

CFTC Publishes Long-Awaited Comparability Determination for EU Margin Rules

Market participants may not, however, forego compliance with their obligation to post and/or collect margin under the CFTC Margin Rules.

On October 13, 2017, the US Commodity Futures Trading Commission (CFTC) issued a comparability determination (the CFTC EU Comparability Determination) applicable to non-prudentially regulated swap dealers and major swap participants (CFTC Swap Entities),¹ in respect of the EU's margin requirements for non-centrally cleared over-the-counter (OTC) derivatives (the EU Margin Rules).² The CFTC generally found the EU Margin Rules comparable to the CFTC's uncleared swap margin requirements (CFTC Margin Rules) in the CFTC EU Comparability Determination. However — as described in further detail below — the application of the CFTC EU Comparability Determination is limited to instances in which both sets of rules apply to the transaction in question, requiring both parties to post and/or collect margin where required under the CFTC Margin Rules. This limited application means that the CFTC EU Comparability Determination does not actually provide relief from the posting/collection requirements under the CFTC Margin Rules for those “financial end-user” counterparties which are otherwise exempt from the EU Margin Rules by virtue of qualifying as an “NFC-” for purposes of EU derivatives regulations.

Notably, the CFTC EU Comparability Determination would only affect CFTC Swap Entities and their uncleared swap counterparties. The Prudential Regulators³ have not yet published any comparability determinations with respect to the PR Margin Rules (defined below).

In addition to summarizing the CFTC EU Comparability Determination, this *Client Alert* also includes a brief overview of the European Commission's (EC's) recent equivalence decision in respect of the CFTC Margin Rules, which was likewise issued on October 13, 2017.⁴

Please refer to Latham's helpful Reference Guide for a more detailed comparison of the CFTC Margin Rules and the EU Margin Rules: [US vs. EU Margin Rules: Comparative Summary as of October 13, 2017](#).

Background

In September 2013, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO), at the direction of the Group of Twenty (G-20), published international standards for margin requirements for non-centrally cleared derivatives (the

International Standards).⁵ The International Standards were intended to reduce the opportunity for regulatory arbitrage by creating an international framework for uncleared swaps that regulators could use as a guide to frame their respective margin rules. In October 2015, the Prudential Regulators became the first financial regulators worldwide to finalize their margin requirements for uncleared derivatives transactions (the PR Margin Rules and, collectively with the CFTC Margin Rules, the US Margin Rules).⁶ The PR Margin Rules apply to uncleared swap and uncleared security-based swap transactions entered into by CFTC-registered swap dealers and major swap participants, as well as by security-based swap dealers and major security-based swap participants, in each case which are subject to regulatory oversight by the Prudential Regulators (PR Swap Entities and, collectively with CFTC Swap Entities, Swap Entities). Financial regulatory authorities worldwide have followed suit, with the EU, Canada, Japan, Switzerland, and Australia each having finalized their respective margin requirements for uncleared derivative transactions.

Shortly after the joint finalization by the Prudential Regulators of the PR Margin Rules in October 2015, the CFTC finalized the CFTC Margin Rules on December 16, 2015.⁷ Applicable to CFTC Swap Entities, the CFTC Margin Rules largely track the PR Margin Rules.

Subject to a four-year phased-in compliance schedule, CFTC Swap Entities entering into uncleared swaps with CFTC-registered swap dealers or major swap participants, or with Financial End-Users (as defined in CFTC Rule 23.151)⁸ with Material Swaps Exposure⁹ must collect and post initial margin (IM)¹⁰ and variation margin (VM)¹¹ on a daily basis. CFTC Swap Entities entering into uncleared swaps with Financial End-Users that do not have Material Swaps Exposure must collect and post daily VM, but are not required to post or collect IM.

Pursuant to the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA), certain uncleared swaps entered into with certain Exempted End-Users using such uncleared swaps to hedge or mitigate commercial risk are exempt from the US Margin Rules.¹²

Cross-Border Application of CFTC Margin Rules

The CFTC finalized regulations addressing the cross-border application of the CFTC Margin Rules in May 2016 (the CFTC Cross-Border Margin Rules).¹³ The CFTC Cross-Border Margin Rules subject all uncleared swap transactions entered into by US CFTC Swap Entities to the CFTC Margin Rules, as well as certain uncleared swaps entered into by non-US CFTC Swap Entities where the risk flows back to a US entity. Under the CFTC Cross-Border Margin Rules, an uncleared swap entered into by a non-US CFTC Swap Entity with a non-US Person¹⁴ counterparty is excluded from the CFTC Margin Rules (the Exclusion), provided that both of the following conditions are met:

- Neither counterparty's obligations under the uncleared swap are guaranteed by a US Person (where a guarantee is defined broadly to capture any arrangement pursuant to which one party to the uncleared swap with a non-US Person counterparty has rights of recourse against a US Person guarantor with respect to the non-US Person counterparty's relevant uncleared swap obligations)
- Neither counterparty is (i) an FCS (defined below), nor (ii) a US branch of a non-US CFTC Swap Entity

The Exclusion is not available for certain inter-affiliate uncleared swaps. A non-US CFTC Swap Entity would be a "Foreign Consolidated Subsidiary" (an FCS) under the CFTC Cross-Border Margin Rules if its financial statements are included in those of an ultimate parent entity (*i.e.*, 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 US generally accepted accounting principles (GAAP)) that is a US Person, regardless

of whether such US ultimate parent entity guarantees the non-US CFTC Swap Entity's obligations under the relevant uncleared swap transaction.

The CFTC Cross-Border Margin Rules diverge from the cross-border application of the PR Margin Rules in a number of instances. Notably, if a non-US Financial End-User with no US Person guarantee of its relevant uncleared swap obligations is ineligible for the Exclusion due to the identity of its CFTC Swap Entity counterparty (or the CFTC Swap Entity counterparty's guarantor), substituted compliance may nonetheless be available with respect to such non-US Financial End-User's uncleared swaps with either (i) US CFTC Swap Entities or (ii) non-US CFTC Swap Entities with a US Person guarantee of their relevant uncleared swap obligations. Substituted compliance, however, is only available with respect to the CFTC Swap Entity's posting of IM to the non-US Financial End-User (*i.e.*, not with respect to the CFTC Swap Entity's collection of IM from the non-US Financial End-User or the posting / collection of VM). The effect of this provision is that such a substituted compliance determination would not benefit non-US Financial End-Users without Material Swaps Exposure because such entities would not otherwise be subject to the IM posting/collection requirements under the CFTC Margin Rules.

The CFTC issued its first substituted compliance determination under the CFTC Cross-Border Margin Rules in September 2016, with respect to the Japanese Margin Rules¹⁵ (CFTC Japanese Comparability Determination).¹⁶ More than a year later, the CFTC has issued its second substituted compliance determination under the CFTC Cross-Border Margin Rules — this time with respect to the EU Margin Rules (*i.e.*, the CFTC EU Comparability Determination).¹⁷ The table below summarizes the CFTC's two comparability determinations thus far in respect of the CFTC Margin Rules.

Summary of Comparability Determinations Under the CFTC Margin Rules

	EU Margin Rules	Japanese Margin Rules
CFTC Margin Rules		
Covered Products (CFTC Rule § 23.151) ¹⁸	* See Note 1 (below)	* See Note 3 (below)
Covered Entities + Counterparties (CFTC Rule § 23.152) ¹⁹	* See Note 2 (below)	* See Note 3 (below)
Treatment of Inter-Affiliate Transactions (CFTC Rule 23.159) ²⁰	Comparable	Not Comparable ²¹
Margin Calculation Methodologies (CFTC Rules 23.154, 23.155) ²²	Comparable	Comparable
IM Model Approval Processes/Standards (CFTC Rule 23.154(b)) ²³	Comparable	Comparable
Timing + Manner for Collection/Payment (CFTC Rules 23.152, 23.153) ²⁴	Comparable	Comparable
IM Thresholds (CFTC Rule 23.154(a)(3)) ²⁵	Comparable	Comparable
Risk Management Controls for IM/VM Calculation (CFTC Rule 23.154(b)(5)) ²⁶	Comparable	Comparable
Eligible Collateral (CFTC Rule 23.156) ²⁷	Comparable	Comparable
Custodial Arrangements, Segregation, and Rehypothecation (CFTC Rule 23.157) ²⁸	Comparable	Comparable
Margin Documentation (CFTC Rule 23.158) ²⁹	Comparable	Comparable
Cross-Border Application (CFTC Rule 23.160) ³⁰	Comparable	Comparable
Supervision + Enforcement	Comparable	Comparable

Note 1: Covered Products

CFTC Margin Rules

The CFTC Margin Rules apply to uncleared swaps entered into on or after the relevant compliance date, except that physically-settled foreign exchange (FX) forwards and FX swaps, as well as the fixed, physically-settled exchange of principal in cross-currency swaps³¹ (collectively, FX Products) are exempt from the CFTC Margin Rules.

EU Margin Rules

The EU Margin Rules apply to non-centrally cleared OTC derivatives (uncleared OTC derivatives) entered into on or after the relevant compliance date, except that:

- FX Products are exempt from the IM requirements under the EU Margin Rules.

- Hedging swaps related to regulated covered bonds (Covered Bond Swaps) are exempt from both IM and VM requirements under the EU Margin Rules.

CFTC Comparability Determination

While it was expressly “beyond the scope of” the CFTC EU Comparability Determination “to definitively map any differences between the definitions of ‘swap’ and ‘uncleared swap’ under the [Commodity Exchange Act] and [CFTC] regulations[,] and the EU’s definitions of ‘OTC derivative’ and ‘non-centrally cleared OTC derivative,’” and notwithstanding the CFTC’s statement that “such definitions largely cover the same products and instruments[,]” the CFTC expressly recognized that there are circumstances in which a CFTC Swap Entity may enter into a transaction that is an “uncleared swap” for purposes of the CFTC Margin Rules, but which is not a “non-centrally cleared OTC derivative” for purposes of the EU Margin Rules (or vice versa). With respect to such transactions, the CFTC stated that “the [CFTC Margin Rules] would apply to the transaction but the EU’s margin rules would not apply and thus, substituted compliance would not be available.”³²

Said differently, the CFTC Margin Rules would continue to apply to a CFTC Swap Entity’s uncleared swap transactions, notwithstanding the fact that any of those uncleared swaps would be exempt or otherwise fall outside the scope of the EU Margin Rules. In such circumstances, the parties must comply with the applicable IM / VM posting/collection requirements for such uncleared swaps under the CFTC Margin Rules.

Note 2: Covered Entities + Counterparties

CFTC Margin Rules

The CFTC Margin Rules apply to CFTC Swap Entities, in respect of their uncleared swaps with either (i) other Swap Entities or (ii) Financial End-Users. The CFTC EU Comparability Determination is expressly limited to CFTC Swap Entities, meaning that PR Swap Entities must await a comparability determination from the Prudential Regulators before they may substitute compliance with the EU Margin Rules under the PR Margin Rules.³³

EU Margin Rules

The EU Margin Rules apply to uncleared OTC derivatives entered into between any of the following types of counterparties: (i) Financial Counterparties (FCs);³⁴ (ii) Non-Financial Counterparties above the clearing thresholds (NFC+);³⁵ and (iii) third-country entities (TCEs) that would be FC or NFC+ if established in the EU (TCEs (FC/NFC+)).³⁶

CFTC Comparability Determination

The CFTC expressly noted in the CFTC EU Comparability Determination that there may be gaps between the counterparties captured under the CFTC Margin Rules, as opposed to under the EU Margin Rules:

Given the definitional differences and differences in activity thresholds with respect to the scope of application of the [CFTC] Margin Rule[s] and the EU’s margin requirements, the Commission notes the possibility that the [CFTC] Margin Rule[s] and the EU’s margin rules may not apply to every uncleared swap that a [CFTC Swap Entity] may enter into with a[n] EU counterparty. For example, it appears possible that a financial end user with “material swaps exposure” would meet the definition of “covered counterparty” under the [CFTC] Margin Rule[s] (and thus the initial and variation margin requirements) while at the same time fall under the EU’s clearing threshold (an NFC-) and not be subject [to] the EU margin requirements. It may also be possible that the [CFTC] Margin [Rules’]

definition of “financial end-user” could capture an entity that is an NFC under the EU’s margin regime.

With these differences in scope in mind, the Commission reiterates that no [CFTC Swap Entity] may rely on substituted compliance unless it and its transaction are subject to both the [CFTC] Margin Rule[s] and the EU’s margin rules; a [CFTC Swap Entity] may not voluntarily comply with the EU’s margin rules where such law does not otherwise apply. Likewise, a [CFTC Swap Entity] that is not seeking to rely on substituted compliance should understand that the EU’s margin rules may apply to its counterparty irrespective of the [CFTC Swap Entity]’s decision to comply with the [CFTC] Margin Rule[s].³⁷

Said differently, the CFTC Margin Rules would continue to apply to a CFTC Swap Entity’s in-scope trades with its Financial End-User counterparties, notwithstanding the fact that any of those counterparties are NFC- for purposes of the EU Margin Rules. In such circumstances, the parties must comply with the applicable IM/VM posting and collection requirements under the CFTC Margin Rules.

Note 3: Japanese Margin Rules

Covered Products

The Japanese Margin Rules apply to uncleared OTC derivatives entered into on or after the relevant compliance date, other than the following exempted products:

- Physically-settled FX forwards and FX swaps; provided that the fixed, physically-settled exchange of principal in cross-currency swaps are only exempt from the IM requirements under the Japanese Margin Rules
- OTC Commodity Derivatives (except with respect to Japanese Covered Entities (defined below) with Specified OTC Commodities Licenses)³⁸

As with the EU Margin Rules, the CFTC expressly noted in the CFTC Japanese Comparability Determination that there may be gaps between the products captured under the CFTC Margin Rules, as opposed to under the Japanese Margin Rules. Per the CFTC Japanese Comparability Determination, the CFTC Margin Rules would continue to apply to a CFTC Swap Entity’s uncleared swap transactions, notwithstanding the fact that any of those uncleared swaps would be exempt or otherwise fall outside the scope of the Japanese Margin Rules. In such circumstances, the parties must comply with the applicable IM/VM posting and collection requirements for such uncleared swaps under the CFTC Margin Rules.³⁹

Covered Entities + Counterparties

The Japanese Margin Rules apply to uncleared OTC derivatives entered into between any of the following types of counterparties, in each case which have an OTC Derivatives Notional⁴⁰ of at least ¥300 billion: (i) Type 1 Financial Instruments and Business Operators (FIBOs);⁴¹ (ii) Registered Financial Institutions;⁴² and (iii) certain Japanese governmental banking entities (collectively, Japanese Covered Entities).⁴³

As with the EU Margin Rules, the CFTC expressly noted in the CFTC Japanese Comparability Determination that there may be gaps between the counterparties captured under the CFTC Margin Rules, as opposed to under the Japanese Margin Rules. Per the CFTC Japanese Comparability Determination, the CFTC Margin Rules would continue to apply to a CFTC Swap Entity’s in-scope trades with its Financial End-User counterparties, notwithstanding the fact that any of those counterparties may

not be Japanese Covered Entities. In such circumstances, the parties must comply with the applicable IM/VM posting and collection requirements for such uncleared swaps under the CFTC Margin Rules.⁴⁴

EU Equivalence Decision

Concurrent with the publication of the CFTC EU Comparability Determination on October 13, 2017, the EC published its own decision recognizing equivalence of the CFTC Margin Rules in respect of the EU Margin Rules. Note that the PR Margin Rules were outside the scope of the EC's equivalence decision. Accordingly, compliance by CFTC Swap Entities with the CFTC Margin Rules (but not by PR Swap Entities with the PR Margin Rules) in respect of uncleared OTC derivative transactions that are subject to margin requirements under both the EU Margin Rules and the CFTC Margin Rules, and to which the CFTC Swap Entity counterparty is established in the United States, shall constitute compliance with the EU Margin Rules, effective November 3, 2017.

Covered Products

The EC qualified its equivalence decision with respect to the CFTC Margin Rules, providing that:

The requirements of the [CFTC Margin Rules] apply to swaps, which encompass almost all contracts defined as OTC derivatives in Regulation (EU) No 648/2012 with the exception of foreign exchange forwards and foreign exchange swaps, for which the [CFTC Margin Rules] set[] no requirements. In addition, CFTC Regulations do not contain any specific treatment for structured products including covered bonds and securitisations. In the Union, foreign exchange swaps and foreign exchange forwards are exempted from the initial margins requirements, and derivatives associated with covered bonds for hedging purposes may also be exempted from initial margin requirements. This Decision should therefore only apply to OTC derivatives that are subject to margins under both the [EU Margin Rules] and the CFTC [Margin Rules].⁴⁵

Said differently, the EU Margin Rules will continue to apply to uncleared cross-border OTC derivative transactions as between FC, NFC+, and/or TCE (FC/NFC+) counterparties where such transactions are subject to the EU Margin Rules, notwithstanding the fact that such transactions (e.g., FX Products) may be exempt or otherwise fall outside the scope of the CFTC Margin Rules. In such circumstances, the parties must comply with the applicable IM/VM posting and/or collection requirements, as applicable, for such uncleared OTC derivative transactions under the EU Margin Rules.

Covered Entities + Counterparties

The EC limited its equivalence decision to the CFTC Margin Rules and entities subject to such rules (*i.e.*, CFTC Swap Entities and their counterparties), providing that:

[T]he legal, supervisory and enforcement arrangements . . . for the exchange of collateral that are applied to transactions regulated as 'swaps' by the [CFTC] in accordance with section 721(a)(21) of the Dodd-Frank Act and that are not cleared by a CCP shall be considered as equivalent to the requirements of Article 11(3) of Regulation (EU) No 648/2012, where at least one of the counterparties to those transactions is established in the USA and registered with the CFTC as a swap dealer or major swap participant, and that counterparty is subject to the [CFTC Margin Rules].⁴⁶

As such, PR Swap Entities and their counterparties are outside the scope of the EU equivalence decision.

Conclusion

While these comparability determinations champion regulatory efficiency and allow parties to benefit from the less restrictive regulatory regime, it is important to note that the CFTC's substituted compliance determinations are limited to only those circumstances in which both the CFTC Margin Rules and the relevant foreign regulatory regime (*i.e.*, the EU Margin Rules or the Japanese Margin Rules, as applicable) would each require the posting and/or collection of margin under the relevant transaction. As such, parties should carefully analyze the impact of the CFTC's comparability determinations on their particular trading relationships to understand where they may benefit from substituted compliance under the CFTC Margin Rules.

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Endnotes

- ¹ A swap dealer or major swap participant is "prudentially regulated" if it is subject to regulatory oversight by the Prudential Regulators (defined below).
- ² Comparability Determination for the European Union: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 82 Fed. Reg. 48394 (Oct. 18, 2017), available at <https://www.gpo.gov/fdsys/pkg/FR-2017-10-18/pdf/2017-22616.pdf> (CFTC EU Comparability Determination).
- ³ The term "Prudential Regulators" as used herein means: (i) the Office of the Comptroller of the Currency (Department of Treasury); (ii) the Board of Governors of the Federal Reserve System (FRB); (iii) the Federal Deposit Insurance Corporation; (iv) the Farm Credit Administration (FCA); and (v) the Federal Housing Finance Agency (FHFA). 7 U.S.C. § 1a(39).
- ⁴ See Commission Implementing Decision (EU) 2017/1857 of 13 October 2017 on the recognition of the legal, supervisory and enforcement arrangements of the United States of America for derivative transactions supervised by the Commodity Futures Trading Commission as equivalent to certain requirements of Article 11 of Regulation (EU) No 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories, 2017 O.J. (L 265) (Oct. 14, 2017), available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017D1857&from=EN> (EU Equivalence Decision).
- ⁵ Margin Requirements for Non-Centrally Cleared Derivatives (updated March 2015), available at <http://www.bis.org/bcbs/publ/d317.pdf>.
- ⁶ Margin and Capital Requirements for Covered Swap Entities, 80 Fed. Reg. 74840 (Nov. 30, 2015), available at <https://www.gpo.gov/fdsys/pkg/FR-2015-11-30/pdf/2015-28671.pdf>. For further discussion, please refer to Latham's *Client Alert* regarding the PR Margin Rules. Prudential Regulators Are First to Finalize Uncleared Swap Margin Rules, *Client Alert* No. 1896 (Nov. 20, 2015), available at <https://www.lw.com/thoughtLeadership/LW-prudential-regulators-finalize-uncleared-swap-margin-rules>.
- ⁷ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-01-06/pdf/2015-32320.pdf>. For further discussion, please refer to Latham's *Client Alert* regarding the CFTC Margin Rules. CFTC Uncleared Swap Margin Rules to Take Effect in September, *Client Alert* No. 1928 (Feb. 19, 2016), available at <https://www.lw.com/thoughtLeadership/lw-cftc-uncleared-swap-margin-september>.
- ⁸ The CFTC Margin Rules define "Financial End-Users" to include the following counterparties:
 - Bank holding companies (or Margin Affiliates thereof)
 - Savings and loan holding companies
 - Certain US intermediate holding companies
 - Certain nonbank financial institutions supervised by the FRB
 - Depository institutions
 - Foreign banks
 - Federal or state credit unions
 - Certain institutions functioning solely in a trust or fiduciary capacity
 - Industrial loan companies, industrial banks, or similar institutions
 - State-licensed or registered credit or lending entities
 - State-licensed or registered money services businesses
 - Entities regulated by the FHFA
 - Institutions regulated by the FCA

- Securities holding companies
- Brokers or dealers
- Investment advisers
- Registered investment companies, certain securitization vehicles, or private real estate investment entities
- Registered security-based swap dealers or major security-based swap participants
- Business development companies
- Private funds relying on Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act; mortgage-related funds (including some REITs) relying on Section 3(c)(5)(C) of the Investment Company Act; and issuers of asset-backed securities relying on Rule 3a-7 under the Investment Company Act
- Commodity pools, commodity pool operators, or commodity trading advisors
- Floor brokers, floor traders, or introducing brokers
- Futures commission merchants
- Employee benefit plans
- Insurance companies or other entities primarily engaged in writing insurance or reinsuring risks underwritten by insurance companies or that are otherwise subject to supervision as an insurance company by an insurance regulator
- Entities, persons or arrangements that are, or hold themselves out as being, an entity, person or arrangement that raises money from investors, accepts money from clients or uses its own money primarily for purposes of investing or trading, or facilitating the investing or trading, in loans, securities, swaps, funds, or other assets
- Foreign entities that would be considered Financial End-Users or Swap Entities if they were organized in the United States

The term Financial End-User expressly excludes any counterparty that is:

- A sovereign entity
- A multilateral development bank
- The Bank for International Settlements
- An entity that is exempt from the definition of “financial entity” under the Commodity Exchange Act
- An affiliate that qualifies for the inter-affiliate exemption from clearing
- An eligible treasury affiliate expressly exempted from the CFTC Margin Rules (*i.e.*, one qualifying under the Interim Final Rule) — note that the PR Margin Rules do not expressly exclude eligible treasury affiliates from the “Financial End-User” definition therein

17 C.F.R. 23.151; see 12 U.S.C. §§ 1752(1), (6), 1841(c)(2)(D), (c)(2)(H), 2001 *et seq.*, 4502(20), 5323; 15 U.S.C. §§ 78a *et seq.*, 80a-1 *et seq.*, 80a-3, 80a-53(a), 80b-2(a); 29 U.S.C. § 1002; 12 C.F.R. § 252.153; 17 C.F.R. § 270.3a-7.

⁹ The CFTC Margin Rules define “Material Swaps Exposure” to mean an average daily aggregate notional amount of uncleared swaps, uncleared security-based swaps, FX forwards and FX swaps with all counterparties for June, July and August of the previous calendar year that exceeds US\$8 billion (calculated only for business days and aggregated with the Financial End-User’s Margin Affiliates)

For purposes of the CFTC Margin Rules, a company is considered a “Margin Affiliate” of another company under any of the following conditions:

- Either company consolidates the other on financial statements prepared in accordance with US Generally Accepted Accounting Principles, the International Financial Reporting Standards or other similar standards (referred to collectively herein as Accounting Standards).
- Both companies are consolidated with a third company on a financial statement prepared in accordance with Accounting Standards.
- For a company that is not subject to Accounting Standards, such consolidation would have occurred if such Accounting Standards had applied.

See 17 C.F.R. § 23.151.

¹⁰ “Initial margin” is defined in the CFTC Margin Rules to mean collateral as calculated in accordance with a permitted IM model that is posted or collected in connection with one or more uncleared swaps. 17 C.F.R. § 23.151.

¹¹ “Variation margin” is defined in the CFTC Margin Rules to mean collateral provided by a party to its counterparty to meet the performance of its obligation under one or more uncleared swaps between the parties as a result of a change in value of such obligations since the trade was executed or the last time such collateral was provided. 17 C.F.R. § 23.151.

¹² “Exempted End-Users” refers to the following types of counterparties using uncleared swaps to hedge or mitigate commercial risk:

- (i) Commercial end-users, including treasury affiliates (that do not otherwise qualify as Financial End-Users) acting as agent

(ii) Financial institutions (*i.e.*, small banks, savings associations, Farm Credit System institutions, credit unions) with total assets of US\$10 billion or less, and certain financial cooperatives hedging the risks associated with originating loans for their members

(iii) Captive finance companies

See 17 C.F.R. § 23.150(b); *see also* 7 U.S.C. § [2(h)(1)(A), 2(h)(7)(A), 2(h)(7)(D), 4(c)(1)].

¹³ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements, 81 Fed. Reg. 34818 (May 31, 2016), *available at* <https://www.gpo.gov/fdsys/pkg/FR-2016-05-31/pdf/2016-12612.pdf>. For further discussion, please refer to Latham's *Client Alert* regarding the CFTC Cross-Border Margin Rules in proposed form. CFTC Proposes Cross-Border Application of Margin Requirements for Uncleared Swaps, *Client Alert* No. 1865 (Aug. 13, 2015), *available at* <https://www.lw.com/thoughtLeadership/lw-CFTC-Cross-Border-Application-Uncleared-Swaps>.

¹⁴ "US Person" is defined in the CFTC Cross-Border Margin Rules to mean:

(i) A natural person who is a resident of the United States

(ii) An estate of a decedent who was a resident of the United States at the time of death

(iii) A corporation, partnership, limited liability company (an 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 that has its principal place of business in the United States, including any branch of such legal entity

(iv) A 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) A trust governed by the laws of a state or other jurisdiction of the United States, if a court within the United States is able to exercise primary supervision over the administration of the trust

(vi) A legal entity (other than an LLC, limited liability partnership or similar entity where all of the owners of the entity have limited liability) that is owned by one or more persons described in (i)-(v) above and for which such person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity, including any branch of the legal entity

(vii) An 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 (i)-(vi) above.

17 C.F.R. § 23.160(a)(10). The CFTC Cross-Border Margin Rules align with the cross-border application of the PR Margin Rules in most respects. Notably, however, differences in the determination of what constitutes a US Person may lead to different outcomes as between the two sets of uncleared swap margin rules.

¹⁵ "Japanese Margin Rules" refers to the margin requirements for uncleared OTC derivatives under the following instruments promulgated by the Japan Financial Services Agency (JFSA): (i) Cabinet Office Ordinance on Financial Instruments Business (Cabinet Office Ordinance No. 52 of August 6, 2007) (*kinyu syohin torihiki gyo tou ni kansuru naikakuhurei*), including supplementary provisions; (ii) various supervisory guidelines; and (iii) JFSA Public Notification No. 15 of March 31, 2016, JFSA Public Notification No. 16 of March 31, 2016 and JFSA Public Notification No. 17 of March 31, 2016. *See* Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 63376, 63378 (Sept. 15, 2016), *available at* <https://www.gpo.gov/fdsys/pkg/FR-2016-09-15/pdf/2016-22045.pdf> (CFTC Japanese Comparability Determination).

Japan has separate margin rules for OTC Commodity Derivatives (defined below) that are administered by the Japanese Ministry of Economy, Trade and Industry (METI) and the Japanese Ministry of Agriculture, Forestry and Fisheries (MAFF), which were finalized on August 1, 2016. While the respective margin rules for OTC Derivatives and OTC Commodity Derivatives are separate, the METI/MAFF uncleared OTC Commodity Derivatives margin rules incorporate the corresponding Japanese Margin Rules by reference, and are captured by the CFTC Japanese Comparability Determination. *See* CFTC Japanese Comparability Determination, 81 Fed. Reg. at 63380.

¹⁶ *See* CFTC Japanese Comparability Determination.

¹⁷ "EU Margin Rules" refers to the delegated regulation that specifies margin requirements for uncleared OTC derivatives adopted by the EC on October 4, 2016 and published in the Official Journal of the European Union (EU Journal) on December 15, 2016. The EU Margin Rules entered into force on January 4, 2017 (*i.e.*, 20 days after their publication in the EU Journal). Commission Delegated Regulation (EU) 2016/2251 of 4 October 2016 Supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC Derivatives, Central Counterparties and Trade Repositories with Regard to Regulatory Technical Standards for Risk-Mitigation Techniques for OTC Derivative Contracts Not Cleared by a Central Counterparty, 2016 O.J. (L 340) 39 (Dec. 15, 2016), *available at* <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R2251&from=EN>.

¹⁸ 17 C.F.R. § 23.151.

¹⁹ 17 C.F.R. § 23.152.

²⁰ 17 C.F.R. § 23.159.

²¹ While the CFTC Margin Rules require the collection and posting of VM and, in certain cases, the collection of IM between consolidated affiliates, the Japanese Margin Rules do not require collection or posting of IM or VM between consolidated

affiliates. Accordingly, the CFTC determined that the outcomes of the requirements applicable to inter-affiliate derivatives under the Japanese Margin Rules are not applicable to the corresponding requirements under the CFTC Margin Rules; CFTC Swap Entities must therefore comply with the CFTC Margin Rules with respect to inter-affiliate swaps, notwithstanding they otherwise would be able to avail themselves of substituted compliance under the CFTC Japanese Comparability Determination. See CFTC Japanese Comparability Determination, 81 Fed. Reg. at 63382.

22 17 C.F.R. §§ 23.154, 23.155.

23 17 C.F.R. § 23.154(b).

24 17 C.F.R. §§ 23.152, 23.153.

25 17 C.F.R. § 23.154(a)(3).

26 17 C.F.R. § 23.154(b)(5).

27 17 C.F.R. § 23.156.

28 17 C.F.R. § 23.157.

29 17 C.F.R. § 23.158.

30 17 C.F.R. § 23.160.

31 "Cross-currency swap" is defined in the CFTC Margin Rules to mean 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 on the date the swap is entered into, with a reversal of the exchange of principal at a later date that is agreed upon when the swap is entered into. 17 C.F.R. § 23.151.

32 See CFTC EU Comparability Determination, 82 Fed. Reg. at 48397-48398.

33 See CFTC EU Comparability Determination, 82 Fed. Reg. at 48398.

34 "Financial Counterparties" refers to investment firms, credit institutions, insurance undertakings, assurance undertakings, reinsurance undertakings, undertakings for collective investments in transferrable securities (UCITS) and their managers, institutions for occupational retirement provision and alternative investment funds managed by alternative investment fund managers (AIFMs) (in each case, authorized pursuant to relevant EU directives).

35 "Non-Financial Counterparties" refers to an undertaking established in the EU other than an FC or a central counterparty. NFCs are divided into the categories of NFC+ or NFC-, depending on whether they are above or below the clearing threshold.

The "clearing threshold" is €1 billion for each of credit and equity derivatives and €3 billion for each of interest rate, FX, commodity and other derivatives. Contracts objectively measurable as reducing risks relating to commercial and treasury financing activity are excluded from these clearing threshold calculations.

36 Trades between two TCEs (FC/NFC+) are in-scope if either (i) there is a "direct, substantial and foreseeable effect" within the EU or (ii) the application of margin-related obligations is necessary to prevent evasion of EMIR.

37 CFTC EU Comparability Determination, 82 Fed. Reg. at 48398-48399 (emphasis added).

38 Japanese Covered Entities with Specified OTC Commodities License must treat OTC Commodity Derivatives as in-scope under the Japanese Margin Rules.

"OTC Commodity Derivative" as used in the Japanese Margin Rules has the meaning assigned to such term in Article 2, Paragraph 14 of the Commodity Derivatives Act (Act No. 239 of August 5, 1950).

"Specified OTC Commodities License" has the meaning assigned to such term in the Japanese Margin Rules.

39 See CFTC Japanese Comparability Determination, 81 Fed. Reg. at 63379-63380.

40 "OTC Derivatives Notional" refers to the average total amount of notional principal of uncleared OTC derivatives (limited to those which are subject to the mandatory reporting requirements under the Financial Instruments and Exchange Act, No. 25 of 1948 (FIEA)) calculated over a one-year period beginning on the first business day of April of the year immediately preceding the previous year, and ending on the last day of March of the previous year (or, if the relevant reference date is in December of a given year, a one-year period beginning on the first business day of April of the previous year, and ending on the last day of March of the relevant year). In determining whether a market participant is below the ¥300 billion threshold, the OTC Derivatives Notional calculation excludes physically-settled FX forwards and FX swaps, but includes the fixed, physically-settled exchange of principal in cross-currency swaps. With respect to uncleared OTC derivatives transactions to which a trust account is party, the OTC Derivatives Notional is separately calculated for each individual trust account. See CFTC Japanese Comparability Determination, 81 Fed. Reg. at 63381.

41 "Type 1 FIBO" refers to Type 1 Financial Instruments and Business Operators registered under FIEA. Pursuant to Article 29 of FIEA, any person that engages in trade activities that constitute "Financial Instruments Business" (e.g., uncleared OTC derivatives, or intermediary, brokerage (excluding brokerage for securities clearing) or agency services therefor) must register as a FIBO under FIEA.

42 "Registered Financial Institution" or "RFI" refers to banks that conduct specified activities in the course of trade, including uncleared OTC derivatives, which are required to be registered pursuant to Article 33-2 of FIEA.

43 Specifically, Japanese Covered Entities include Type 1 FIBOs, RFIs (including insurance companies and trust accounts that are RFIs), as well as Shoko Chukin Bank, the Development Bank of Japan, Shinkin Central Bank, and the Norinchukin Bank. See CFTC Japanese Comparability Determination, 81 Fed. Reg. at 63381.

⁴⁴ See CFTC Japanese Comparability Determination, 81 Fed. Reg. at 63380-63381.

⁴⁵ EU Equivalence Decision, 2017 O.J. (L 265) 25.

⁴⁶ EU Equivalence Decision, 2017 O.J. (L 265) 26-27 (emphasis added).