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Questions and Answers Concerning the Final Prudential Regulator Margin Rules for Non-Cleared Swaps

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BACKGROUND

The five US prudential regulators for swaps (the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve, the Comptroller of the Currency, the Farm Credit Administration and the Federal Housing Finance Agency) have each adopted (1) a final margin rule, and (2) an interim final margin rule (collectively, the "Rules") that set mandatory margin requirements for swap dealers, security-based swap dealers, major swap participants and major security-based swap participants (each, a "Swap Entity" or "SE") that are regulated by those agencies with respect to swaps and security-based swaps that are not cleared with a derivatives clearing organization or clearing agency.[i] The Rules take the form of a common text that has been adopted by each regulator with changes specific to that regulator so that, for instance, the authority provisions, the definition of covered swap entity and relevant cross-references are different for each regulator.

As a supplement to our November 10 advisory describing the highlights of the Rules (available here), this advisory provides more detailed information about the Rules.

QUESTIONS AND ANSWERS

1. What is the subject of the Rules?

The Rules are entitled "Margin and Capital Requirements For Covered Swap Entities", but deal only with margin for non-cleared swaps.[ii] (The prudential regulators all have recently adopted revised capital rules for the entities they regulate and are not adding any additional capital rules at this time.)

2. Why did the regulators issue both a final rule and an interim final rule?

The Rules have been issued in two parts because Section 303 of the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA) requires that the agencies implementing the exemption from the margin rules established by that law (the "TRIPRA Exemption") must do so by promulgating an interim final rule that is subject to public comment. There is no such requirement for any other part of the rules relating to margin.

[i] The text of the Rules common to all the agencies can be found at https://www.fdic.gov/news/news/press/2015/pr15081.html. The text has not yet been published in the Federal Register.

[ii] As a noteworthy matter of terminology, the CFTC and the SEC refer to non-cleared swaps in their proposed rules as "uncleared swaps."

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3. Which entities are subject to the Rules?

The Rules only apply to Swap Entities (each, a "Covered Swap Entity" or CSE) that have a "prudential regulator" (as defined in the Commodity Exchange Act (CEA)). As evidenced by the list of prudentially regulated entities (see Exhibit A), all CSEs are banks or regulated financial institutions. (The Rules do not apply to all affiliates of such entities that are SEs, but this point is not particularly significant since any affiliate of a CSE that is an SE will be subject to substantially similar margin rules promulgated by the Commodity Futures Trading Commission (CFTC) or the Securities and Exchange Commission (SEC), as the case may be.) Since the Rules dictate the behavior of CSEs toward financial end users, however, they indirectly affect those entities as well since a CSE will not be able to execute swaps with any financial end user that does not agree to allow the CSE to impose margin in accordance with the Rules.

4. What types of swaps are subject to the Rules?

The Rules apply to all non-cleared swaps of a CSE without regard to the particular registration that makes the relevant entity a CSE. They consequently apply to both the swaps and security-based swaps of a CSE, even if the CSE is a registrant with respect to only one of those two types of derivatives.

5. What is the basic approach of the Rules to calculating margin?

The margin requirements for a particular non-cleared swap or security-based swap are determined by the regulatory categorization of the two counterparties (see Exhibit B).

If the transaction is between (1) two CSEs, (2) a CSE and a Swap Entity, or (3) a CSE and a "financial end user" with "material swaps exposure", it is subject to mandatory initial margin (IM) and variation margin (VM) requirements.

If the transaction is between a Covered Swap Entity and a financial end user (FEU) that does not have a material swaps exposure, VM applies, but not IM.

The Rules do not set mandatory margin requirements for any counterparty (a "non-financial end user") to a CSE that is not a CSE, SE or a financial end user, but they do require a CSE to collect margin to the extent that "the covered swap entity determines will appropriately address the credit risk posed by the counterparty."

6. Are any swaps exempt from the Rules?

Yes. As a result of TRIPRA, the Rules do not apply to any non-cleared swap or security-based swap if the counterparty is:

(1) a non-financial entity (including small financial institution and a captive finance company) that qualifies for the clearing exception under section 2(h)(7)(A) of the Commodity Exchange Act or section 3C(g)(1) of the Securities Exchange Act;

(2) a cooperative entity that qualifies for an exemption from the clearing requirements issued under section 4(c)(1) of the Commodity Exchange Act; or

(3) a treasury affiliate acting as agent that satisfies the criteria for an exception from clearing in section 2(h)(7)(D) of the Commodity Exchange Act or section 3C(g)(4) of the Securities Exchange Act.

The TRIPRA Exemption is superfluous for non-financial end users since the Rules do not apply at all to such entities, but it is potentially very significant for any FEU (such as a financial institution with $10 billion or less in total assets) that is currently entitled to claim one of the identified exemptions from mandatory clearing. Moreover, the TRIPRA Exception applies to swaps that are not yet subject to mandatory clearing so it is available for any swap for which a party would be entitled to claim an exemption if mandatory clearing did apply.

7. How is affiliation determined?

Affiliation is now a function of financial consolidation, so a company is an affiliate of another company if:

(1) either company consolidates the other on financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles, the International Financial Reporting Standards, or other similar standards;

(2) both companies are consolidated with a third company on a financial statement prepared in accordance with such principles or standards; or

(3) for a company that is not subject to such principles or standards, if consolidation as described in paragraph (a) or (b) of this definition would have occurred if such principles or standards had applied.

As a result of this definitional approach, it is unlikely that separate funds in a fund complex will be treated as affiliated entities for purposes of the Rules.

8. What is a "financial end user"?

The definition of "financial end user" (see Exhibit C) is similar to, but intended to be more objective than, the definition of "financial entity" in the CEA because it lists the specific types of entities that are included and intentionally omits the catch-all for persons "predominantly engaged in" banking or financial activities that is found in the latter definition. However, the definition contains a new catch-all that picks up any collective investment vehicle or proprietary trader (i.e., any entity that is, or holds itself out as being, an entity, person, or arrangement that raises money from investors, accepts money from clients, or uses its own money primarily for the purpose of investing or trading or facilitating the investing or trading 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 Rules include an explicit exemption from the definition of "financial end user" (and thus from the Rules) for sovereign entities (but not states and municipalities), multilateral development banks (such as the World Bank), captive finance companies and The Bank for International Settlements.

If a counterparty to a CSE is a non-US person, the CSE nevertheless must determine if the counterparty would be an FEU if it was organized in the United States.

9. How is "material swaps exposure" measured?

"Material swaps exposure" or "MSE" for a financial end user means that the FEU 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 ("Included Transactions") with all counterparties for June, July and August of the previous calendar year that exceeds $8 billion, where such amount is calculated only for business days.[iii] If an FEU has a material swaps exposure based on a calculation for June, July and August in a given year (Year 1), it will not become an FEU "with material swaps exposure" until January 1 of the next calendar year (Year 2), but it will be considered to have a material swaps exposure for the whole of Year 2 even if its notional amount of swaps is equal to or less than the threshold when tested for June, July and August in Year 2. Every FEU must do its first calculation of MSE for June, July and August of 2015. The threshold for material swaps exposure was increased to $8 billion from $3 billion in the proposed rules.

If an FEU comes to have an MSE, the new rules only apply to swaps executed with the FEU after the change in status. If an FEU ceases to have material swaps exposure, it ceases to be subject to mandatory IM for any swaps.

[iii] The "material swaps exposure" terminology is fundamentally misleading since it is not actually a measure of (a) materiality (because the threshold does not vary based on the size of the entity), (b) swap activity (because it looks at foreign exchange swaps and forwards in addition to swaps), or (c) exposure (because it looks at notional amounts rather than mark-to-market values).

10. How does the material swaps exposure threshold compare with other swap rule thresholds?

The formula for calculating MSE has the same components as that for calculating a CSE's compliance date threshold but uses different dates. The MSE formula is different than the formula for calculating the *de minimis* threshold for swap dealer registration even though the threshold level ($8 billion) is the same for both purposes. Table 1 below shows the differences between various swap rule thresholds:

Table 1

Topic	Material Swaps Exposure Threshold	Margin Rule Phase-in Threshold	CFTC Swap Dealer *De Minimis* Threshold	SEC SBS Dealer *De Minimis* Threshold
Level	$8 billion	$3 trillion	$8 billion [Possibly reducing to $3 billion by 2018]	$8 billion for CDS $400k for other SBS [Possibly reducing to $3 billion for CDS and $150k for other SBS by 2018]
Transactions Counted	All Swaps, SBS, FX swaps and FX forwards	All Swaps, SBS, FX swaps and FX forwards	Dealing swaps only	Dealing SBS only
Measurement Period	June, July and August of each year	March April and May of each year	Rolling 12 month calculation	Rolling 12 month calculation
Aggregation	Calculated for entity and all affiliates (as defined in the Rules)	Calculated for entity and all affiliates (as defined in the Rules)	Calculated for entity and all affiliates (as defined in the CFTC swap rules) except for affiliated SDs and MSPs	Calculated for entity and all affiliates (as defined in the SEC swap rules) except for affiliated SBSDs and MSBSPs

11. When is a CSE required to collect IM?

A CSE is required to collect initial margin for any non-cleared swap with a CSE, SE or financial end user with MSE. The IM for any particular swap must be collected on or before the business day following the day of execution and must be adjusted (if necessary) on a daily basis until the swap terminates or expires. The definition of "day of execution" is structured so that any swap that is executed after 4:00 p.m. or on a non-business day in any relevant time zone is deemed to have been executed on the following business day, but for any routine transaction between parties in the same time zone, the timing in the Rules is likely to be shorter than the typical timing of collateral transfers under an ISDA Credit Support Annex.

12. When is a CSE required to post IM?

A CSE is only required to post IM to a financial end user with MSE. The absence of a requirement to post IM to a CSE or SE counterparty is surprising, but is not significant as a practical matter since any such counterparty will have its own requirement to collect collateral, thus ensuring that IM is collected and posted by both parties. The CSE, and not the financial end user, calculates the IM that the CSE is required to post. That amount must be "at least as large" as the amount of IM that the CSE is collecting for the same swap. In practice, those two amounts should always be identical.

13. How is IM calculated?

The amount of IM a CSE must collect with respect to a swap can be calculated either by reference to an model approved by the relevant prudential regulator or by using percentages from a table provided in the Rules (see Exhibit D). This approach calculates IM as a percentage of notional amount for each type of swap identified. There is no explicit exception for fully paid swaps in the methodology for calculation of the IM collection amount using the table, so the Rules require the purchaser of an option (including a cap) for which the premium is paid up-front to post IM (if IM is otherwise applicable and the parties are using the

table to calculate IM). The amount of IM calculated in accordance with the Rules is the minimum amount a CSE is required to collect, so a CSE is free to negotiate higher amounts if it so desires.

14. Is netting permitted in calculating IM by reference to the Table in the Rules?

The IM requirement for multiple swaps subject to an eligible master netting agreement (EMNA) can be reduced using the following formula that provides some limited netting benefit:

Initial Margin = 0.4 x Gross Initial Margin + 0.6 x NGR x 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.

15. What is an "Eligible Master Netting Agreement"?

The Rules define an eligible master netting agreement 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 conservatorship, 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 has a well-founded basis to conclude 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.

16. When can a model be used to calculate IM?

A CSE can calculate IM using an IM model only if the model meets numerous detailed requirements set out in the Rules and, in addition, has been approved in writing by the prudential regulator for that entity. In particular, a model must estimate potential future exposure to a 99 percent confidence level assuming a 10-day holding period (unless the maturity of the swap is less than 10 days). In addition, a swap entity using a model must verify periodically that the IM requirements generated by its model are at least equal to the amounts that a derivatives clearing organization would require for similar cleared transactions. The International Swaps and Derivatives Association (ISDA) is developing a standard model for IM that can be used by all market participant as an alternative to each dealer creating its own proprietary model.

17. Is netting permitted in calculating IM by reference to a model?

An IM model may allow for calculation of IM on a portfolio basis among all the swaps covered by an enforceable master netting agreement. The netting permitted is limited in that "empirical correlations under an eligible master netting agreement" may only be recognized "within each broad risk category," not "across" such categories. The broad risk categories are "agricultural commodity, energy commodity, metal commodity and other commodity, credit, equity, and foreign exchange or interest rate."

18. What types of collateral can be used for IM?

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" or "discount," during a severe economic downturn. A list of eligible IM collateral is attached as Exhibit E and the haircuts for the different types of eligible collateral are noted on Exhibit F. Some types of collateral must be "investment grade" as defined by the releavnt regulator, and these definitions are problematic as a practical matter since (as a result of the Dodd-Frank Act requirements) they do not contain any reference to public credit ratings. There is an additional 8 percent discount for initial margin collateral denominated in a currency that is not the currency of settlement for the non-cleared swap or non-cleared security-based swap or the termination currency specified in a relevant EMNA (so long as there is only one termination currency).

The Rules explicitly prohibit the use of securities of the following types of entities as collateral even if they would otherwise fit with in the relevant definitions:

(1) a party to the swap or an affiliate of a party;

(2) a bank holding company, a savings and loan holding company, a US intermediate holding company of a foreign bank; or

(3) a systemically significant nonbank financial institution supervised under Title I of the Dodd-Frank Act.

19. What are the segregation rules for IM?

IM (but not VM) for each party must be segregated in an account with an independent custodian. The custodian must be a party that is not affiliated with either party to the swap (using the financial consolidation test for affiliation). Substitution of collateral is permitted, but not rehypothecation. Parties are not required to use the same independent custodian.

20. How do parties choose a custodian to hold initial margin?

The Rules do not specify how custodians are selected and do not allocate the costs of the custody arrangement, so these details are left to the parties to agree.

21. What conditions must a custodian meet to be eligible to hold initial margin?

A prospective custodian must be unaffiliated with both parties and must be acting pursuant to a custody agreement that meets the following two conditions:

(1) the agreement prohibits the custodian from rehypothecating, repledging, reusing or otherwise transferring (through securities lending, securities borrowing, repurchase agreement, reverse repurchase agreement or other means) the collateral held by the custodian, except that cash collateral may be held in a general deposit account with the custodian if the funds in the account are used to purchase eligible collateral assets, such assets are held in compliance with the rules, and such purchase takes place within a time period reasonably necessary to consummate such purchase after the cash collateral is posted as initial margin; and

(2) it 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.

22. When is a CSE required to collect and post VM?

A CSE must collect variation margin for a non-cleared swap or non-cleared security-based swap equal to the "variation margin amount" from a CSE, SE or FEU counterparty when that amount is positive and post variation margin equal to the variation margin amount to the counterparty when that amount is negative. The VM for any particular swap must be collected on or before the business days following the day of execution and must be adjusted thereafter on a daily basis until the swap terminates or expires. The definition of "day of execution" is structured so that any swap that is executed after 4:00 p.m. or on a non-business day in any relevant time zone is deemed to have been executed on the following business day.

23. How is VM calculated?

"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 posted with respect to such non-cleared swap or non-cleared security-based swap. The Rules do not prescribe a methodology for calculating VM, so a CSE can use existing market models to calculate the daily mark-to-market change in the value of a relevant transaction. The preamble to the Rules contains the clarification that VM can be calculated on a mid-market basis. Margin requirements will apply on a daily basis. VM applies at least once per business day "on and after the date" on which "it enters into" a swap. There is no discussion in the Rules or the preamble as to how margin applies when the effective date of a swap is later than the trade date.

24. Is netting permitted in calculating VM?

To the extent that one or more non-cleared swaps or security-based swaps are executed pursuant to an eligible master netting agreement, a covered swap entity may calculate and comply with the applicable requirements of the Rules on an aggregate net basis with respect to all non-cleared swaps and non-cleared security-based swaps governed by such agreement. The preamble to the Rules says that netting is not permitted between transactions that are swaps and security-based swaps and those that are not (such as equity options and FX forwards and swaps).

25. What types of collateral can be used for VM?

Eligible collateral for variation margin depends on the type of counterparty the covered swap entity is facing in its swap transaction. For swaps between a covered swap entity and another swap entity, eligible collateral for variation margin is limited to only immediately available cash funds denominated in US dollars, another major currency, or the currency of settlement for the swap.

When a covered swap entity faces financial end user counterparties, a CSE may exchange variation margin in any of the same forms of collateral as the Rules permit for initial margin collateral. There is an 8 percent discount for variation margin collateral denominated in a currency that is not the currency of settlement for the non-cleared swap or non-cleared security-based swap, except for immediately available cash funds denominated in US dollars or another major currency. (The regulators have been asked to clarify if parties also can use collateral that is denominated in the termination currency specified in a relevant EMNA without incurring the 8 percent cross-currency haircut.)

26. Can two CSEs (or a CSE and an SE) that are counterpartties in a swap use different methodologies for collecting margin?

That is possible in theory but unlikely to occur in practice because parties will not want to have different collateral requirements for the same swap.

27. Do the Rules apply to transactions between CSEs and their affiliates?

The Rules apply to non-cleared swaps between affiliates (defined by reference to consolidation in financial statements rather than by voting control), but they specify that a) such swaps need only be counted once in calculating aggregate group transaction activity, b) each affiliate may be granted a separate margin threshold of $20 million, c) a CSE does not have to post IM to an affiliate, d) non-cash IM from an affiliate can be held by a CSE or an affiliated custodian, and e) the exposure on some affiliate swaps can be modeled using a shorter assumed holding period.

28. How do the Rules apply in cross-border situations?

The Rules do not apply to "any foreign non-cleared swap or non-cleared security-based swap of a foreign covered swap entity."

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 non-US branch of a US bank);

(2) a US branch, agency, or subsidiary of a foreign bank;

(3) an non-US entity that is a subsidiary of an entity that is organized under the laws of the United States or any state.

A "foreign" swap is a swap of a foreign covered swap entity in which neither the counterparty to the foreign covered swap entity nor any party that provides a guarantee of either party's obligations is an entity described in clauses (1) to (3) above or a natural person who is resident in the United States.

There is also a special rule that gives relief to non-US branches and subsidiaries of US CSEs if local law or regulatory restrictions make segregation unavailable.

29. Is there any substitute compliance available under the Rules?

The Rules provide for substituted compliance under the rules of another jurisdiction in certain limited cases if the prudential regulators have collectively determined that those rules are comparable to the Rules. A covered swap entity may rely on a comparability determination only if:

(1) The covered swap entity's obligations under the non-cleared swap or non-cleared security-based swap do not have a guarantee from:

  (A) an entity organized under the laws of the United States or any state (other than a US branch or agency of a foreign bank) or a natural person who is a resident of the United States; or

  (B) a branch or office of an entity organized under the laws of the United States or any state; and

(2) The covered swap entity is:

  (A) a foreign covered swap entity;

  (B) a US branch or agency of a foreign bank; or

  (C) an entity that is not organized under the laws of the United States or any state and is a subsidiary of a depository institution, Edge corporation or agreement corporation.

30. Is there any collateral posting threshold?

The Rules allow a CSE to agree to a threshold of up to $50 million before IM must be delivered. The threshold is applied on a consolidated entity level so it represents the maximum aggregate unsecured IM exposure that one CSE and all its affiliates can have to the other party and all its affiliates. Allocation of the threshold among entities in the same group, and/or multiple master agreements of the same entity creates numerous practical issues. The threshold for posting VM with an unaffiliated party is always zero.

31. Is there a minimum transfer amount for margin?

The Rules set a minimum transfer amount of $500,000, which applies to IM and VM combined. The minimum transfer amount applies for each separate counterparty.

32. How have the prudential regulators addressed curency differences between the Rules and the International Standards?

The IM threshold amount and the minimum transfer amount are roughly equivalent to the ones set in the international standards for non-cleared swap margin published by the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions in September 2013 (the "International Standards"). However, those amounts are denominated in euros in the International Standards. The US dollar amounts in the Rules are intended to be consistent with current exchange rates between the euro and the US dollar. The prudential regulators have stated explicitly that they expect

to consider periodically the numerical amounts expressed in the Rules and their relation to amounts denominated in other currencies and will propose adjustments in the future as they deem appropriate.

33. What are the compliance dates for the Rules?

The compliance date for two counterparties subject to mandatory VM is March 1, 2017 (unless both parties exceed the "VM Threshold," in which case their compliance date will be September 1, 2016). The compliance date for two counterparties subject to mandatory IM can be September 1 of any year from 2016–2020 (inclusive) (depending on the earliest date for which both parties exceed the applicable "IM Threshold"). An entity exceeds the VM Threshold if the entity and 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 ("Included Transactions") with all counterparties for March, April, and May of 2016 that exceeds $3 trillion, where such amount is calculated only for business days. An entity exceeds the IM Threshold for a particular year if the entity and all its affiliates have an average daily aggregate notional amount of Included Transactions with all counterparties for March, April and May of the previous calendar year that exceeds (1) $3 trillion for 2016, (2) $2.25 trillion for 2017, (3) $1.5 trillion for 2018, (4) $ .75 trillion for 2019, and (5) zero for 2020, where such amount is calculated only for business days. A CSE consequently is likely to have different compliance dates with different counterparties.

34. Do the Rules apply to swaps executed before a party's compliance date?

The Rules grandfather the margin treatment of pre-compliance date swaps if they are documented in a different master agreement from post-compliance date swaps. There is, however, a provision in the Rules that was not in the original proposal from the regulators that says that pre- and post-compliance date swaps can be treated separately even if they are in the same master agreement if they are contained in separate "netting portfolios that independently meet . . . the definition of eligible master netting agreement." Further study will be required to determine if it is possible for a single document to meet that standard given that the definition of eligible master netting agreement generally requires CSEs to conduct sufficient legal review to have a "well-founded basis" that the agreement will be enforceable.

35. What are the documentation requirements in the Rules?

A covered swap entity must 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 noncleared 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; and

(3) describes the methods, procedures, rules and inputs used to calculate initial margin for non-cleared swaps and non-cleared security based swaps entered into between the covered swap entity and the counterparty.

ISDA is expected to facilitate the process of creating compliant margin documents by means of new standard forms and new documentation protocols.

36. Do the Rules apply to voluntary margin arrangements?

The detailed requirements that are applicable to mandatory IM and VM are not applicable to voluntary IM or VM. If the parties voluntarily agree to exchange collateral to an extent not required specifically by the Rules they may do so in any mutually agreed

form and manner except that a swap entity must require segregation with an independent custodian for "any collateral other than variation margin" that it agrees voluntarily to deliver to a counterparty. A swap dealer may accordingly continue to use traditional forms of margining with Non-financial End Users, such as having a loan and a swap secured by the same package of collateral.

EXHIBIT A

List of Covered Swap Entities

For the OCC— any national bank or subsidiary thereof, Federal savings association or subsidiary thereof, or Federal branch or agency of a foreign bank that is a swap entity, or any other entity that the OCC determines.

For the 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 a swap entity, or any other entity that the FDIC determines.

For the Farm Credit Administration—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.

For the Federal Housing Finance Agency—any FHFA-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, as amended (12 U.S.C. 4502(20)).

For the Board of Governors of the Federal Reserve— any swap entity that is a (1) state member bank (as defined in 12 CFR 208.2(g)), (2) bank holding company (as defined in 12 U.S.C. 1841), (3) savings and loan holding company (as defined in 12 U.S.C. 1467a), (4) foreign banking organization (as defined in 12 CFR 211.21(0)), (5) foreign bank that does not operate an insured branch, (6) state branch or state agency of a foreign bank (as defined in 12 U.S.C. 3101(b)(11) and (12)), (7) Edge or agreement corporation (as defined in 12 CFR 211.1(c)(2) and (3)) or (8) covered swap entity as determined by the Board. Covered swap entity would not include an affiliate of an entity listed in (1) through (7) 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.

EXHIBIT B

Final Prudential Regulator Margin Rules for Non-cleared Swaps

This table summarizes the initial margin (IM) and variation margin (VM) requirements applicable to non-cleared swaps that were issued in October 2015 by US prudential regulators in the form of (1) a final margin rule, and (2) an interim final rule (collectively, the "Rules"). This table shows the margin requirements for various pairs of swap counterparties after the Rules are fully in effect. Terms used in the table are defined below the table.

	Party B			
Party A	**Swap Entity**	**Financial End User with Material Swaps Exposure**	**Other Financial End User**	**End User**
Swap Entity	Mandatory IM and VM for both parties (each Swap Entity calculates the IM it collects)	Mandatory IM and VM for both parties (Swap Entity calculates the IM for both parties)	Mandatory VM but not IM (but Swap Entity must collect IM to extent it deems appropriate to mitigate counterparty credit risk)	No Mandatory IM or VM (but Swap Entity must collect IM and/or VM to extent it deems appropriate to mitigate counterparty credit risk)
Financial End User with Material Swaps Exposure	Mandatory IM and VM for both parties (Swap Entity calculates the IM for both parties)	No Mandatory IM or VM	No Mandatory IM or VM	No Mandatory IM or VM
Other Financial End User	Mandatory VM but not IM (but Swap Entity must collect IM to extent it deems appropriate to mitigate counterparty credit risk)	No Mandatory IM or VM	No Mandatory IM or VM	No Mandatory IM or VM
End User	No Mandatory IM or VM (but Swap Entity must collect IM and/or VM to extent it deems appropriate to mitigate counterparty credit risk)	No Mandatory IM or VM	No Mandatory IM or VM	No Mandatory IM or VM

For the purposes of this table:

- "Swap Entity" means a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant.
- "Financial End User" (or FEU) has the meaning assigned to that term in the Rules.
- "End User" means any party other than a Swap Entity or an FEU.
- "Material Swaps Exposure" means, with respect to any entity, 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 calendar year that exceeds $8 billion, where such amount is calculated only for business days.

EXHIBIT C

"Financial End User" means any party to a derivative that is not a Swap Entity but is:

(i) A bank holding company or an affiliate thereof; a savings and loan holding company; a US intermediate holding company established or designated for purposes of compliance with 12 CFR 252.153; 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; but excluding entities registered or licensed solely on account of financing the entity's direct sales of goods or services to customers; or

(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 in accordance with the Farm Credit Act of 1971, as amended, 12 U.S.C. § 2001 et seq., that is regulated by the Farm Credit Administration ;

(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 Securities and Exchange Commission

(viii) 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)); a floor broker, a floor trader, or introducing broker as defined, respectively, in 1a(22), 1a(23) and 1a(31) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(22), 1a(23), and 1a(31)); or a futures commission merchant as defined in 1a(28) of the Commodity Exchange Act (7 U.S.C. 1a(28));

(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, person, or arrangement that is, or holds itself out as being, an entity, person, or arrangement that raises money from investors, accepts money from clients, or uses its own money primarily for the purpose of investing or trading or facilitating the investing or trading in loans, securities, swaps, funds or other assets for resale or other disposition or otherwise trading in loans, securities, swaps, funds or other assets; or

(xii) An entity that would be a financial end user as described above if it were organized under the laws of the United States or any state thereof.

The term "financial end user" does not include any counterparty that is:

- a sovereign entity;
- a multilateral development bank [as defined in the Rules];
- The Bank for International Settlements;
- a captive finance company that qualifies for the exemption from the definition of financial entity pursuant to section 2(h)(7)(C)(iii) of the Commodity Exchange Act and implementing regulations; or
- an affiliate that qualifies for the 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.

EXHIBIT D

Standardized Minimum Gross Initial Margin Requirements for Non-cleared Swaps and Non-cleared Security-Based Swaps	
Asset Class	**Gross Initial Margin** (Percentage 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

EXHIBIT E

Eligible Collateral

- 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;
- a security that is issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, a US 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;
- a security that is issued by, or fully guaranteed as to the timely 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 applicable regulatory capital rules;
- 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 US government-sponsored enterprise that is operating with capital support or another form of direct financial assistance from the US government that enables the repayments of the US government-sponsored enterprise's eligible securities;
- a publicly traded debt security, but not an asset-backed security, that is issued by a US government-sponsored enterprise not operating with capital support or another form of direct financial assistance from the US government and that the covered swap entity determines is "investment grade" (as defined by the appropriate prudential regulator);
- 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;
- a publicly traded debt security that the covered swap entity determines is "investment grade" (as defined by the appropriate prudential regulator);
- 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 a 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;
- certain redeemable government bond funds, described below; and
- gold.

EXHIBIT F

Margin Values for Non-cash Margin Collateral[1]	
Asset Class	**Haircut** (Percentage of Market Value)
Eligible government and related debt (e.g., central bank, multilateral development bank, GSE securities identified in §_.6(a)(2)(iv) or §_.6(b)(5)) with residual maturity less than one-year	0.5
Eligible government and related debt (e.g., central bank, multilateral development bank, GSE securities identified in §_.6(a)(2)(iv) or §_.6(b)(5)) with residual maturity between one and five years	2.0
Eligible government and related debt (e.g., central bank, multilateral development bank, GSE securities identified in §_.6(a)(2)(iv) or §_.6(b)(5)) with residual maturity greater than five years	4.0
Eligible corporate debt (including eligible GSE debt securities not identified in §_.6(a)(2)(iv) or §_.6(b)(5): residual maturity less than one year	1.0
Eligible corporate debt (including eligible GSE debt securities not identified in §_.6(a)(2)(iv) or §_.6(b)(5): residual maturity between one and five years	4.0
Eligible corporate (including eligible GSE debt securities not identified in §_.6(a)(2)(iv) or §_.6(b)(5): residual maturity greater than five years	8.0
Other eligible publicly traded debt: residual maturity less than one year	1.0
Other eligible publicly traded debt: residual maturity between one and five years	4.0
Other eligible publicly traded debt: residual maturity greater than five years	8.0
Equities included in S&P 500 or related index	15.0
Equities included in S&P 1500 Composite or related index but not S&P 500 or related index	25.0
Gold	15.0

[1] The discount to be applied to an eligible investment fund is the weighted average discount on all assets within the eligible investment fund at the end of the prior month. The weights to be applied in the weighted average should be calculated as a fraction of the fund's total market value that is invested in each asset with a given discount amount. As an example, an eligible investment fund that is comprised solely of $100 of 91-day Treasury bills and $100 of three-year US Treasury bonds would receive a discount of (100/200)*0.5+(100/200)*2.0=(0.5)*0.5+(0.5)*2.0=1.25 percent.