

CFTC Issues Non-Cleared Swap Margin Comparability Determinations for Australia and Japan

April 8, 2019

The Commodity Futures Trading Commission (the “**CFTC**”) has expanded the scope of its current comparability determinations with respect to margin requirements applicable to non-cleared swap transactions (“**Margin Rules**”) for swaps subject to Margin Rules in Japan and Australia. Specifically, on March 26, 2019, the CFTC issued an amended comparability determination that expands the current margin comparability determination for Japan’s Margin Rules,¹ and on March 27, 2019, the CFTC issued a new margin comparability determination with respect to Australia’s Margin Rules.²

As a result of these determinations, Margin Rules in Japan and Australia are deemed by the CFTC to be comparable with all aspects of the CFTC’s Margin Rules, and CFTC-registered swap dealers (“**SDs**”) or major swap participants (“**MSPs**”) subject to both the CFTC’s and either Japan’s or Australia’s Margin Rules may satisfy their CFTC non-cleared swap margin compliance obligations by complying with Japan’s or Australia’s Margin Rules, as applicable.

The following Memorandum provides a brief background and overview of the comparability determinations.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors.

NEW YORK

Colin D. Lloyd
+1 212 225 2809
clloyd@cgsh.com

Brian J. Morris
+1 212 225 2795
bmorris@cgsh.com

Jeffrey A. White
+1 212 225 2858
jewwhite@cgsh.com

¹ CFTC Issues Amended Margin Comparability Determination for Japan, CFTC Release No. 7899-19 (Mar. 26, 2019).

² CFTC Approves Comparability Determination for Australia Uncleared Swap Margin Rules for Substituted Compliance Purposes, CFTC Release No. 7902-19 (Mar. 27, 2019).

clearygottlieb.com



© Cleary Gottlieb Steen & Hamilton LLP, 2019. All rights reserved.

This memorandum was prepared as a service to clients and other friends of Cleary Gottlieb to report on recent developments that may be of interest to them. The information in it is therefore general, and should not be considered or relied on as legal advice. Throughout this memorandum, “Cleary Gottlieb” and the “firm” refer to Cleary Gottlieb Steen & Hamilton LLP and its affiliated entities in certain jurisdictions, and the term “offices” includes offices of those affiliated entities.

Background

As part of an effort to streamline regulation and promote efficiency in the international derivatives market, the CFTC has adopted a “substituted compliance” framework for SDs and MSPs who are subject to both the CFTC’s and another foreign jurisdiction’s Margin Rules.³ Under this framework, the CFTC compares a foreign jurisdiction’s Margin Rules to its own such rules. If the CFTC determines that the two sets of Margin Rules are sufficiently similar in “purpose and effect,”⁴ the CFTC issues a “comparability determination” for that foreign jurisdiction.⁵ SDs and MSPs may then rely on that comparability determination to “substitute” their compliance with Margin Rules of the foreign jurisdiction which received the comparability determination for their compliance with the CFTC’s Margin Rules.⁶

Under the CFTC’s substituted compliance framework, an SD or MSP that is not a U.S. person (as defined by the CFTC’s Margin Rules) and is not guaranteed by a U.S. person is eligible for substituted compliance with all aspects of the comparable foreign jurisdiction’s Margin Rules, unless its counterparty is a U.S. SD or MSP or a non-U.S. SD or MSP that has a U.S. guarantor, in which case substituted compliance would only be available in respect of the non-U.S. SD’s or MSP’s obligation to collect initial margin.⁷ An SD or MSP that is a U.S. person or is guaranteed by a U.S. person is only eligible for substituted compliance with the comparable foreign jurisdiction’s requirements for posting initial margin.⁸

³ Margin Requirements for Uncleared Swaps for [SDs] and [MSPs]—Cross-Border Application of the Margin Requirements, 81 Fed. Reg. 34818 (May 31, 2016).

⁴ When conducting this analysis, the CFTC considers “the scope and objectives of the relevant foreign jurisdiction’s margin requirements; whether the relevant foreign jurisdiction’s margin requirements achieve comparable outcomes to the Commission’s corresponding margin requirements; and the ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction’s margin requirements” (footnotes omitted). *Id.* at 34836–37.

⁵ *Id.* at 34837.

⁶ *Id.*

1. Initial Japan Determination

The CFTC first issued a comparability determination with respect to Japan’s Margin Rules in 2016 (the “**Initial Japan Determination**”).⁹ In that determination, which was the first comparability determination issued with respect to the CFTC’s Margin Rules, the CFTC found that some, but not all, of the Japan Financial Services Agency’s Margin Rules were comparable. Specifically, the CFTC determined that Japan’s Margin Rules regarding inter-affiliate swaps and the scope of entities which were subject to the Margin Rules were not comparable.¹⁰

This lack of full comparability complicated cross-border compliance with the Margin Rules and reflected a “stricter rule applies” approach to comparability of cross-border Margin Rules. For example, after the CFTC issued the Initial Japan Determination, SDs subject to the CFTC’s Margin Rules requested, and were granted, CFTC relief from the requirement to post and collect variation margin on a T+1 timeframe with certain counterparties, requesting instead a T+3 standard to accommodate the use of Japanese government bonds, a common form of collateral in Japan which settle in two or three days.¹¹

2. EU Determination

In 2017, the CFTC issued another comparability determination with respect to the European Union’s Margin Rules (the “**EU Determination**”).¹² Confusion over the scope of entities covered by the

⁷ *Id.* at 34829–30.

⁸ *Id.* at 34829.

⁹ Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for [SDs] and [MSPs], 81 Fed. Reg. 63376 (Sep. 15, 2016).

¹⁰ *Id.* at 63381–82. Japan does not apply its uncleared swap margin requirements “to non-financial institutions nor to financial institutions below certain thresholds of activity in OTC derivatives” nor “to OTC derivative transactions between counterparties that are ‘Consolidated Companies’”. *Id.*

¹¹ CFTC No-Action Letter No. 17-13 (Feb. 23, 2017).

¹² Comparability Determination for the European Union: Margin Requirements for Uncleared Swaps for [SDs] and [MSPs], 82 Fed. Reg. 48394 (Oct. 18, 2017).

EU Determination prompted Chairman Giancarlo to clarify in a speech that the determination covered an SD's or MSP's transactions with the full scope of counterparties subject to the CFTC's Margin Rules, including transactions with entities that are not subject to margin requirements under parallel EU Margin Rules.¹³

3. *Cross-Border White Paper*

Subsequent to the EU Determination, in October 2018, Chairman Giancarlo published a cross-border swaps regulation white paper, which, among other proposed reforms, called for the CFTC to generally exercise greater deference to regulations in foreign jurisdictions that have adopted reforms comparable to the CFTC's regime.¹⁴

Current Determinations

The amended comparability determination for Japan eliminates the limitations in the Initial Japan Determination by deeming *all* of Japan's Margin Rules to be comparable to the CFTC's Margin Rules, including with respect to inter-affiliate transactions, the types of counterparties and the timing of collateral exchange.¹⁵ Similarly, the comparability determination issued for Australia covers all aspects of Australia's Margin Rules, specifically finding comparability with respect to:

- Entities Subject to Uncleared Swap Margin Requirements;
- Treatment of Inter-Affiliate Swaps;
- Methodologies for Calculating Initial and Variation Margin Amounts;

- Process and Standards for Approving Models for Calculating Initial Margin;
- Timing and Manner of Collection and Payment of Margin;
- Threshold Levels or Amounts;
- Risk Management Controls for Calculation of Initial and Variation Margin;
- Eligible Collateral;
- Custodial Arrangements, Segregation, and Rehypotheication;
- Margin Documentation; and
- Cross-Border Application/Reciprocity.

As a result, Australia is now the third foreign jurisdiction, joining Japan and the European Union, for which the CFTC has issued a comparability determination for its Margin Rules.

These comparability determinations reflect the CFTC's efforts to give greater deference to comparable foreign regimes, abandoning the "stricter rule applies" approach. In connection with the unanimous approval of these comparability determinations, Chairman Giancarlo noted that these comparability determinations reflect a "principles-based holistic analysis that focuses on regulatory outcomes rather than on a strict rule-by-rule comparison", unlike the "strict rule applies" approach used in the Initial Japan Determination.¹⁶

¹³ Remarks of Chairman J. Christopher Giancarlo to the ABA Derivatives and Futures Section Conference, Naples, Florida (Jan. 19, 2018), <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo34>.

¹⁴ White Paper, *Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-U.S. Regulation*, J. Christopher Giancarlo, Chairman, CFTC (Oct. 1, 2018); see also Alert Memorandum, *CFTC Chairman Proposes Cross-Border Swaps Regulation Version 2.0*, Cleary Gottlieb (Oct. 10, 2018), <https://www.clearygottlieb.com/-/media/files/alert-memos-2018/cftc-chairman-proposes-crossborder-swaps-regulation-version.pdf>.

¹⁵ Relief under CFTC No-Action Letter No. 17-13, which was set to expire on March 1, 2020, is now superseded by the amended determination.

¹⁶ Statement of Chairman J. Christopher Giancarlo on Australia Comparability Determination: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (Mar. 27, 2019), <https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement032719>; Statement of Chairman J. Christopher Giancarlo on Amendment to Japan Comparability Determination: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (Mar. 26, 2019), <https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement032619>.