consistent with the CFTC Cross-Border Guidance (discussed below), which would apply the CFTC Margin Requirements to US CSEs (other than a foreign branch of a US bank that is not a CSE), irrespective of whether the counterparty is a US person or not and without the possibility of substituted compliance, except where the CSE is facing a non-US person counterparty that is a "guaranteed affiliate" or "affiliate conduit"
- An "entity-level" approach, which would apply the CFTC Margin Requirements to CSEs on a firmwide level, irrespective of where the swap is executed or whether the counterparty is a US person, but with the possibility of substituted compliance
- An approach mirroring the cross-border approach taken by the Prudential Regulator Proposed Margin Rules (discussed immediately below)⁸

The CFTC did not choose any of the three alternatives, but rather proposed an approach similar to the Prudential Regulator Proposed Margin Rules, but that has been modified in several respects.

Prudential Regulator Proposed Margin Requirements

On September 24, 2014, the Prudential Regulators published proposed regulations to implement initial and variation margin requirements on uncleared swaps for SDs and MSPs that have a Prudential Regulator (the Prudential Regulator Proposed Margin Rules).⁹ The Prudential Regulator Proposed Margin Rules were substantially similar to the CFTC Proposed Margin Rules, except as pertained to the cross-border application of the margin requirements: the Prudential Regulators would apply the margin requirements to all uncleared swaps of CSEs under their supervision, except in the case of a foreign uncleared swap¹⁰ entered into by a foreign covered swap entity (FCSE),¹¹ and only if (i) neither the FCSE's

nor the non-US counterparty's obligations under the relevant swap were guaranteed by a US person and (ii) neither party were controlled by a US person.¹²

Existing CFTC Cross-Border Guidance

On July 26, 2013, the CFTC finalized its interpretive statement and guidance regarding how the Dodd-Frank Act swap provisions would generally apply on a cross-border basis (the CFTC Cross-Border Guidance).¹³ Notably, the CFTC Cross-Border Guidance included, *inter alia*, a definition of "US Person"¹⁴ and a broad interpretation of the term "guarantee."¹⁵ If the approach to cross-border swap transactions that was taken in the CFTC Cross-Border Guidance were taken with respect to applying margin requirements, a non-US CSE whose obligations under a swap transaction were not guaranteed by a US Person would not be subject to any margin requirements promulgated by the CFTC.¹⁶

For purposes of the application of the CFTC Margin Requirements to uncleared cross-border swap transactions, the approach taken in the Proposed Rules would take precedence over that taken in the CFTC Cross-Border Guidance.¹⁷

International Margin Requirements

The proposed uncleared swaps margin requirements in both the US and the EU were repropounded in light of the publication by the Basel Committee on Banking Supervision (the BCBS) and the Board of the International Organization of Securities Commissions (IOSCO) in September 2013 which set forth an international framework for uncleared swap margin requirements (the International Standards).¹⁸ In accordance with the agreements by the Group of Twenty (G-20), these International Standards are meant to serve as a guide and frame the local jurisdiction policymaking.

With this background in mind, we turn to our discussion of the Proposed Rules. Given the complexity of the Proposed Rules, we recommend referencing the chart included in the back of this *Client Alert*.

I. Proposed Definitions

US Person

For purposes of the application of the CFTC Margin Requirements to cross-border swap transactions, the Proposed Rules would define "US Person" to entail:

- (i) Any natural person who is a resident of the United States
- (ii) Any estate of a decedent who was a resident of the United States at the time of death
- (iii) Any corporation, partnership, limited liability company (LLC), business or other trust, association, joint-stock company, fund or any form of entity similar to any of the foregoing (other than an entity described in (iv) or (v), below) (a Legal Entity), in each case that is organized or incorporated under the laws of the United States or having its principal place of business¹⁹ in the United States (including any branch of the Legal Entity)
- (iv) Any pension plan for the employees, officers or principals of a Legal Entity described in (iii), above, unless the pension plan is primarily for foreign employees of such entity
- (v) Any trust governed by the laws of a state or other jurisdiction in the United States, if a court within the United States is able to exercise primary supervision over the administration of the trust

(vi) Any Legal Entity (other than an LLC, limited liability partnership or similar entity where all of the owners of the entity have limited liability) owned by one or more persons described in any of (i)-(v), above, who bear(s) unlimited responsibility for the obligations and liabilities of the Legal Entity (including any branch of the Legal Entity)

(vii) Any individual account or joint account (discretionary or not) where the beneficial owner (or one of the beneficial owners, in the case of a joint account) is a person described in any of (i)-(vi)²⁰

No Majority Ownership Prong

The CFTC Cross-Border Guidance incorporated a "majority ownership" concept in its corresponding prong (vi) of the US Person definition (*i.e.*, a Legal Entity would generally be characterized as a US Person if such Legal Entity were "directly or indirectly majority-owned" by one or more persons falling within the term "US Person" and such US Person(s) bear(s) unlimited responsibility for the obligations and liabilities of the Legal Entity).²¹ The US Person definition proposed by the CFTC in the Proposed Rules does not include a US majority ownership prong for purposes of applying the CFTC Margin Requirements.²²

Foreign Branches of US Persons

The US Person definition proposed by the CFTC in the Proposed Rules approaches a person's legal status at the entity level — the definition includes any foreign operations that are part of the US Person, regardless of their location; therefore, a foreign branch of a US Person would be considered a US Person for purposes of applying the CFTC Margin Requirements²³ and, importantly, foreign branches do not get any special treatment, unlike in the CFTC Cross-Border Guidance.²⁴

Non-US Subsidiaries/Affiliates of US Persons

Under the US Person definition proposed by the CFTC in the Proposed Rules, an affiliate or subsidiary of a US Person, which is organized or incorporated in a non-US jurisdiction, would not be deemed a "US Person" solely by virtue of its relationship with a US Person.²⁵

Reasonable Reliance on Counterparty US Person Representation

The CFTC would generally allow a party to a swap transaction to reasonably rely on its counterparty's written representation in determining whether such swap counterparty falls within the (proposed) US Person definition.²⁶

Guarantee

For purposes of the application of the CFTC Margin Requirements to cross-border swap transactions, the Proposed Rules would define "Guarantee" as an arrangement pursuant to which one party to a swap transaction with a non-US counterparty has rights of recourse against a US Person guarantor with respect to the non-US counterparty's obligations under the relevant swap transaction.²⁷ It would be irrelevant under the Proposed Rules, if finalized, whether or not such US Person guarantor were affiliated with the non-US counterparty.²⁸

Rights of Recourse

For purposes of the proposed Guarantee definition in the Proposed Rules, a swap counterparty has "rights of recourse" against a US Person guarantor if such counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the US Person guarantor in connection with the non-US counterparty's obligations under the swap.²⁹ It would be irrelevant under the Proposed Rules, if finalized, (a) whether or not such right of recourse were conditioned upon the non-US counterparty's insolvency or failure to meet its obligations under the

relevant swap or (b) whether or not the swap counterparty seeking to enforce the Guarantee is required to make a demand for payment or performance from the non-US counterparty before proceeding against the US Person guarantor.³⁰ Furthermore, so long as legally enforceable rights of recourse are created under the laws of the relevant jurisdiction, the Proposed Rules would not require that the terms of the Guarantee be included within the swap documentation or otherwise reduced to writing.³¹

The proposed definition of Guarantee is narrower in scope than the one in the CFTC Cross-Border Guidance, which interpreted the term Guarantee broadly to include not only traditional guarantees of payment or performance of related swaps, but also other arrangements that, in view of all the facts and circumstances, support the non-US Person's ability to pay or perform its swap obligations.³²

Foreign Consolidated Subsidiaries

In an effort to capture non-US CSEs whose swap obligations are not guaranteed by US Persons but nonetheless have financial support from US Person affiliates, the CFTC has proposed to incorporate the concept of foreign consolidated subsidiaries for purposes of applying the CFTC Margin Requirements to cross-border swap transactions.³³ The Proposed Rules would define a "Foreign Consolidated Subsidiary" (FCS) as a non-US CSE in which an ultimate parent entity that is a US Person has a controlling interest (in accordance with US generally accepted accounting principles (GAAP)), such that the US Person ultimate parent entity includes the non-US CSE's operating results, financial position and statements of cash flows in such ultimate parent entity's consolidated financial statements (in accordance with GAAP).³⁴ As proposed, the term "ultimate parent entity" would mean the parent entity in a consolidated group in which none of the other entities in the consolidated group has a controlling interest (in accordance with GAAP).³⁵

II. Proposed Cross-Border Application

Substituted Compliance

The CFTC has proposed a standard of review that, if finalized, would apply to CFTC determinations regarding whether a CSE could satisfy its obligations under the CFTC Margin Requirements by complying with the margin requirements of a foreign jurisdiction relevant to a swap transaction (*i.e.*, substituted compliance). Even if the CFTC has determined that a CSE may avail itself of substituted compliance, (a) such CSE would remain subject to the CFTC's examination and enforcement authority and (b) failure to comply with the applicable foreign margin requirements could result in a violation of the CFTC Margin Requirements.³⁶ The Proposed Rules would require the CFTC to make any substituted compliance determinations on an outcomes-based comparability standard (referred to herein as a Comparability Determination).³⁷

Comparability Determination

Under the Proposed Rules, the CFTC would determine whether a CSE could avail itself of substituted compliance with respect to the CFTC Margin Requirements by evaluating whether the relevant foreign jurisdiction has rules and regulations that achieve outcomes comparable to the CFTC Margin Requirements as well as the International Standards. In making such a Comparability Determination, the CFTC would take the following factors into consideration:

- The scope and objectives of the relevant foreign jurisdiction's margin requirements
- How the relevant foreign jurisdiction's margin requirements compare to the International Standards

- Whether the relevant foreign jurisdiction's margin requirements achieve comparable outcomes to the CFTC's corresponding margin requirements
- The ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's margin requirements
- Any other factors and circumstances the CFTC deems relevant³⁸

Uncleared Swap Obligations of US CSEs

The Proposed Rules would apply the CFTC Margin Requirements to all uncleared swaps entered into by US CSEs, with no exclusions.³⁹ However, with respect to a US CSE posting initial margin to any non-US Person counterparty (including a non-US CSE, FCS or US branch of a non-US CSE) whose obligations under the uncleared swap are not guaranteed by a US Person, the CFTC has proposed that substituted compliance would be available with respect to such initial margin, so long as each of the following three conditions are met:

- The swap counterparty is neither (a) a US Person nor (b) a non-US Person whose obligations under the relevant swap are guaranteed by a US Person.
- The swap counterparty is subject to a foreign jurisdiction's margin requirements.
- The CFTC has issued a Comparability Determination with respect to such foreign jurisdiction's requirements regarding the posting of initial margin by the CSE.⁴⁰

If substituted compliance is available, the US CSE would satisfy its obligation to post initial margin by posting initial margin in the form and amount, and at such times, that its non-US Person counterparty is required to collect initial margin pursuant to such foreign jurisdiction's margin requirements.⁴¹ Substituted compliance would not apply to the collection of margin by the US CSE from the non-US counterparty.⁴²

Foreign Branches of US CSEs

Because foreign branches of a US CSE are treated as part of the related principal entity, an uncleared swap executed by or through a foreign branch of a US CSE would be treated as if it were an uncleared swap of such US CSE, for purposes of the CFTC Margin Requirements.⁴³

Uncleared Swap Obligations Guaranteed by a US Person

The Proposed Rules would apply the same treatment that applies to US CSEs to non-US CSEs (including a US branch of a non-US CSE and an FCS) whose obligations under the relevant swap are guaranteed by a US Person.⁴⁴

Uncleared Swap Obligations Not Guaranteed by a US Person

If the swap obligations of a non-US CSE (including a US branch of a non-US CSE and an FCS) under the relevant swap are not guaranteed by a US Person, substituted compliance would be available with respect to its uncleared swaps with any counterparty other than (i) swap transactions subject to the Exclusion (discussed below), and (ii) if the non-US CSE is facing either (a) a US CSE counterparty or (b) a non-US CSE counterparty whose obligations under the relevant swap are guaranteed by a US Person, in which case substituted compliance would only be available for initial margin collected by the non-US CSE whose swap obligations are not guaranteed by a US Person.⁴⁵

Foreign Consolidated Subsidiaries

As pertains to margin requirements, the CFTC has proposed that, if the obligations of an FCS under a swap transaction are not guaranteed by a US Person, substituted compliance be available to such FCS to the same extent as other non-US CSEs whose obligations under the swap are not guaranteed by a US Person.⁴⁶

Exclusion

The Proposed Rules would exclude certain swaps from the CFTC Margin Requirements entered into by non-US CSEs with non-US persons (including a non-US CSE) (the Exclusion). A non-US CSE would not be required to comply with the CFTC Margin Requirements for uncleared swaps entered into with non-US persons, so long as each of the following two conditions are met:

- Neither counterparty's obligations under the relevant swap are guaranteed by a US Person.
- Neither counterparty is a US branch of a non-US CSE or an FCS.⁴⁷

Uncleared swaps of non-US CSEs not satisfying the requirements for the above Exclusion would still be subject to the CFTC Margin Requirements with the possibility of substituted compliance and would still be subject to the CFTC's capital requirements.⁴⁸

Because the CFTC believes that the swap activities of an FCS has a direct impact on the financial position, risk profile and market value of its US Person ultimate parent entity, the Exclusion would not be available for swaps to which an FCS is a party.⁴⁹

Similarly, the CFTC has an interest in regulating entities that are located in the United States. As a result, while uncleared swaps executed through or by a US branch of a non-US CSE are treated principally the same as those swaps executed directly with the non-US CSE, the Exclusion would not be available to such US branch of a non-US CSE.⁵⁰

Proposed Cross-Border Application of the CFTC Margin Requirements

Counterparty #1 (CP1)	Counterparty #2	Substituted Compliance Available?		Initial Margin (IM)*		Variation Margin (VM)*	
		IM	VM	CP1 Posting	CP1 Collecting	CP1 Posting	CP1 Collecting
US CSE	US Person (including US CSE)	N	N	US	US	US	US
	Non-US Person (including non-US CSE, FCS & US branch of non-US CSE) w/ US Person Guarantee of the relevant swap obligations	N	N	US	US	US	US
	Non-US Person (including non-US CSE, FCS & US branch of non-US CSE) w/ <u>no</u> US Person Guarantee of the relevant swap obligations	Y	N	Non-US	US	US	US
Non-US CSE (incl. FCS & US branch of non-US CSE FCS) whose obligations under the relevant swap are guaranteed by US Person	US Person (including US CSE)	N	N	US	US	US	US
	Non-US Person (including non-US CSE, FCS & US branch of non-US CSE) w/ US Person Guarantee of the relevant swap obligations	N	N	US	US	US	US
	Non-US Person (including non-US CSE, FCS & US branch of non-US CSE) w/ <u>no</u> US Person Guarantee of the relevant swap obligations	Y	N	Non-US	US	US	US
FCS whose obligations under the relevant swap are <u>not</u> guaranteed by US Person	US CSE	Y	N	US	Non-US	US	US
	US Person (that is not a US CSE)	Y	Y	Non-US	Non-US	Non-US	Non-US
	Non-US CSE (including FCS & US branch of non-US CSE) w/ US Person Guarantee of the relevant swap obligations	Y	N	US	Non-US	US	US

Counterparty #1 (CP1)	Counterparty #2	Substituted Compliance Available?		Initial Margin (IM)*		Variation Margin (VM)*	
		IM	VM	CP1 Posting	CP1 Collecting	CP1 Posting	CP1 Collecting
	Non-US Person w/ US Person Guarantee of the relevant swap obligations (except a non-US CSE, US branch of non-US CSE & FCS w/ US Person Guarantee of the relevant swap obligations)	Y	Y	Non-US	Non-US	Non-US	Non-US
	Non-US Person (including non-US CSE, US branch of non-US CSE & FCS) w/ no US Person Guarantee of the relevant swap obligations	Y	Y	Non-US	Non-US	Non-US	Non-US
US branch of non-US CSE whose obligations under the relevant swap are not guaranteed by US Person	US CSE	Y	N	US	Non-US	US	US
	US Person (that is not a US CSE)	Y	Y	Non-US	Non-US	Non-US	Non-US
	Non-US CSE (including FCS & US branch of non-US CSE) w/ US Person Guarantee of the relevant swap obligations	Y	N	US	Non-US	US	US
	Non-US Person w/ US Person Guarantee of the relevant swap obligations (except a non-US CSE, US branch of non-US CSE & FCS w/ US Person Guarantee of the relevant swap obligations)	Y	Y	Non-US	Non-US	Non-US	Non-US
	Non-US Person (including non-US CSE, US branch of non-US CSE & FCS) w/ no US Person Guarantee of the relevant swap obligations	Y	Y	Non-US	Non-US	Non-US	Non-US
Non-US CSE (that is not a FCS or US branch of non-US CSE) whose obligations under the relevant swap are not guaranteed by US Person	US CSE	Y	N	US	Non-US	US	US
	US Person (that is not a CSE)	Y	Y	Non-US	Non-US	Non-US	Non-US

Counterparty #1 (CP1)	Counterparty #2	Substituted Compliance Available?		Initial Margin (IM)*		Variation Margin (VM)*	
		IM	VM	CP1 Posting	CP1 Collecting	CP1 Posting	CP1 Collecting
	Non-US CSE (including FCS & US branch of non-US CSE) w/ US Person Guarantee of the relevant swap obligations	Y	N	US	Non-US	US	US
	Non-US Person w/ US Person Guarantee of the relevant swap obligations (except a non-US CSE w/ US Person Guarantee of the relevant swap obligations)	Y	Y	Non-US	Non-US	Non-US	Non-US
	FCS w/ no US Person Guarantee of the relevant swap obligations	Y	Y	Non-US	Non-US	Non-US	Non-US
	US branch of non-US CSE w/ no US Person Guarantee of the relevant swap obligations	Y	Y	Non-US	Non-US	Non-US	Non-US
	Non-US Person (including a non-US CSE, but not FCS or US branch of a non-US CSE) w/ no US Person Guarantee of the relevant swap obligations	Eligible for Exclusion					

* Indicates applicable regulation for margin requirement

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Endnotes

- ¹ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 80 Fed. Reg. 41376 (proposed June 29, 2015) (to be codified at 17 C.F.R. pt. 23) *available at* <http://www.gpo.gov/fdsys/pkg/FR-2015-07-14/pdf/2015-16718.pdf> (Proposed Rules).
- ² Section 1a(39) of the Commodity Exchange Act (the CEA), as amended by Section 721 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), defines "prudential regulator" to include the Board of Governors of the Federal Reserve System (the FRB), the Office of the Comptroller of the Currency (the OCC), the Federal Deposit Insurance Corporation (the FDIC), the Farm Credit Administration and the Federal Housing Finance Agency.
- ³ 7 U.S.C. § 6s(e)(3)(D)(ii); *see also* 15 U.S.C. § 8302(a)(1).
- ⁴ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23732 (proposed April 28, 2011) (to be codified at 17 C.F.R. pt. 23), *available at* <http://www.gpo.gov/fdsys/pkg/FR-2011-04-28/pdf/2011-9598.pdf>. For further discussion, please refer to our *Client Alert* regarding the CFTC's regulatory proposals to implement Title VII of the Dodd-Frank Act: Commodity Futures Trading Commission "Pro Forma" Proposed Rules July 2011 (July 6, 2011), *available at* <http://www.lw.com/thoughtLeadership/4233-CommodityFuturesTradingCommission-ProForma-ProposedRulesJuly2011>.
- ⁵ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 Fed. Reg. 59897 (proposed Oct. 3, 2014) (to be codified at 17 C.F.R. pts. 23, 140), *available at* <http://www.gpo.gov/fdsys/pkg/FR-2014-10-03/pdf/2014-22962.pdf> (CFTC Proposed Margin Rules). For further discussion, please refer to our *Client Alert* on the CFTC Proposed Margin Rules. UPDATE: Swap Dealers Will Face Significant Challenges from Reproposed Margin Rules for Uncleared Swaps, *Client Alert* No. 1792 (Jan. 26, 2015), *available at* <http://www.lw.com/thoughtLeadership/lw-dealers-margin-rules-for-uncleared-swaps>.
- ⁶ The CFTC Proposed Margin Rules would define "financial end-user" to include: (a) bank holding companies (and their affiliates); (b) savings and loan holding companies; (c) nonbank financial institutions supervised by the FRB under Title I of the Dodd-Frank Act; (d) depository institutions; (e) foreign banks; (f) federal or state credit unions; (g) state-licensed or registered credit or lending entities; (h) broker-dealers; (i) money services businesses (e.g., check casher, money transmitter, currency dealer or exchange or money order or traveller's check issuer); (j) registered investment companies; (k) real estate investment companies; (l) investment advisors; (m) securities holding companies; (n) business development companies; (o) private funds; (p) private mortgage real estate investment trusts (REITs); (q) securitization vehicles; (r) commodity pools; (s) commodity pool operators (CPOs); (t) commodity trading advisors (CTAs); (u) futures commission merchants (FCMs); (v) employee benefit plans; (w) insurance companies; (x) cooperatives that are financial institutions; (y) entities that are, or hold themselves 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; (z) foreign entities that would be considered to be financial end-users if they were organized in the United States; and (aa) any other entities the CFTC determines should be treated as a financial end-user; specifically **excluded** from the proposed definition of "financial end-user" are (i) sovereign entities; (ii) multilateral development banks; (iii) the Bank for International Settlements; (iv) entities that are exempt from the definition of "financial entity" under Section 2(h)(7)(C)(iii) of the CEA; and (v) affiliates that qualify for the clearing exemption under Section 2(h)(7)(D) of the CEA. CFTC Proposed Margin Rules, 79 Fed. Reg. at 59926-27.
- ⁷ As the CFTC proposed in the CFTC Proposed Margin Rules, a financial end-user would have a "material swaps exposure" if it had an average daily aggregate notional amount of uncleared swaps in excess of USD\$3 billion. Proposed Rule 151 (proposing amendment of 17 C.F.R. pt. 23).
- ⁸ CFTC Proposed Margin Rules, 79 Fed. Reg. at 59917.
- ⁹ Margin and Capital Requirements for Covered Swap Entities, 79 Fed. Reg. 53748 (Sept. 24, 2014) (to be codified at 12 C.F.R. pts. 45, 237, 349, 624, 1221), *available at* <http://www.gpo.gov/fdsys/pkg/FR-2014-09-24/pdf/2014-22001.pdf> (Prudential Regulators Proposed Margin Rules).
- ¹⁰ The Prudential Regulator Proposed Margin Rules would define a "foreign uncleared swap" to mean any uncleared swap of a foreign covered swap entity (FCSE) (as defined below) to which neither the counterparty nor the guarantor (on either side) is: (a) an entity organized under US or State law (including a US branch, agency or subsidiary of a foreign bank); (b) a branch or office of an entity organized under US or State law; or (c) an entity controlled by an entity organized under US or State law. Proposed Section __.9(b); Prudential Regulators Proposed Margin Rules, 79 Fed. Reg. at 57379; *see* Proposed Rules, 80 Fed. Reg. at 41379, n. 23.
- ¹¹ The Prudential Regulator Proposed Margin Rules would define an "FCSE" as any CSE that is **not** (a) an entity organized under US or State law (including a US branch, agency or subsidiary of a foreign bank); (b) a branch or office of an entity organized under US or State law; or (c) an entity controlled by an entity organized under US or State law. Proposed Section __.9(c); Prudential Regulators Proposed Margin Rules, 79 Fed. Reg. at 57379; *see* Proposed Rules, 80 Fed. Reg. at 41379, n. 23.
- ¹² The Prudential Regulator Proposed Margin Rules would define "control" of another company to entail: (a) 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; (b) ownership or control of 25 percent or more of the total equity of the company, directly or indirectly acting through one or more other persons; or (c) control in any manner of the election of a majority of the directors or trustees of the

company. Proposed Section __.2, Prudential Regulators Proposed Margin Rules, 79 Fed. Reg. at 57389; see Proposed Rules, 80 Fed. Reg. at 41379.

¹³ Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45292 (July 26, 2013), available at <http://www.gpo.gov/fdsys/pkg/FR-2013-07-26/pdf/2013-17958.pdf> (CFTC Cross-Border Guidance). For further discussion, please refer to our *Client Alert* on the CFTC Cross-Border Guidance. CFTC Issues its Last Word on the Cross-Border Application of Derivatives Regulations (For Now), *Client Alert* No. 1567 (July 25, 2013), available at <http://www.lw.com/thoughtLeadership/LW-CFTC-cross-border-derivative>.

¹⁴ Under the CFTC Cross-Border Guidance, "US Person" is defined to include: (a) any natural person who is a resident of the United States; (b) any estate of a decedent who was a resident of the United States at the time of death; (c) any corporation, partnership, limited liability company (LLC), business or other trust, association, joint-stock company, fund or any form of enterprise similar to any of the foregoing (other than an entity described in (d) or (e), below) (a Legal Entity), in each case that is organized or incorporated under the laws of a state or other jurisdiction in the United States or having its principal place of business in the United States; (d) any pension plan for the employees, officers or principals of a Legal Entity described in (c), unless the pension plan is primarily for foreign employees of such Legal Entity; (e) any trust governed by the laws of a state or other jurisdiction in the United States, if a court within the United States is able to exercise primary supervision over the administration of the trust; (f) any commodity pool, pooled account, investment fund or other collective investment vehicle that is not described in (c) and that is majority-owned by one or more persons described in any of (a)-(e), except any commodity pool, pooled account, investment fund or other collective investment vehicle that is publicly offered only to non-US persons and not offered to US persons; (g) any Legal Entity (other than an LLC, limited liability partnership (LLP) or similar entity where all of the owners of the entity have limited liability) that is directly or indirectly majority-owned by one or more persons described in any of (a)-(e) and in which such person(s) bear(s) unlimited responsibility for the obligations and liabilities of the Legal Entity; and (h) any individual account or joint account (discretionary or not) where the beneficial owner (or one of the beneficial owners, in the case of a joint account) is a person described in any of (a)-(g). CFTC Cross-Border Guidance, 78 Fed. Reg. at 45316-17.

¹⁵ CFTC Cross-Border Guidance, 78 Fed. Reg. at 45320, n. 267.

¹⁶ See Proposed Rules, 80 Fed. Reg. at 41379; CFTC Cross-Border Guidance, 78 Fed. Reg. at 45318, 45359.

¹⁷ Note that while the CFTC stated in the CFTC Cross-Border Guidance that, as a general policy matter, it expected to apply the CFTC Margin Requirements as a transaction-level requirement, the Proposed Rules, if finalized, would supersede the CFTC Cross-Border Guidance as a matter of administrative law. CFTC Cross-Border Guidance, 78 Fed. Reg. at 45338-45340; see Proposed Rules, 80 Fed. Reg. at 41378, n. 14.

¹⁸ Margin Requirements for Non-Centrally Cleared Derivatives (Sept. 2013), available at <http://www.bis.org/publ/bcbs261.pdf> (BCBS-IOSCO Framework).

¹⁹ The Proposed Rules would interpret "principal place of business" in prong (iii) of the US Person definition to mean the location from which the officers, partners or managers of the Legal Entity primarily direct, control and coordinate the activities of the Legal Entity. Proposed Rules, 80 Fed. Reg. at 41383 (citing *Hertz Corp. v. Friend*, 559 U.S. 77, 80 (2010)).

²⁰ Proposed Rule 160(a)(10) (proposing amendment of 17 C.F.R. pt. 23); see Proposed Rules, 80 Fed. Reg. at 41382.

²¹ CFTC Cross-Border Guidance, 78 Fed. Reg. at 45316-17.

²² See Proposed Rule 160(a)(10) (proposing amendment of 17 C.F.R. pt. 23); Proposed Rules, 80 Fed. Reg. at 41383.

²³ See Proposed Rule 160(a)(10) (proposing amendment of 17 C.F.R. pt. 23); Proposed Rules, 80 Fed. Reg. at 41383.

²⁴ See CFTC Cross-Border Guidance, 78 Fed. Reg. at 45315, 45327-45330, 45342-45348, 45350-45353.

²⁵ Proposed Rules, 80 Fed. Reg. at 41383.

²⁶ Proposed Rules, 80 Fed. Reg. at 41383-41384. As a policy, the CFTC would consider reliance to be "reasonable" when a party to a swap transaction conducts reasonable due diligence on its swap counterparty, with what is reasonable in a particular situation to depend on the relevant facts and circumstances. *Id.*

²⁷ Proposed Rule 160(a)(2) (proposing amendment of 17 C.F.R. pt. 23); see Proposed Rules, 80 Fed. Reg. at 41384.

²⁸ Proposed Rules, 80 Fed. Reg. at 41384.

²⁹ Proposed Rule 160(a)(2) (proposing amendment of 17 C.F.R. pt. 23); see Proposed Rules, 80 Fed. Reg. at 41384.

³⁰ Proposed Rules, 80 Fed. Reg. at 41384.

³¹ Proposed Rules, 80 Fed. Reg. at 41384.

³² CFTC Cross-Border Guidance, 78 Fed. Reg. at 45320, n. 267; see Proposed Rules, 80 Fed. Reg. at 41384, n. 58.

³³ Proposed Rules, 80 Fed. Reg. at 41385-41386.

³⁴ Proposed Rule 160(a)(1) (proposing amendment of 17 C.F.R. pt. 23); see Proposed Rules, 80 Fed. Reg. at 41385.

³⁵ Proposed Rule 160(a)(6) (proposing amendment of 17 C.F.R. pt. 23); see Proposed Rules, 80 Fed. Reg. at 41385, n. 59.

³⁶ Proposed Rules, 80 Fed. Reg. at 41389; see also 17 C.F.R. §§ 23.203, 23.606.

³⁷ Proposed Rule 160(c) (proposing amendment of 17 C.F.R. pt. 23); see Proposed Rules, 80 Fed. Reg. at 41389-41390.

³⁸ Proposed Rule 160(c)(3) (proposing amendment of 17 C.F.R. pt. 23).

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- ³⁹ Proposed Rule 160(b)(1) (proposing amendment of 17 C.F.R. pt. 23); see Proposed Rules, 80 Fed. Reg. at 41386.
- ⁴⁰ Proposed Rule 160(b)(1) (proposing amendment of 17 C.F.R. pt. 23).
- ⁴¹ Proposed Rule 160(b)(1) (proposing amendment of 17 C.F.R. pt. 23).
- ⁴² Proposed Rules, 80 Fed. Reg. at 41387; see Proposed Rule 160(b)(1) (proposing amendment of 17 C.F.R. pt. 23).
- ⁴³ Proposed Rules, 80 Fed. Reg. at 41386, n. 64.
- ⁴⁴ Proposed Rule 160(b)(1) (proposing amendment of 17 C.F.R. pt. 23); see Proposed Rules, 80 Fed. Reg. at 41386.
- ⁴⁵ Proposed Rule 160(b)(2)(i), (iii) (proposing amendment of 17 C.F.R. pt. 23); see Proposed Rules, 80 Fed. Reg. at 41387, n. 65.
- ⁴⁶ Proposed Rule 160(b)(2)(iv) (proposing amendment of 17 C.F.R. pt. 23); Proposed Rules, 80 Fed. Reg. at 41387.
- ⁴⁷ Proposed Rule 160(b)(2)(ii) (proposing amendment of 17 C.F.R. pt. 23).
- ⁴⁸ Proposed Rules, 80 Fed. Reg. at 41387-41388; see Capital Requirements of Swap Dealers and Major Swap Participants, 76 Fed. Reg. 27802 (May 12, 2011), available at <http://www.gpo.gov/fdsys/pkg/FR-2011-05-12/pdf/2011-10881.pdf>.
- ⁴⁹ Proposed Rule 160(b)(2)(ii)(C) (proposing amendment of 17 C.F.R. pt. 23); Proposed Rules, 80 Fed. Reg. at 41385.
- ⁵⁰ Proposed Rules, 80 Fed. Reg. at 41388; see Proposed Rule 160(b)(2)(ii)(B) (proposing amendment of 17 C.F.R. pt. 23).