

Board of Governors of the Federal Reserve System

Regulation KK

Swaps Margin and Swaps Push-Out

12 CFR 237; as amended effective September 1, 2020



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AUTHORITY: 7 U.S.C. 6s(e), 15 U.S.C. 78o-10(e), 15 U.S.C. 8305, 12 U.S.C. 221 *et seq.*, 12 U.S.C. 343-350, 12 U.S.C. 1818, 12 U.S.C. 1841 *et seq.*, 12 U.S.C. 3101 *et seq.*, and 12 U.S.C. 1461 *et seq.*

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SUBPART A—Margin and Capital Requirements for Covered Swap Entities

SECTION 237.1—Authority, Purpose, Scope, Exemptions, and Compliance Dates

(a) *Authority.* This subpart (Regulation KK) is issued by the Board of Governors of the Federal Reserve System (Board) under section 4s(e) of the Commodity Exchange Act of 1936, as amended (7 U.S.C. 6s(e)), and section 15F(e) of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78o-10(e)), as well as under the Federal Reserve Act, as amended (12 U.S.C. 221 *et seq.*); section 8 of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818); the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841*et seq.*); the International Banking Act of 1978, as amended (12 U.S.C. 3101 *et seq.*), and the Home Owners' Loan Act, as amended (1461 *et seq.*).

(b) *Purpose.* Section 4s of the Commodity Exchange Act of 1936 (7 U.S.C. 6s) and section 15F of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10) require the Board to establish capital and margin requirements for any state member bank (as defined in 12 CFR 208.2(g)), bank holding company (as defined in 12 U.S.C. 1841), savings and loan holding company (as defined in 12 U.S.C. 1467a (on or after the transfer established under section 311 of the Dodd-Frank Act) (12 U.S.C. 5411)), foreign banking organization (as defined in 12 CFR 211.21(o)), foreign bank that does not operate an insured branch, state branch or state agency of a foreign bank (as defined in 12 U.S.C. 3101(b)(11) and (12)), or Edge or agreement corporation (as defined in 12 CFR 211.1(c)(2) and (3)) that is registered as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant with respect to all non-cleared swaps and non-cleared security-based swaps. This subpart implements section 4s of the Commodity Exchange Act of 1936 and

section 15F of the Securities Exchange Act of 1934 by defining terms used in the statute and related terms, establishing capital and margin requirements, and explaining the statutes' requirements.

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

(d) *Exemptions.*

(1) *Swaps.* The requirements of this subpart (except for section 237.12) shall not apply to a non-cleared swap if the counterparty:

- (i) Qualifies for an exception from clearing under section 2(h)(7)(A) of the Commodity Exchange Act of 1936 (7 U.S.C. 2(h)(7)(A)) and implementing regulations;
- (ii) Qualifies for an exemption from clearing under a rule, regulation, or order that the Commodity Futures Trading Commission issued pursuant to its authority under section 4(c)(1) of the Commodity Exchange Act of 1936 (7 U.S.C. 6(c)(1)) concerning cooperative entities that would otherwise be subject to the requirements of section 2(h)(1)(A) of the Commodity Exchange Act of 1936 (7 U.S.C. 2(h)(1)(A)); or
- (iii) Satisfies the criteria in section 2(h)(7)(D) of the Commodity Exchange Act of 1936 (7 U.S.C. 2(h)(7)(D)) and implementing regulations.

(2) *Security-based swaps.* The requirements of this subpart (except for section 237.12) shall not apply to a non-cleared security-based swap if the counterparty:

- (i) Qualifies for an exception from clearing under section 3C(g)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78c-3(g)(1)) and implementing regulations; or
- (ii) Satisfies the criteria in section

3C(g)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c-3(g)(4)) and implementing regulations.

(e) *Compliance dates.* Covered swap entities shall comply with the minimum margin requirements of this subpart on or before the following dates for non-cleared swaps and non-cleared security-based swaps entered into on or after the following dates:

(1) September 1, 2016 with respect to the requirements in section 237.3 for initial margin and section 237.4 for variation margin for any non-cleared swaps and non-cleared security-based swaps, where both:

- (i) The covered swap entity combined with all its affiliates; and
- (ii) Its counterparty combined with all its affiliates, have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps for March, April and May 2016 that exceeds \$3 trillion, where such amounts are calculated only for business days; and
- (iii) In calculating the amounts in paragraphs (e)(1)(i) and (ii) of this section, an entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time, and shall not count a swap or security-based swap that is exempt pursuant to paragraph (d) of this section.

(2) March 1, 2017 with respect to the requirements in section 237.4 for variation margin for any other covered swap entity with respect to non-cleared swaps and non-cleared security-based swaps entered into with any other counterparty.

(3) September 1, 2017 with respect to the requirements in section 237.3 for initial margin for any non-cleared swaps and non-cleared security-based swaps, where both:

- (i) The covered swap entity combined with all its affiliates; and
- (ii) Its counterparty combined with all its affiliates, have an average daily aggregate notional amount of non-cleared swaps,

- non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps for March, April and May 2017 that exceeds \$2.25 trillion, where such amounts are calculated only for business days; and
- (iii) In calculating the amounts in paragraphs (e)(3)(i) and (ii) of this section, an entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time, and shall not count a swap or security-based swap that is exempt pursuant to paragraph (d) of this section.
- (4) September 1, 2018 with respect to the requirements in section 237.3 for initial margin for any non-cleared swaps and non-cleared security-based swaps, where both:
- (i) The covered swap entity combined with all its affiliates; and
- (ii) Its counterparty combined with all its affiliates, have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps for March, April and May 2018 that exceeds \$1.5 trillion, where such amounts are calculated only for business days; and
- (iii) In calculating the amounts in paragraphs (e)(4)(i) and (ii) of this section, an entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time, and shall not count a swap or security-based swap that is exempt pursuant to paragraph (d) of this section.
- (5) September 1, 2019 with respect to the requirements in section 237.3 for initial margin for any non-cleared swaps and non-cleared security-based swaps, where both:
- (i) The covered swap entity combined with all its affiliates; and
- (ii) Its counterparty combined with all its affiliates, have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards and foreign exchange swaps for March, April and May 2019 that exceeds \$0.75 trillion, where such amounts are calculated only for business days; and
- (iii) In calculating the amounts in paragraphs (e)(5)(i) and (ii) of this section, an entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time, and shall not count a swap or security-based swap that is exempt pursuant to paragraph (d) of this section.
- (6) September 1, 2021 with respect to requirements in section 237.3 for initial margin for any non-cleared swaps and non-cleared security-based swaps, where both:
- (i) The covered swap entity combined with all its affiliates; and
- (ii) Its counterparty combined with all its affiliates, have an average daily aggregate notional amount of non-cleared swaps, foreign exchange forwards and foreign exchange swaps for March, April and May 2021 that exceeds \$50 billion, where such amounts are calculated only for business days; and
- (iii) In calculating the amounts in paragraphs (e)(6)(i) and (ii) of this section, an entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time, and shall not count a swap or security-based swap that is exempt pursuant to paragraph (d) of this section.
- (7) September 1, 2022 with respect to requirements in section 237.3 for initial margin for any other covered swap entity with respect to non-cleared swaps and non-cleared security-based swaps entered into with any other counterparty.
- (f) Once a covered swap entity must comply with the margin requirements for non-cleared swaps and non-cleared security-based swaps,

with respect to a particular counterparty based on the compliance dates in paragraph (e) of this section, the covered swap entity shall remain subject to the requirements of this subpart with respect to that counterparty.

(g)(1) If a covered swap entity's counterparty changes its status such that a non-cleared swap or non-cleared security-based swap with that counterparty becomes subject to stricter margin requirements under this subpart (such as if the counterparty's status changes from a financial end user without material swaps exposure to a financial end user with material swaps exposure), then the covered swap entity shall comply with the stricter margin requirements for any non-cleared swap or non-cleared security-based swap entered into with that counterparty after the counterparty changes its status.

(2) If a covered swap entity's counterparty changes its status such that a non-cleared swap or non-cleared security-based swap with that counterparty becomes subject to less strict margin requirements under this subpart (such as if the counterparty's status changes from a financial end user with material swaps exposure to a financial end user without material swaps exposure), then the covered swap entity may comply with the less strict margin requirements for any non-cleared swap or non-cleared security-based swap entered into with that counterparty after the counterparty changes its status as well as for any outstanding non-cleared swap or non-cleared security-based swap entered into after the applicable compliance date in paragraph (e) of this section and before the counterparty changed its status.

(h) *Legacy swaps.* Covered swaps entities are required to comply with the requirements of this subpart for non-cleared swaps and non-cleared security-based swaps entered into on or after the relevant compliance dates for variation margin and for initial margin established in paragraph (e) of this section. Any non-cleared swap or non-cleared security-based swap entered into before such relevant date shall remain outside the scope of this subpart if amendments are made to the non-

cleared swap or non-cleared security-based swap by method of adherence to a protocol, other amendment of a contract or confirmation, or execution of a new contract or confirmation in replacement of and immediately upon termination of an existing contract or confirmation, as follows:

(1) Amendments to the non-cleared swap or non-cleared security-based swap solely to comply with the requirements of 12 CFR part 47, 12 CFR part 252 subpart I, or 12 CFR part 382, as applicable;

(2) The non-cleared swap or non-cleared security based swap was amended under the following conditions:

(i) The swap was originally entered into before the relevant compliance date established in paragraph (e) of this section and one party to the swap booked it at, or otherwise held it at, an entity (including a branch or other authorized form of establishment) located in the United Kingdom;

(ii) The entity in the United Kingdom subsequently arranged to amend the swap, solely for the purpose of transferring it to an affiliate, or a branch or other authorized form of establishment, located in any European Union member state or the United States, in connection with the entity's planning for or response to the event described in paragraph (h)(2)(iii) of this section, and the transferee is:

(A) A covered swap entity, or

(B) A covered swap entity's counterparty to the swap, and the counterparty represents to the covered swap entity that the counterparty performed the transfer in compliance with the requirements of paragraphs (h)(2)(i) and (ii) of this section;

(iii) The law of the European Union ceases to apply to the United Kingdom pursuant to Article 50(3) of the Treaty on European Union, without conclusion of a Withdrawal Agreement between the United Kingdom and the European Union pursuant to Article 50(2);

(iv) The amendments do not modify any of the following: The payment amount calculation methods, the maturity date, or the notional amount of the swap;

- (v) The amendments cause the transfer to take effect on or after the date of the event described in paragraph (h)(2)(iii) of this section transpires; and
- (vi) The amendments cause the transfer to take effect by the later of:
- (A) The date that is one year after the date of the event described in paragraph (h)(2)(iii) of this section; or
 - (B) Such other date permitted by transitional provisions under Article 35 of Commission Delegated Regulation (E.U.) No. 2016/2251, as amended.
- (3) (i) Amendments to the non-cleared swap or non-cleared security-based swap that are made solely to accommodate the replacement of:
- (A) An interbank offered rate (IBOR) including, but not limited to, the London Interbank Offered Rate (LIBOR), the Tokyo Interbank Offered Rate (TIBOR), the Bank Bill Swap Rate (BBSW), the Singapore Interbank Offered Rate (SIBOR), the Canadian Dollar Offered Rate (CDOR), Euro Interbank Offered Rate (EURIBOR), and the Hong Kong Interbank Offered Rate (HIBOR);
 - (B) Any other interest rate that a covered swap entity reasonably expects to be replaced or discontinued or reasonably determines has lost its relevance as a reliable benchmark due to a significant impairment; or
 - (C) Any other interest rate that succeeds a rate referenced in paragraph (h)(3)(i)(A) or (B) of this section. An amendment made under this paragraph (h)(3)(i)(C) could be one of multiple amendments made under this paragraph (h)(3)(i)(C). For example, an amendment could replace an IBOR with a temporary interest rate and later replace the temporary interest rate with a permanent interest rate.
- (ii) Amendments to accommodate replacement of an interest rate described in paragraph (h)(3)(i) of this section may also incorporate spreads or other adjustments to the replacement interest rate and make other necessary technical changes to operationalize the determination of payments or other exchanges of economic value using the replacement interest rate, including changes to determination dates, calculation agents, and payment dates. The changes may not extend the maturity or increase the total effective notional amount of the non-cleared swap or non-cleared security-based swap beyond what is necessary to accommodate the differences between market conventions for an outgoing interest rate and its replacement.
- (iii) Amendments to accommodate replacement of an interest rate described in paragraph (h)(3)(i) of this section may also be effectuated through portfolio compression between or among covered swap entities and their counterparties. Portfolio compression under this paragraph is not subject to the limitations in paragraph (h)(4) of this section, but any non-cleared swaps or non-cleared security-based swaps resulting from the portfolio compression may not have a longer maturity or increase the total effective notional amount more than what is necessary to accommodate the differences between market conventions for an outgoing interest rate and its replacement.
- (4) Amendments solely to reduce risk or remain risk-neutral through portfolio compression between or among covered swap entities and their counterparties, as long as any non-cleared swaps or non-cleared security-based swaps resulting from the portfolio compression do not:
- (i) Exceed the sum of the total effective notional amounts of all of the swaps that were submitted to the compression exercise that had the same or longer remaining maturity as the resulting swap; or
 - (ii) Exceed the longest remaining maturity of all the swaps submitted to the compression exercise.
- (5) The non-cleared swap or non-cleared security-based swap was amended solely for one of the following reasons:
- (i) To reflect technical changes, such as addresses, identities of parties for delivery of formal notices, and other administrative or operational provisions as long as they do not alter the non-cleared

swap's or non-cleared security-based swap's underlying asset or reference, the remaining maturity, or the total effective notional amount; or

(ii) To reduce the notional amount, so long as:

(A) All payment obligations attached to the total effective notional amount being eliminated as a result of the amendment are fully terminated; or

(B) All payment obligations attached to the total effective notional amount being eliminated as a result of the amendment are fully novated to a third party, who complies with applicable margin rules for the novated portion upon the transfer.

Business day means any day other than a Saturday, Sunday, or legal holiday.

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

Company means a corporation, partnership, limited liability company, business trust, special purpose entity, association, or similar organization.

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

Covered swap entity means 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(o));
- (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 paragraphs (1) through (7) of this definition for which the Office of the Comptroller of the Currency or the Federal Deposit Insurance Corporation is the prudential regulator or that is required to be registered with the U.S. Commodity Futures Trading Commission as a swap dealer or major swap participant or with the U.S. Securities and Exchange Commission as a security-based swap dealer or major security-based swap participant.

Cross-currency swap means a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in an-

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SECTION 237.2—Definitions

Affiliate. 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;
- (3) For a company that is not subject to such principles or standards, if consolidation as described in paragraph (1) or (2) of this definition would have occurred if such principles or standards had applied; or
- (4) The Board has determined that a company is an affiliate of another company, based on Board's conclusion that either company provides significant support to, or is materially subject to the risks or losses of, the other company.

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

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

other 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.

Currency of settlement means a currency in which a party has agreed to discharge payment obligations related to a non-cleared swap, a non-cleared security-based swap, a group of non-cleared swaps, or a group of non-cleared security-based swaps subject to a master agreement at the regularly occurring dates on which such payments are due in the ordinary course.

Day of execution means the calendar day at the time the parties enter into a non-cleared swap or non-cleared security-based swap, provided:

- (1) If each party is in a different calendar day at the time the parties enter into the non-cleared swap or non-cleared security-based swap, the day of execution is deemed the latter of the two dates; and
- (2) If a non-cleared swap or non-cleared security-based swap is:
 - (i) Entered into after 4:00 p.m. in the location of a party; or
 - (ii) Entered into on a day that is not a business day in the location of a party, then the non-cleared swap or non-cleared security-based swap is deemed to have been entered into on the immediately succeeding day that is a business day for both parties, and both parties shall determine the day of execution with reference to that business day.

Dealer has the meaning specified in section 3(a)(5) of the Securities Exchange Act of 1934 (12 U.S.C. 78c(a)(5)).

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

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

Eligible collateral means collateral described in section 237.6.

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

- (1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default following any stay permitted by paragraph (2) of this definition, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty;
- (2) The agreement provides the covered swap entity the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case,

- (i) Any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(A) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act (12 U.S.C. 1811 *et seq.*), title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5381 *et seq.*), the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended (12 U.S.C. 4617), or the Farm Credit Act of 1971, as amended (12 U.S.C. 2183 and 2279cc), or laws of foreign jurisdictions that are substantially similar to the U.S. laws referenced in this paragraph (2)(i)(A) in order to facilitate the orderly resolution of the defaulting counterparty; or

(B) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (2)(i)(A) of this definition; and

- (ii) The agreement may limit the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty to the extent necessary for the counterparty to comply with the re-

quirements of part 47, subpart I of part 252 or part 382 of title 12, as applicable;

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

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

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

(A) The agreement meets the requirements of paragraph (2) of this definition; and

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

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

Financial end user means:

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

(i) A bank holding company or an affiliate thereof; a savings and loan holding company; a U.S. 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; except entities registered or licensed solely on account of financing the entity's direct sales of goods or services to customers;

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

(iv) A regulated entity as defined in section 1303(20) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended (12 U.S.C. 4502(20)) or 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 U.S. Securities and Exchange Commission 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 Act of 1940 (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. 80b-2(a)); an entity that would be an investment company under section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3) but for section 3(c)(5)(C); or an entity that is deemed not to be an investment company under section 3 of the Investment Company Act of 1940 pursuant to Investment Company Act Rule 3a-7 (17 CFR 270.3a-7) of the U.S. Securities and Exchange Commission;

(viii) A commodity pool, a commodity pool operator, or a commodity trading advisor as defined, respectively, in section 1a(10), 1a(11), and 1a(12) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(10), 1a(11), and 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 of 1936 (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 described in paragraph (1) of this definition or a swap entity, if it were organized under the laws of the United States or any State thereof.

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

(i) A sovereign entity;

(ii) A multilateral development bank;

(iii) The Bank for International Settlements;

(iv) An entity that is exempt from the definition of financial entity pursuant to section 2(h)(7)(C)(iii) of the Commodity Exchange Act of 1936 (7 U.S.C. 2(h)(7)(C)(iii)) and implementing regulations; or

(v) An affiliate that qualifies for the exemption from clearing pursuant to section 2(h)(7)(D) of the Commodity Exchange Act of 1936 (7 U.S.C. 2(h)(7)(D)) or section 3C(g)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c-3(g)(4)) and implementing regulations.

Foreign bank means an organization that is organized under the laws of a foreign country and that engages directly in the business of banking outside the United States.

Foreign exchange forward has the meaning specified in section 1a(24) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(24)).

Foreign exchange swap has the meaning specified in section 1a(25) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(25)).

Initial margin means the collateral as calculated in accordance with section 237.8 that is posted or collected in connection with a non-cleared swap or non-cleared security-based swap.

Initial margin collection amount means:

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

(2) In the case of a covered swap entity that uses an initial margin model pursuant to section 237.8, the amount of initial mar-

gin with respect to a non-cleared swap or non-cleared security-based swap that is required under the initial margin model.

Initial margin model means an internal risk management model that:

- (1) Has been developed and designed to identify an appropriate, risk-based amount of initial margin that the covered swap entity must collect with respect to one or more non-cleared swaps or non-cleared security-based swaps to which the covered swap entity is a party; and
- (2) Has been approved by the Board pursuant to section 237.8.

Initial margin threshold amount means an aggregate credit exposure of \$50 million resulting from all non-cleared swaps and non-cleared security-based swaps between a covered swap entity and its affiliates, and a counterparty and its affiliates. For purposes of this calculation, an entity shall not count a swap or security-based swap that is exempt pursuant to section 237.1(d).

Major currency means:

- (1) United States Dollar (USD);
- (2) Canadian Dollar (CAD);
- (3) Euro (EUR);
- (4) United Kingdom Pound (GBP);
- (5) Japanese Yen (JPY);
- (6) Swiss Franc (CHF);
- (7) New Zealand Dollar (NZD);
- (8) Australian Dollar (AUD);
- (9) Swedish Kroner (SEK);
- (10) Danish Kroner (DKK);
- (11) Norwegian Krone (NOK); or
- (12) Any other currency as determined by the Board.

Margin means initial margin and variation margin.

Market intermediary means a securities holding company; a broker or dealer; a futures commission merchant as defined in 1a(28) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(28)); a swap dealer as defined in section 1a(49) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(49)); or a security-based swap dealer as defined in section 3(a)(71) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(71)).

Material swaps exposure for an entity means that an entity and its affiliates have an average daily aggregate notional amount of non-cleared swaps, non-cleared security-based swaps, foreign exchange forwards, and foreign exchange swaps with all counterparties for June, July, and August of the previous calendar year that exceeds \$8 billion, where such amount is calculated only for business days. An entity shall count the average daily aggregate notional amount of a non-cleared swap, a non-cleared security-based swap, a foreign exchange forward or a foreign exchange swap between the entity and an affiliate only one time. For purposes of this calculation, an entity shall not count a swap or security-based swap that is exempt pursuant to section 237.1(d).

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

Non-cleared swap means a swap that is not cleared by a derivatives clearing organization registered with the Commodity Futures Trading Commission pursuant to section 5b(a) of the Commodity Exchange Act of 1936 (7 U.S.C. 7a-1(a)) or by a clearing organization that the Commodity Futures Trading Commission has exempted from registration by rule or order pursuant to section 5b(h) of the Commodity Exchange Act of 1936 (7 U.S.C. 7a-1(h)).

Non-cleared security-based swap means a security-based swap that is not, directly or indirectly, submitted to and cleared by a clear-

ing agency registered with the U.S. Securities and Exchange Commission pursuant to section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1) or by a clearing agency that the U.S. Securities and Exchange Commission has exempted from registration by rule or order pursuant to section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1).

Prudential regulator has the meaning specified in section 1a(39) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(39)).

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

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

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

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

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

Subsidiary. A company is a subsidiary of another company if:

- (1) The company is consolidated by the other company on financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles, the International Financial Reporting Standards, or other similar standards;
- (2) For a company that is not subject to such principles or standards, if consolidation as described in paragraph (1) of this definition would have occurred if such principles or standards had applied; or
- (3) The Board has determined that the company is a subsidiary of another company, based on Board's conclusion that ei-

ther company provides significant support to, or is materially subject to the risks of loss of, the other company.

Swap has the meaning specified in section 1a(47) of the Commodity Exchange Act of 1936 (7 U.S.C. 1a(47)).

Swap entity means a person that is registered with the Commodity Futures Trading Commission as a swap dealer or major swap participant pursuant to the Commodity Exchange Act of 1936 (7 U.S.C. 1 *et seq.*), or a person that is registered with the U.S. Securities and Exchange Commission as a security-based swap dealer or a major security-based swap participant pursuant to the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

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

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

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.

3-3682**SECTION 237.3—Initial Margin**

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

(1) Zero; or

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

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

(c) *Timing.* A covered swap entity shall comply with the initial margin requirements described in paragraphs (a) and (b) of this section on each business day, for a period beginning on or before the business day following the day of execution and ending on the date the non-cleared swap or non-cleared security-based swap terminates or expires.

(d) *Other counterparties.* A covered swap entity is not required to collect or post initial margin with respect to any non-cleared swap or non-cleared security-based swap described in section 237.1(d). For any other non-cleared swap or non-cleared security-based swap between a covered swap entity and a counterparty that is neither a financial end user with a material swaps exposure nor a swap entity, the covered swap entity shall collect initial margin at such times and in such forms and such amounts (if any), that the covered swap entity determines appropriately

addresses the credit risk posed by the counterparty and the risks of such non-cleared swap or non-cleared security-based swap.

3-3683**SECTION 237.4—Variation Margin**

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

(b) *Timing.* A covered swap entity shall comply with the variation margin requirements described in paragraph (a) of this section on each business day, for a period beginning on or before the business day following the day of execution and ending on the date the non-cleared swap or non-cleared security based swap terminates or expires.

(c) *Other counterparties.* A covered swap entity is not required to collect or post variation margin with respect to any non-cleared swap or non-cleared security-based swap described in section 237.1(d). For any other non-cleared swap or non-cleared security-based swap between a covered swap entity and a counterparty that is neither a financial end user nor a swap entity, the covered swap entity shall collect variation margin at such times and in such forms and such amounts (if any), that the covered swap entity determines appropriately addresses the credit risk posed by the counterparty and the risks of such non-cleared swap or non-cleared security-based swap.

3-3684**SECTION 237.5—Netting Arrangements, Minimum Transfer Amount, and Satisfaction of Collecting and Posting Requirements**

(a) *Netting arrangements.*

(1) For purposes of calculating and com-

plying with the initial margin requirements of section 237.3 using an initial margin model as described in section 237.8, or with the variation margin requirements of section 237.4, a covered swap entity may net non-cleared swaps or non-cleared security-based swaps in accordance with this subsection.

(2) To the extent that one or more non-cleared swaps or non-cleared security-based swaps are executed pursuant to an eligible master netting agreement between a covered swap entity and its counterparty that is a swap entity or financial end user, a covered swap entity may calculate and comply with the applicable requirements of this subpart on an aggregate net basis with respect to all non-cleared swaps and non-cleared security-based swaps governed by such agreement, subject to paragraph (a)(3) of this section.

(3) (i) Except as permitted in paragraph (a)(3)(ii) of this section, if an eligible master netting agreement covers non-cleared swaps and non-cleared security-based swaps entered into on or after the applicable compliance date set forth in section 237.1(e) or (g), all the non-cleared swaps and non-cleared security-based swaps covered by that agreement are subject to the requirements of this subpart and included in the aggregate netting portfolio for the purposes of calculating and complying with the margin requirements of this subpart.

(ii) An eligible master netting agreement may identify one or more separate netting portfolios that independently meet the requirements in paragraph (1) of the definition of “Eligible master netting agreement” in section 237.2 and to which collection and posting of margin applies on an aggregate net basis separate from and exclusive of any other non-cleared swaps or non-cleared security-based swaps covered by the eligible master netting agreement. Any such netting portfolio that contains any non-cleared swap or non-cleared security-based swap entered into on or after the applicable compliance date set forth in section 237.1(e) or (g) is subject to the requirements of this subpart. Any such netting portfolio that contains only non-cleared swaps or non-

cleared security-based swaps entered into before the applicable compliance date is not subject to the requirements of this subpart.

(4) If a covered swap entity cannot conclude after sufficient legal review with a well-founded basis that the netting agreement described in this section meets the definition of eligible master netting agreement set forth in section 237.2, the covered swap entity must treat the non-cleared swaps and non-cleared security based swaps covered by the agreement on a gross basis for the purposes of calculating and complying with the requirements of this subpart to collect margin, but the covered swap entity may net those non-cleared swaps and non-cleared security-based swaps in accordance with paragraphs (a)(1) through (3) of this section for the purposes of calculating and complying with the requirements of this subpart to post margin.

(b) *Minimum transfer amount.* Notwithstanding section 237.3 or section 237.4, a covered swap entity is not required to collect or post margin pursuant to this subpart with respect to a particular counterparty unless and until the combined amount of initial margin and variation margin that is required pursuant to this subpart to be collected or posted and that has not yet been collected or posted with respect to the counterparty is greater than \$500,000.

(c) *Satisfaction of collecting and posting requirements.* A covered swap entity shall not be deemed to have violated its obligation to collect or post margin from or to a counterparty under section 237.3, section 237.4, or section 237.6(e) if:

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

(2) The covered swap entity has:

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

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

3-3685

SECTION 237.6—Eligible Collateral

(a) *Non-cleared swaps and non-cleared security-based swaps with a swap entity.* For a non-cleared swap or non-cleared security-based swap with a swap entity, a covered swap entity shall collect initial margin and variation margin required pursuant to this subpart solely in the form of the following types of collateral:

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

(i) U.S. dollars or another major currency; or

(ii) The currency of settlement for the non-cleared swap or non-cleared security-based swap;

(2) With respect to initial margin only:

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

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

(iii) A security that is issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to the covered swap entity as set forth in section 237.12;

(iv) A publicly traded debt security issued by, or an asset-backed security fully guaranteed as to the payment of principal and interest by, a U.S. government-sponsored enterprise that is operating with capital support or another form of

direct financial assistance received from the U.S. government that enables the repayments of the U.S. government-sponsored enterprise's eligible securities;

(v) A publicly traded debt security that meets the terms of 12 CFR 1.2(d) and is issued by a U.S. government-sponsored enterprise not operating with capital support or another form of direct financial assistance from the U.S. government, and is not an asset-backed security;

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

(vii) A security solely in the form of:

(A) Publicly traded debt not otherwise described in paragraph (a)(2) of this section that meets the terms of 12 CFR 1.2(d) and is not an asset-backed security;

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

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

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

(viii) Securities in the form of redeemable securities in a pooled investment fund representing the security-holder's proportional interest in the fund's net assets and that are issued and redeemed only on the basis of the market value of the fund's net assets prepared each business day after the security-holder makes its investment commitment or redemption request to the fund, if:

(A) The fund's investments are limited to the following:

(1) Securities that are issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the

Treasury, and immediately-available cash funds denominated in U.S. dollars; or

(2) Securities denominated in a common currency and issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to the covered swap entity as set forth in section 237.12, and immediately-available cash funds denominated in the same currency; and

(B) Assets of the fund may not be transferred through securities lending, securities borrowing, repurchase agreements, reverse repurchase agreements, or other means that involve the fund having rights to acquire the same or similar assets from the transferee; or

(ix) Gold.

(b) *Non-cleared swaps and non-cleared security-based swaps with a financial end user.* For a non-cleared swap or non-cleared security-based swap with a financial end user, a covered swap entity shall collect and post initial margin and variation margin required pursuant to this subpart solely in the form of the following types of collateral:

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

(i) U.S. dollars or another major currency; or

(ii) The currency of settlement for the non-cleared swap or non-cleared security-based swap;

(2) 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;

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

(4) A security that is issued by, or fully guaranteed as to the payment of principal

and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to the covered swap entity as set forth in section 237.12;

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

(6) A publicly traded debt security that meets the terms of 12 CFR 1.2(d) and is issued by a U.S. government-sponsored enterprise not operating with capital support or another form of direct financial assistance from the U.S. government, and is not an asset-backed security;

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

(8) A security solely in the form of:

(i) Publicly traded debt not otherwise described in this paragraph (b) that meets the terms of 12 CFR 1.2(d) and is not an asset-backed security;

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

(A) The Standard & Poor's Composite 1500 Index or any other similar index of liquid and readily marketable equity securities as determined by the Board;

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

(9) Securities in the form of redeemable securities in a pooled investment fund representing the security-holder's proportional interest in the fund's net assets and that are issued and redeemed only on the basis of the market value of the fund's net assets

prepared each business day after the security-holder makes its investment commitment or redemption request to the fund, if:

- (i) The fund's investments are limited to the following:
 - (A) Securities that are issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury, and immediately-available cash funds denominated in U.S. dollars; or
 - (B) Securities denominated in a common currency and issued by, or fully guaranteed as to the payment of principal and interest by, the European Central Bank or a sovereign entity that is assigned no higher than a 20 percent risk weight under the capital rules applicable to the covered swap entity as set forth in section 237.12, and immediately-available cash funds denominated in the same currency; and
 - (ii) Assets of the fund may not be transferred through securities lending, securities borrowing, repurchase agreements, reverse repurchase agreements, or other means that involve the fund having rights to acquire the same or similar assets from the transferee; or
- (10) Gold.
- (c)(1) The value of any eligible collateral collected or posted to satisfy margin requirements pursuant to this subpart is subject to the sum of the following discounts, as applicable:
 - (i) 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 U.S. dollars or another major currency;
 - (ii) An 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, except for eligible types of collateral denominated in a single termination currency designated as payable to the non-posting counterparty as part of the eligible master netting agreement; and
 - (iii) For variation and initial margin non-cash collateral, the discounts described in appendix B of this subpart.
 - (2) The value of variation margin or initial margin collateral is computed as the product of the cash or market value of the eligible collateral asset times one minus the applicable discounts pursuant to paragraph (c)(1) of this section expressed in percentage terms. The total value of all variation margin or initial margin collateral is calculated as the sum of those values for each eligible collateral asset.
- (d) Notwithstanding paragraphs (a) and (b) of this section, eligible collateral for initial margin and variation margin required by this subpart does not include a security issued by:
 - (1) The party or an affiliate of the party pledging such collateral;
 - (2) A bank holding company, a savings and loan holding company, a U.S. intermediate holding company established or designated for purposes of compliance with 12 CFR 252.153, a foreign bank, a depository institution, a market intermediary, a company that would be any of the foregoing if it were organized under the laws of the United States or any State, or an affiliate of any of the foregoing institutions; or
 - (3) 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).
 - (e) A covered swap entity shall monitor the market value and eligibility of all collateral collected and posted to satisfy the minimum initial margin and minimum variation margin requirements of this subpart. To the extent that the market value of such collateral has declined, the covered swap entity shall promptly collect or post such additional eligible collateral as is necessary to maintain compliance with the margin requirements of this subpart. To the extent that the collateral is no longer eligible, the covered swap entity shall promptly collect or post sufficient eligible re-

placement collateral to comply with the margin requirements of this subpart.

(f) A covered swap entity may collect or post initial margin and variation margin that is required by section 237.3(d) or section 237.4(c) or that is not required pursuant to this subpart in any form of collateral.

3-3686

SECTION 237.7—Segregation of Collateral

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

(b) A covered swap entity that collects initial margin required by section 237.3(a) with respect to a non-cleared swap or a non-cleared security-based swap shall require that such initial margin be held by one or more custodians that are not the covered swap entity or counterparty and not affiliates of the covered swap entity or the counterparty.

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

(1) Prohibits the custodian from rehypothecating, repledging, reusing, or otherwise transferring (through securities lending, 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 an asset described in section 237.6(a)(2) or (b), such asset is held in compliance with this section 237.7, 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) Is a legal, valid, binding, and enforceable agreement under the laws of all rel-

evant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding.

(d) Notwithstanding paragraph (c)(1) of this section, a custody agreement may permit the posting party to substitute or direct any reinvestment of posted collateral held by the custodian, provided that, with respect to collateral collected by a covered swap entity pursuant to section 237.3(a) or posted by a covered swap entity pursuant to section 237.3(b), the agreement requires the posting party to:

(1) Substitute only funds or other property that would qualify as eligible collateral under section 237.6, and for which the amount net of applicable discounts described in appendix B of this subpart would be sufficient to meet the requirements of section 237.3; and

(2) Direct reinvestment of funds only in assets that would qualify as eligible collateral under section 237.6, and for which the amount net of applicable discounts described in appendix B of this subpart would be sufficient to meet the requirements of section 237.3.

3-3687

SECTION 237.8—Initial Margin Models and Standardized Amounts

(a) *Standardized amounts.* Unless a covered swap entity's initial margin model conforms to the requirements of this section, the covered swap entity shall calculate the amount of initial margin required to be collected or posted for one or more non-cleared swaps or non-cleared security-based swaps with a given counterparty pursuant to section 237.3 on a daily basis pursuant to appendix A of this subpart.

(b) *Use of initial margin models.* A covered swap entity may calculate the amount of initial margin required to be collected or posted for one or more non-cleared swaps or non-cleared security-based swaps with a given counterparty pursuant to section 237.3 on a daily basis using an initial margin model only if the initial margin model meets the requirements of this section.

(c) *Requirements for initial margin model.*

- (1) A covered swap entity must obtain the prior written approval of the Board before using any initial margin model to calculate the initial margin required in this subpart.
 - (2) A covered swap entity must demonstrate that the initial margin model satisfies all of the requirements of this section on an ongoing basis.
 - (3) A covered swap entity must notify the Board in writing 60 days prior to:
 - (i) Extending the use of an initial margin model that the Board has approved under this section to an additional product type;
 - (ii) Making any change to any initial margin model approved by the Board under this section that would result in a material change in the covered swap entity's assessment of initial margin requirements; or
 - (iii) Making any material change to modeling assumptions used by the initial margin model.
 - (4) The Board may rescind its approval of the use of any initial margin model, in whole or in part, or may impose additional conditions or requirements if the Board determines, in its sole discretion, that the initial margin model no longer complies with this section.
- (d) *Quantitative requirements.*
- (1) The covered swap entity's initial margin model must calculate an amount of initial margin that is equal to the potential future exposure of the non-cleared swap, non-cleared security-based swap or netting portfolio of non-cleared swaps or non-cleared security-based swaps covered by an eligible master netting agreement. Potential future exposure is an estimate of the one-tailed 99 percent confidence interval for an increase in the value of the non-cleared swap, non-cleared security-based swap or netting portfolio of non-cleared swaps or non-cleared security-based swaps due to an instantaneous price shock that is equivalent to a movement in all material underlying risk factors, including prices, rates, and spreads, over a holding period equal to the shorter of ten business days or the maturity of the non-cleared swap, non-cleared security-based swap or netting portfolio.
 - (2) All data used to calibrate the initial margin model must be based on an equally weighted historical observation period of at least one year and not more than five years and must incorporate a period of significant financial stress for each broad asset class that is appropriate to the non-cleared swaps and non-cleared security-based swaps to which the initial margin model is applied.
 - (3) The covered swap entity's initial margin model must use risk factors sufficient to measure all material price risks inherent in the transactions for which initial margin is being calculated. The risk categories must include, but should not be limited to, foreign exchange or interest rate risk, credit risk, equity risk, and commodity risk, as appropriate. For material exposures in significant currencies and markets, modeling techniques must capture spread and basis risk and must incorporate a sufficient number of segments of the yield curve to capture differences in volatility and imperfect correlation of rates along the yield curve.
 - (4) In the case of a non-cleared cross-currency swap, the covered swap entity's initial margin model need not recognize any risks or risk factors associated with the fixed, physically-settled foreign exchange transaction associated with the exchange of principal embedded in the non-cleared cross-currency swap. The initial margin model must recognize all material risks and risk factors associated with all other payments and cash flows that occur during the life of the non-cleared cross-currency swap.
 - (5) The initial margin model may calculate initial margin for a non-cleared swap or non-cleared security-based swap or a netting portfolio of non-cleared swaps or non-cleared security-based swaps covered by an eligible master netting agreement. It may reflect offsetting exposures, diversification, and other hedging benefits for non-cleared swaps and non-cleared security-based swaps that are governed by the same eligible master netting agreement by incorporating empirical correlations within the following broad risk categories, provided the covered swap entity validates and demonstrates the reasonableness of its process for modeling and measuring hedging benefits: Commod-

ity, credit, equity, and foreign exchange or interest rate. Empirical correlations under an eligible master netting agreement may be recognized by the initial margin model within each broad risk category, but not across broad risk categories.

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

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

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

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

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

(11) The covered swap entity may not incorporate any proxy or approximation used to capture the risks of the covered swap entity's non-cleared swaps or non-cleared

security-based swaps unless it has first demonstrated to the satisfaction of the Board that such proxy or approximation is appropriate.

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

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

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

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

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

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

(1) The covered swap entity must maintain a risk control unit that reports directly to

senior management and is independent from the business trading units.

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

- (i) An evaluation of the conceptual soundness of (including developmental evidence supporting) the initial margin model;
 - (ii) An ongoing monitoring process that includes verification of processes and benchmarking by comparing the covered swap entity's initial margin model outputs (estimation of initial margin) with relevant alternative internal and external data sources or estimation techniques. The benchmark(s) must address the chosen model's limitations. When applicable, the covered swap entity should consider benchmarks that allow for non-normal distributions such as historical and Monte Carlo simulations. When applicable, validation shall include benchmarking against observable margin standards to ensure that the initial margin required is not less than what a derivatives clearing organization or a clearing agency would require for similar cleared transactions; and
 - (iii) An outcomes analysis process that includes backtesting the initial margin model. This analysis must recognize and compensate for the challenges inherent in backtesting over periods that do not contain significant financial stress.
- (3) If the validation process reveals any material problems with the initial margin model, the covered swap entity must promptly notify the Board of the problems, describe to the Board any remedial actions being taken, and adjust the initial margin model to ensure an appropriately conservative amount of required initial margin is being calculated.
- (4) The covered swap entity must have an internal audit function independent of

business-line management and the risk control unit that at least annually assesses the effectiveness of the controls supporting the covered swap entity's initial margin model measurement systems, including the activities of the business trading units and risk control unit, compliance with policies and procedures, and calculation of the covered swap entity's initial margin requirements under this subpart. At least annually, the internal audit function must report its findings to the covered swap entity's board of directors or a committee thereof.

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

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

3-3688

SECTION 237.9—Cross-Border Application of Margin Requirements

(a) *Transactions to which this rule does not apply.* The requirements of sections 237.3 through 237.8 and sections 237.10 through 237.12 shall not apply to any foreign non-cleared swap or foreign non-cleared security-based swap of a foreign covered swap entity.

(b) For purposes of this section, a foreign non-cleared swap or foreign non-cleared security-based swap is any non-cleared swap or non-cleared security-based swap with respect to which neither the counterparty to the foreign covered swap entity nor any party that provides a guarantee of either party's obliga-

tions under the non-cleared swap or non-cleared security-based swap is:

- (1) An entity organized under the laws of the United States or any State (including a U.S. branch, agency, or subsidiary of a foreign bank) or a natural person who is a resident of the United States;
- (2) A branch or office of an entity organized under the laws of the United States or any State; or
- (3) A swap entity that is a subsidiary of an entity that is organized under the laws of the United States or any State.

(c) For purposes of this section, a foreign covered swap entity is any covered swap entity that is not:

- (1) An entity organized under the laws of the United States or any State, including a U.S. branch, agency, or subsidiary of a foreign bank;
- (2) A branch or office of an entity organized under the laws of the United States or any State; or
- (3) An entity that is a subsidiary of an entity that is organized under the laws of the United States or any State.

(d) Transactions for which substituted compliance determination may apply—

- (1) *Determinations and reliance.* For non-cleared swaps and non-cleared security-based swaps entered into by covered swap entities described in paragraph (d)(3) of this section, a covered swap entity may satisfy the provisions of this subpart by complying with the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps that the prudential regulators jointly, conditionally or unconditionally, determine by public order satisfy the corresponding requirements of sections 237.3 through 237.8 and sections 237.10 through 237.12.
- (2) *Standard.* In determining whether to make a determination under paragraph (d)(1) of this section, the prudential regulators will consider whether the requirements of such foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps applicable to such covered swap entities are comparable to the otherwise applicable requirements of this subpart

and appropriate for the safe and sound operation of the covered swap entity, taking into account the risks associated with non-cleared swaps and non-cleared security-based swaps.

(3) *Covered swap entities eligible for substituted compliance.* A covered swap entity may rely on a determination under paragraph (d)(1) of this section only if:

(i) 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 U.S. 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

(ii) The covered swap entity is:

- (A) A foreign covered swap entity;
- (B) A U.S. 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.

(4) *Compliance with foreign margin collection requirement.* A covered swap entity satisfies its requirement to post initial margin under section 237.3(b) by posting to its counterparty initial margin in the form and amount, and at such times, that its counterparty is required to collect pursuant to a foreign regulatory framework, provided that the counterparty is subject to the foreign regulatory framework and the prudential regulators have made a determination under paragraph (d)(1) of this section, unless otherwise stated in that determination, and the counterparty's obligations under the non-cleared swap or non-cleared security-based swap do not have a guarantee from:

- (i) An entity organized under the laws of the United States or any State (including a U.S. branch, agency, or subsidiary of a foreign bank) or a natural person who is a resident of the United States; or

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

(e) *Requests for determinations.*

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

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

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

(A) The scope of transactions covered;

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

(C) The timing of margin requirements;

(D) Any documentation requirements;

(E) The forms of eligible collateral;

(F) Any segregation and rehypothecation requirements; and

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

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

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

(2) A covered swap entity described in paragraph (d)(3) of this section may make a request under this section only if the non-cleared swap or non-cleared security-based swap activities of the covered swap entity

are directly supervised by the authorities administering the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps.

(f) *Segregation unavailable.* Sections 237.3(b) and 237.7 do not apply to a non-cleared swap or non-cleared security-based swap entered into by:

(1) A foreign branch of a covered swap entity that is a depository institution; or

(2) A covered swap 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, if:

(i) Inherent limitations in the legal or operational infrastructure in the foreign jurisdiction make it impracticable for the covered swap entity and the counterparty to post any form of eligible initial margin collateral recognized pursuant to section 237.6(b) in compliance with the segregation requirements of section 237.7;

(ii) The covered swap entity is subject to foreign regulatory restrictions that require the covered swap entity to transact in the non-cleared swap or non-cleared security-based swap with the counterparty through an establishment within the foreign jurisdiction and do not accommodate the posting of collateral for the non-cleared swap or non-cleared security-based swap outside the jurisdiction;

(iii) The counterparty to the non-cleared swap or non-cleared security-based swap is not, and the counterparty'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 (including a U.S. branch, agency, or subsidiary 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;

(iv) The covered swap entity collects initial margin for the non-cleared swap or non-cleared security-based swap in accor-

dance with section 237.3(a) in the form of cash pursuant to section 237.6(b)(1), and posts and collects variation margin in accordance with section 237.4(a) in the form of cash pursuant to section 237.6(b)(1); and

(v) The Board provides the covered swap entity with prior written approval for the covered swap entity's reliance on this paragraph (f) for the foreign jurisdiction.

(g) *Guarantee* means an arrangement pursuant to which one party to a non-cleared swap or non-cleared security-based swap has rights of recourse against a third-party guarantor, with respect to its counterparty's obligations under the non-cleared swap or non-cleared security-based swap. For these purposes, a party to a non-cleared swap or non-cleared security-based swap has rights of recourse against a guarantor if the party has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from the guarantor with respect to its counterparty's obligations under the non-cleared swap or non-cleared security-based swap. In addition, any arrangement pursuant to which the guarantor has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from any other third party guarantor with respect to the counterparty's obligations under the non-cleared swap or non-cleared security-based swap, such arrangement will be deemed a guarantee of the counterparty's obligations under the non-cleared swap or non-cleared security-based swap by the other guarantor.

(h) (1) A covered swap entity described in paragraphs (d)(3)(i) and (ii) of this section is not subject to the requirements of section 237.3(a) or section 237.11(a) for any non-cleared swap or non-cleared security-based swap executed with an affiliate of the covered swap entity; and

(2) For purposes of paragraph (h)(1) of this section, "affiliate" has the same meaning provided in 12 CFR 237.11(d).

3-3689

SECTION 237.10—Documentation of Margin Matters

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

(a) 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 subpart, and at such time as initial margin or variation margin is required to be collected or posted under section 237.3 or section 237.4, as applicable; and

(b) Specifies:

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

(2) 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

(c) 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.

3-3690

SECTION 237.11—Special Rules for Affiliates

(a) (1) A covered swap entity shall calculate on each business day an initial margin collection amount for each counterparty that is a swap entity or financial end user with a material swaps exposure and an affiliate of the covered swap entity.

(2) If the aggregate of all initial margin collection amounts calculated under paragraph (a)(1) of this section does not exceed 15 percent of the covered swap entity's tier 1 capital, the requirements for a covered

swap entity to collect initial margin under section 237.3(a) do not apply with respect to any non-cleared swap or non-cleared security-based swap with a counterparty that is an affiliate.

(3) On each business day that the aggregate of all initial margin collection amounts calculated under paragraph (a)(1) of this section exceeds 15 percent of the covered swap entity's tier 1 capital:

(i) The covered swap entity shall collect initial margin under section 237.3(a) for each additional non-cleared swap and non-cleared security-based swap executed that business day with a counterparty that is a swap entity or financial end user with a material swaps exposure and an affiliate of the covered swap entity, commencing on the day after execution and continuing on a daily basis as required under section 237.3(c), until the earlier of:

(A) The termination date of such non-cleared swap or non-cleared security-based swap, or

(B) The business day on which the aggregate of all initial margin collection amounts calculated under paragraph (a)(1) of this section falls below 15 percent of the covered swap entity's tier 1 capital;

(ii) Notwithstanding section 237.7(b), to the extent the covered swap entity collects initial margin pursuant to paragraph (a)(3)(i) of this section in the form of collateral other than cash collateral, the custodian for such collateral may be the covered swap entity or an affiliate of the covered swap entity; and

(4) For purposes of this paragraph (a), "tier 1 capital" means the sum of common equity tier 1 capital as defined in 12 CFR 217.20(b) and additional tier 1 capital as defined in 12 CFR 217.20(c), as reported in the institution's most recent Consolidated Reports of Income and Condition (Call Report).

(5) If any subsidiary of the covered swap entity (including a subsidiary described in section 237.9(h)) executes any non-cleared swap or non-cleared security-based swap with any counterparty that is a swap entity

or financial end user with a material swaps exposure and an affiliate of the covered swap entity:

(i) The covered swap entity shall treat such non-cleared swap or security-based swap as its own for purposes of this paragraph (a); and

(ii) If the subsidiary is itself a covered swap entity, the compliance by its parent affiliated covered swap entity with this paragraph (a)(5) shall be deemed to establish the subsidiary's compliance with the requirements of this paragraph (a) and to exempt the subsidiary from the requirements for a covered swap entity to collect initial margin under section 237.3(a) from an affiliate.

(b) The requirement for a covered swap entity to post initial margin under section 237.3(b) does not apply with respect to any non-cleared swap or non-cleared security-based swap with a counterparty that is an affiliate.

(c) Section 237.3(d) shall apply to a counterparty that is an affiliate in the same manner as it applies to any counterparty that is neither a financial end user without a material swap exposure nor a swap entity.

(d) For purposes of this section,

(1) An *affiliate* means:

(i) An affiliate as defined in section 237.2; or

(ii) Any company that controls, is controlled by, or is under common control with the covered swap entity through the direct or indirect exercise of controlling influence over the management or policies of the controlled company.

(2) A *subsidiary* means:

(i) A subsidiary as defined in section 237.2; or

(ii) Any company that is controlled by the covered swap entity through the direct or indirect exercise of controlling influence over the management or policies of the controlled company.

SECTION 237.12—Capital

A covered swap entity shall comply with:

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

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

(c) In the case of a covered swap entity that is a foreign banking organization (as defined in 12 CFR 211.21(o)), a U.S. intermediate

3-3691 holding company subsidiary of a foreign banking organization (as defined in 12 CFR 252.3(y)) or any state branch or state agency of a foreign bank (as defined in 12 U.S.C. 3101(b)(11) and (12)), the capital standards that are applicable to such covered swap entity under section 225.2(r)(3) of the Board's Regulation Y (12 CFR 225.2(r)(3)) or the Board's Regulation YY (12 CFR part 252); and

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

3-3699.5**APPENDIX A TO SUBPART A—Standardized Minimum Initial Margin Requirements for Non-Cleared Swaps and Non-Cleared Security-Based Swaps**Table A—Standardized minimum gross initial margin requirements for non-cleared swaps and non-cleared security-based swaps¹

Asset class	Gross initial margin (% of notional exposure)
Credit: 0-2 year duration	2
Credit: 2-5 year duration	5
Credit: 5+ year duration	10
Commodity	15
Equity	15
Foreign exchange/currency	6
Cross currency swaps: 0-2 year duration	1
Cross-currency swaps: 2-5 year duration	2
Cross-currency swaps: 5+ year duration	4
Interest rate: 0-2 year duration	1
Interest rate: 2-5 year duration	2
Interest rate: 5+ year duration	4
Other	15

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

$$\text{Initial Margin} = 0.4 \times \text{Gross Initial Margin} + 0.6 \times \text{NGR} \times \text{Gross Initial Margin}$$

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. In cases where the gross replacement cost is zero, the NGR should be set to 1.0.

3-3699.6**APPENDIX B TO SUBPART A—Margin Values for Eligible Noncash Margin Collateral**Table B—Margin values for eligible noncash margin collateral¹

Asset class	Discount (%)
Eligible government and related (e.g., central bank, multilateral development bank, GSE securities identified in section 237.6(a)(2)(iv) or (b)(5) debt: residual maturity less than one-year	0.5
Eligible government and related (e.g., central bank, multilateral development bank, GSE securities identified in section 237.6(a)(2)(iv) or (b)(5) debt: residual maturity between one and five years	2.0
Eligible government and related (e.g., central bank, multilateral development bank, GSE securities identified in section 237.6(a)(2)(iv) or (b)(5) debt: residual maturity greater than five years	4.0
Eligible GSE debt securities not identified in section 237.6(a)(2)(iv) or (b)(5): residual maturity less than one-year	1.0
Eligible GSE debt securities not identified in section 237.6(a)(2)(iv) or (b)(5): residual maturity between one and five years	4.0
Eligible GSE debt securities not identified in section 237.6(a)(2)(iv) or (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 3-year U.S. 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.

3-3700
SUBPART B—PROHIBITION
AGAINST FEDERAL ASSISTANCE TO
SWAPS ENTITIES

SECTION 237.20—Definitions

Unless otherwise specified, for purposes of this subpart:

(a) *Board* means the Board of Governors of the Federal Reserve System.

(b) *Dodd-Frank Act* means the Dodd-Frank Wall Street Reform and Consumer Protection Act.

(c) *Foreign bank* has the same meaning as in section 211.21(n) of the Board's Regulation K (12 CFR 211.21(n)).

(d) *Major security-based swap participant* has the same meaning as in section 3(a)(67) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(67)) and as implemented in rules and orders issued by the Securities and Exchange Commission.

(e) *Major swap participant* has the same meaning as in section 1a(33) of the Commodity Exchange Act (7 U.S.C. 1a(33)) and as

implemented in rules and orders issued by the Commodity Futures Trading Commission.

(f) *Security-based swap* has the same meaning as in section 3(a)(68) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(68)) and as implemented in rules and orders issued by the Securities and Exchange Commission.

(g) *Security-based swap dealer* has the same meaning as in section 3(a)(71) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(71)) and as implemented in rules and orders issued by the Securities and Exchange Commission.

(h) *Swap dealer* has the same meaning as in section 1a(49) of the Commodity Exchange Act (7 U.S.C. 1a(49)) and as implemented in rules and orders issued by the Commodity Futures Trading Commission.

(i) *Swaps entity* means a person that is registered as a swap dealer, security-based swap dealer, major swap participant, or major security-based swap participant under the Commodity Exchange Act or Securities Exchange Act of 1934, other than an insured depository institution that is registered as a major swap participant or major security-based swap participant.

3-3701

SECTION 237.21—Definition of Insured Depository Institution for Purposes of Section 716 of the Dodd-Frank Act

For purposes of section 716 of the Dodd-Frank Act (15 U.S.C. 8305) and this rule, the term “insured depository institution” includes any insured depository institution as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813) and any uninsured U.S. branch or agency of a foreign bank. The terms branch, agency, and foreign bank are defined in section 1 of the International Banking Act of 1978 (12 U.S.C. 3101).

3-3702

SECTION 237.22—Transition Period for Insured Depository Institutions

(a) *Approval of transition period.*

(1) To the extent an insured depository institution for which the Board is the appropriate Federal banking agency qualifies as a

“swaps entity” and would be subject to the Federal assistance prohibition in section 716(a) of the Dodd-Frank Act (15 U.S.C. 8305(a)), the insured depository institution may request a transition period of up to 24 months from the later of July 16, 2013, or the date on which it becomes a swaps entity, during which to conform its swaps activities to the requirements of section 716 of the Dodd-Frank Act (15 U.S.C. 8305) by submitting a request in writing to the Board.

(2) Any request submitted pursuant to this paragraph (a) of this section shall, at a minimum, include the following information:

(i) The length of the transition period requested;

(ii) A description of the quantitative and qualitative impacts of divestiture or cessation of swap or security-based swaps activities on the insured depository institution, including information that addresses the factors in paragraph (c) of this section; and

(iii) A detailed explanation of the insured depository institution’s plan for conforming its activities to the requirements of section 716 of the Dodd-Frank Act (15 U.S.C. 8305) and this part.

(3) The Board may, at any time, request additional information that it believes is necessary for its decision.

(b) *Transition period for insured depository institutions.* Following review of a written request submitted under paragraph (a) of this section, the Board shall permit an insured depository institution for which it is the appropriate Federal banking agency up to 24 months after the later of July 16, 2013, or the date on which the insured depository institution becomes a swaps entity, to comply with the requirements of section 716 of the Dodd-Frank Act (15 U.S.C. 8305) and this subpart based on its consideration of the factors in paragraph (c).

(c) *Factors governing Board determinations.* In establishing an appropriate transition period pursuant to any request under this section, the Board will take into account and make written findings regarding:

- (1) The potential impact of divestiture or cessation of swap or security-based swaps activities on the insured depository institution's:
- (i) Mortgage lending;
 - (ii) Small business lending;
 - (iii) Job creation; and
 - (iv) Capital formation versus the potential negative impact on insured depositors and the Deposit Insurance Fund of the Federal Deposit Insurance Corporation; and
- (2) Any other factor that the Board believes appropriate.
- (d) *Timing of Board review.* The Board will seek to act on a request under paragraph (a) of this section expeditiously after the receipt of a complete request.
- (e) *Extension of transition period.* The Board may extend a transition period provided under this section for a period of up to one additional year. To request an extension of the transition period, an insured depository institution must submit a written request containing the information set forth in paragraph (a) of this section no later than 60 days before the end of the transition period.
- (f) *Authority to impose restrictions during any transition period.* The Board may impose such conditions on any transition period granted under this section as the Board determines are necessary or appropriate.
- (g) *Consultation.* The Board shall consult with the Commodity Futures Trading Commission or the Securities and Exchange Commission, as appropriate, prior to the approval of a request by an insured depository institution for a transition period under this section.

Statutory Authority for Regulation KK

3-3712

COMMODITY EXCHANGE ACT

SECTION 4S—Registration and Regulation of Swap Dealers and Major Swap Participants

* * * * *

(e) *Capital and margin requirements.*

(1) *In general.*

(A) *Swap dealers and major swap participants that are banks.* Each registered swap dealer and major swap participant for which there is a prudential regulator shall meet such minimum capital requirements and minimum initial and variation margin requirements as the prudential regulator shall by rule or regulation prescribe under paragraph (2)(A).

(B) *Swap dealers and major swap participants that are not banks.* Each registered swap dealer and major swap participant for which there is not a prudential regulator shall meet such minimum capital requirements and minimum initial and variation margin requirements as the Commission shall by rule or regulation prescribe under paragraph (2)(B).

(2) *Rules.*

(A) *Swap dealers and major swap participants that are banks.* The prudential regulators, in consultation with the Commission and the Securities and Exchange Commission, shall jointly adopt rules for swap dealers and major swap participants, with respect to their activities as a swap dealer or major swap participant, for which there is a prudential regulator imposing—

- (i) capital requirements; and
- (ii) both initial and variation margin requirements on all swaps that are not cleared by a registered derivatives clearing organization.

(B) *Swap dealers and major swap participants that are not banks.* The Commission shall adopt rules for swap dealers

and major swap participants, with respect to their activities as a swap dealer or major swap participant, for which there is not a prudential regulator imposing—

- (i) capital requirements; and
- (ii) both initial and variation margin requirements on all swaps that are not cleared by a registered derivatives clearing organization.

(C) *Capital.* In setting capital requirements for a person that is designated as a swap dealer or a major swap participant for a single type or single class or category of swap or activities, the prudential regulator and the Commission shall take into account the risks associated with other types of swaps or classes of swaps or categories of swaps engaged in and the other activities conducted by that person that are not otherwise subject to regulation applicable to that person by virtue of the status of the person as a swap dealer or a major swap participant.

(3) *Standards for capital and margin.*

(A) *In general.* To offset the greater risk to the swap dealer or major swap participant and the financial system arising from the use of swaps that are not cleared, the requirements imposed under paragraph (2) shall—

- (i) help ensure the safety and soundness of the swap dealer or major swap participant; and
- (ii) be appropriate for the risk associated with the non-cleared swaps held as a swap dealer or major swap participant.

(B) *Rule of construction.*

(i) *In general.* Nothing in this section shall limit, or be construed to limit, the authority—

- (I) of the Commission to set financial responsibility rules for a futures commission merchant or introducing broker registered pursuant to section 6f (a) of this title (except for section 6f (a)(3) of this title) in accordance with section 6f (b) of this title; or

(II) of the Securities and Exchange Commission to set financial responsibility rules for a broker or dealer registered pursuant to section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o (b)) (except for section 15(b)(11) of that Act (15 U.S.C. 78o (b)(11)) 1 in accordance with section 15(c)(3) of the Securities Exchange Act of 1934 (15 U.S.C. 78o (c)(3)).

(ii) *Futures commission merchants and other dealers.* A futures commission merchant, introducing broker, broker, or dealer shall maintain sufficient capital to comply with the stricter of any applicable capital requirements to which such futures commission merchant, introducing broker, broker, or dealer is subject to under this chapter or the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(C) *Margin requirements.* In prescribing margin requirements under this subsection, the prudential regulator with respect to swap dealers and major swap participants for which it is the prudential regulator and the Commission with respect to swap dealers and major swap participants for which there is no prudential regulator shall permit the use of noncash collateral, as the regulator or the Commission determines to be consistent with—

- (i) preserving the financial integrity of markets trading swaps; and
- (ii) preserving the stability of the United States financial system.

(D) *Comparability of capital and margin requirements.*

- (i) *In general.* The prudential regulators, the Commission, and the Securities and Exchange Commission shall periodically (but not less frequently than annually) consult on minimum capital requirements and minimum initial and variation margin requirements.
- (ii) *Comparability.* The entities described in clause (i) shall, to the maximum extent practicable, establish and maintain comparable minimum capital requirements and minimum initial and

variation margin requirements, including the use of non cash collateral, for—

- (I) swap dealers; and
- (II) major swap participants.

(4) *Applicability with respect to counterparties.* The requirements of paragraphs (2)(A)(ii) and (2)(B)(ii), including the initial and variation margin requirements imposed by rules adopted pursuant to paragraphs (2)(A)(ii) and (2)(B)(ii), shall not apply to a swap in which a counterparty qualifies for an exception under section 2(h)(7)(A), or an exemption issued under section 4(c)(1) from the requirements of section 2(h)(1)(A) for cooperative entities as defined in such exemption, or satisfies the criteria in section 2(h)(7)(D).

* * * * *

[7 USC 6s. As amended by act of Jan. 12, 2015 (129 Stat. 28).]

SECURITIES EXCHANGE ACT

See section 15 at 5-118 *et seq.*, section 15A at 5-126 *et seq.*, section 15B at 5-139 *et seq.*, section 15C at 5-153.3 *et seq.*, and section 15F at 5-153.5.

3-3713

DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

SECTION 716—Prohibition against Federal Government Bailouts of Swaps Entities

(a) *Prohibition on Federal assistance.* Notwithstanding any other provision of law (including regulations), no Federal assistance may be provided to any swaps entity with respect to any swap, security-based swap, or other activity of the swaps entity.

(b) *Definitions.* In this section:

- (1) *Federal assistance.* The term “Federal assistance” means the use of any advances from any Federal Reserve credit facility or discount window that is not part of a program or facility with broad-based eligibility

under section 13(3)(A) of the Federal Reserve Act, Federal Deposit Insurance Corporation insurance or guarantees for the purpose of—

- (A) making any loan to, or purchasing any stock, equity interest, or debt obligation of, any swaps entity;
- (B) purchasing the assets of any swaps entity;
- (C) guaranteeing any loan or debt issuance of any swaps entity; or
- (D) entering into any assistance arrangement (including tax breaks), loss sharing, or profit sharing with any swaps entity.

(2) *Swaps entity.*

(A) *In general.* The term “swaps entity” means any swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, that is registered under—

- (i) the Commodity Exchange Act (7 U.S.C. 1 *et seq.*); or
- (ii) the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(B) *Exclusion.* The term “swaps entity” does not include any major swap participant or major security-based swap participant that is an insured depository institution.

(c) *Affiliates of insured depository institutions.*

The prohibition on Federal assistance contained in subsection (a) does not apply to and shall not prevent an insured depository institution from having or establishing an affiliate which is a swaps entity, as long as such insured depository institution is part of a bank holding company, or savings and loan holding company, that is supervised by the Federal Reserve and such swaps entity affiliate complies with sections 23A and 23B of the Federal Reserve Act and such other requirements as the Commodity Futures Trading Commission or the Securities Exchange Commission, as appropriate, and the Board of Governors of the Federal Reserve System, may determine to be necessary and appropriate.

(d) *Only bona fide hedging and traditional bank activities permitted.* The prohibition in subsection (a) shall apply to any insured depository institution unless the insured depository

institution limits its swap or security-based swap activities to:

(1) Hedging and other similar risk mitigating activities directly related to the insured depository institution’s activities.

(2) Acting as a swaps entity for swaps or security-based swaps involving rates or reference assets that are permissible for investment by a national bank under the paragraph designated as “Seventh.” of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), other than as described in paragraph (3).

(3) *Limitation on credit default swaps.* Acting as a swaps entity for credit default swaps, including swaps or security-based swaps referencing the credit risk of asset-backed securities as defined in section 3(a)(77) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(77)) (as amended by this Act) shall not be considered a bank permissible activity for purposes of subsection (d)(2) unless such swaps or security-based swaps are cleared by a derivatives clearing organization (as such term is defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a)) or a clearing agency (as such term is defined in section 3 of the Securities Exchange Act (15 U.S.C. 78c)) that is registered, or exempt from registration, as a derivatives clearing organization under the Commodity Exchange Act or as a clearing agency under the Securities Exchange Act, respectively.

(e) *Existing swaps and security-based swaps.*

The prohibition in subsection (a) shall only apply to swaps or security-based swaps entered into by an insured depository institution after the end of the transition period described in subsection (f).

(f) *Transition period.* To the extent an insured depository institution qualifies as a “swaps entity” and would be subject to the Federal assistance prohibition in subsection (a), the appropriate Federal banking agency, after consulting with and considering the views of the Commodity Futures Trading Commission or the Securities Exchange Commission, as appropriate, shall permit the insured depository institution up to 24 months to divest the swaps entity or cease the activities that require

registration as a swaps entity. In establishing the appropriate transition period to effect such divestiture or cessation of activities, which may include making the swaps entity an affiliate of the insured depository institution, the appropriate Federal banking agency shall take into account and make written findings regarding the potential impact of such divestiture or cessation of activities on the insured depository institution's (1) mortgage lending, (2) small business lending, (3) job creation, and (4) capital formation versus the potential negative impact on insured depositors and the Deposit Insurance Fund of the Federal Deposit Insurance Corporation. The appropriate Federal banking agency may consider such other factors as may be appropriate. The appropriate Federal banking agency may place such conditions on the insured depository institution's divestiture or ceasing of activities of the swaps entity as it deems necessary and appropriate. The transition period under this subsection may be extended by the appropriate Federal banking agency, after consultation with the Commodity Futures Trading Commission and the Securities and Exchange Commission, for a period of up to 1 additional year.

(g) *Excluded entities.* For purposes of this section, the term "swaps entity" shall not include any insured depository institution under the Federal Deposit Insurance Act or a covered financial company under title II which is in a conservatorship, receivership, or a bridge bank operated by the Federal Deposit Insurance Corporation.

(h) *Effective date.* The prohibition in subsection (a) shall be effective 2 years following the date on which this Act is effective.

(i) *Liquidation required.*

(1) *In general.*

(A) *FDIC insured institutions.* All swaps entities that are FDIC insured institutions that are put into receivership or declared insolvent as a result of swap or security-based swap activity of the swaps entities shall be subject to the termination or transfer of that swap or security-based swap activity in accordance with applicable law prescribing the treatment of those contracts. No taxpayer funds shall

be used to prevent the receivership of any swap entity resulting from swap or security-based swap activity of the swaps entity.

(B) *Institutions that pose a systemic risk and are subject to heightened prudential supervision as regulated under section 113.* All swaps entities that are institutions that pose a systemic risk and are subject to heightened prudential supervision as regulated under section 113, that are put into receivership or declared insolvent as a result of swap or security-based swap activity of the swaps entities shall be subject to the termination or transfer of that swap or security-based swap activity in accordance with applicable law prescribing the treatment of those contracts. No taxpayer funds shall be used to prevent the receivership of any swap entity resulting from swap or security-based swap activity of the swaps entity.

(C) *Non-FDIC insured, non-systemically significant institutions not subject to heightened prudential supervision as regulated under section 113.* No taxpayer resources shall be used for the orderly liquidation of any swaps entities that are non-FDIC insured, non-systemically significant institutions not subject to heightened prudential supervision as regulated under section 113.

(2) *Recovery of funds.* All funds expended on the termination or transfer of the swap or security-based swap activity of the swaps entity shall be recovered in accordance with applicable law from the disposition of assets of such swap entity or through assessments, including on the financial sector as provided under applicable law.

(3) *No losses to taxpayers.* Taxpayers shall bear no losses from the exercise of any authority under this title.

(j) *Prohibition on unregulated combination of swaps entities and banking.* At no time following adoption of the rules in subsection (k) may a bank or bank holding company be permitted to be or become a swap entity unless it conducts its swap or security-based swap activity in compliance with such minimum stan-

dards set by its prudential regulator as are reasonably calculated to permit the swaps entity to conduct its swap or security-based swap activities in a safe and sound manner and mitigate systemic risk.

(k) *Rules.* In prescribing rules, the prudential regulator for a swaps entity shall consider the following factors:

- (1) The expertise and managerial strength of the swaps entity, including systems for effective oversight.
- (2) The financial strength of the swaps entity.
- (3) Systems for identifying, measuring and controlling risks arising from the swaps entity's operations.
- (4) Systems for identifying, measuring and controlling the swaps entity's participation in existing markets.
- (5) Systems for controlling the swaps entity's participation or entry into in* new markets and products.

(l) *Authority of the Financial Stability Oversight Council.* The Financial Stability Oversight Council may determine that,[†] when other provisions established by this Act are insufficient to effectively mitigate systemic risk and protect taxpayers, that swaps entities may no longer access Federal assistance with respect to any swap, security-based swap, or other activity of the swaps entity. Any such determi-

* So in original.

† So in original. The word "that" probably should not appear.

nation by the Financial Stability Oversight Council of a prohibition of federal assistance shall be made on an institution-by-institution basis, and shall require the vote of not fewer than two-thirds of the members of the Financial Stability Oversight Council, which must include the vote by the Chairman of the Council, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairperson of the Federal Deposit Insurance Corporation. Notice and hearing requirements for such determinations shall be consistent with the standards provided in title I.

(m) *Ban on proprietary trading in derivatives.* An insured depository institution shall comply with the prohibition on proprietary trading in derivatives as required by section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

[15 USC 8305. As added by act of July 21, 2010 (124 Stat. 1648).]

FEDERAL RESERVE ACT

See section 13 at 1-111 *et seq.* and section 13A at 1-124 *et seq.*

FEDERAL DEPOSIT INSURANCE ACT

See section 8 at 1-355 *et seq.*

INTERNATIONAL BANKING ACT OF 1978

See sections 1-17 at 1-562 *et seq.*