

**Supporting Statement for the  
Reporting and Recordkeeping Requirements Associated with  
Margin and Capital Requirements for Covered Swaps Entities (Regulation KK)  
(FR KK; OMB No. 7100-0364)**

*Margin and Capital Requirements for Covered Swap Entities  
(Docket No. R-1415; RIN 7100-AD74)*

**Summary**

The Board of Governors of the Federal Reserve System (Board), under delegated authority from the Office of Management and Budget (OMB), proposes to extend for three years, with revision, the Reporting and Recordkeeping Requirements Associated with Margin and Capital Requirements for Covered Swaps Entities (Regulation KK) (FR KK; OMB No. 7100-0364). The Board adopted a final rule<sup>1</sup> that implemented section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Regulation KK treats an uninsured U.S. branch or agency of a foreign bank as an insured depository institution for purposes of section 716 of the Dodd-Frank Act and establishes a process by which a state member bank or uninsured state branch or agency of a foreign bank may request a transition period to conform its swaps activities to the Dodd-Frank Act. The reporting requirements are found in sections 237.22(a)(1) and 237.22(e) of the final rule for state member banks and uninsured U.S. branches or agencies of foreign banks.

The Board, Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), Farm Credit Administration (FCA), and Federal Housing Finance Agency (FHFA) (collectively, the agencies) have adopted a joint final rule that would implement sections 731 and 764 of the Dodd-Frank Act requiring the agencies to establish capital requirements and initial and variation margin requirements for such entities on all non-cleared swaps and non-cleared security-based swaps in order to offset the greater risk to such entities and the financial system arising from the use of swaps and security-based swaps that are not cleared. On September 24, 2014, the agencies published a joint notice of proposed rulemaking in the *Federal Register* for public comment (79 FR 57348). On November 30, 2015, the agencies published a joint notice of final rulemaking in the *Federal Register* (80 FR 74840). The final rule is effective on April 1, 2016. The reporting requirements are found in sections 237.8(c), 8(d), 8(f)(3), and 9(e) and the recordkeeping requirements are found in sections 237.2 (definition of eligible master netting agreement, item 4), 5(c)(2)(i), 7(c), 8(e), 8(f), 8(g), 8(h), 10, and 11(b)(1). The Board accounts for the paperwork burden for any state member bank, bank holding company, savings and loan holding company, foreign banking organization, foreign bank that does not operate an insured branch, state branch or state agency of a foreign bank, or Edge or agreement corporation that is registered as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant.

The total current annual burden for the FR KK is estimated to be 98 hours and with the proposed changes is estimated to increase by 36,866 hours to 36,964 hours. At this time, there are no required reporting forms associated with this information collection.

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<sup>1</sup> See 79 FR 340 (January 3, 2014).

## **Background and Justification**

The structure, language, and purpose of section 716 of the Dodd-Frank Act create an ambiguity as to whether the term “insured depository institution” includes uninsured U.S. branches and agencies of foreign banks for purposes of the various provisions of section 716. The final rule resolves this ambiguity by providing that the term “insured depository institution” includes uninsured U.S. branches and agencies of foreign banks for purposes of section 716 of the Dodd-Frank Act. Accordingly, uninsured branches and agencies of foreign banks are provided the same exceptions and opportunity for transition period relief provided to insured depository institutions. The requirements in section 237.22(a)(1) of Regulation KK establish a process by which a state member bank or uninsured state branch or agency of a foreign bank may request a transition period to conform its swaps activities to the Dodd-Frank Act. The requirements in section 237.22(e) of Regulation KK further establish a process by which such entity may request an extension of the transition period.

## **Description of Information Collection**

The reporting requirements are contained in sections 237.22(a)(1) and 237.22(e) of the final rule. This information collection requirement implemented section 716 of the Dodd-Frank Act for state member banks and uninsured U.S. branches or agencies of foreign banks. Compliance with the information collection is required in order for state member banks or uninsured branches and agencies of foreign banks to obtain the benefit of utilizing a transition period under section 716. No other Federal law mandates these reporting requirements. At this time, there are no required reporting forms associated with this information collection.

Section 237.22(a)(1) provides that an insured depository institution for which the Board is the appropriate Federal banking agency 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, to conform its swaps activities to the requirements of section 716 of the Dodd-Frank Act.<sup>2</sup> Such insured depository institution may request a transition period by submitting a request in writing to the Board. Any request submitted must, at a minimum, include the following information: (1) the length of the transition period requested; (2) 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 section 237.22(c); and (3) 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.<sup>3</sup>

Section 237.22(e) would allow the Board to extend a transition period 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 section 237.22(a) no later than 60 days before the end of the transition period.

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<sup>2</sup> The insured depository institution must also qualify as a “swaps entity” and be subject to the “Federal assistance” prohibition in section 716(a) of the Dodd-Frank Act.

<sup>3</sup> See section 237.22(a)(1).

## **Proposed Revisions**

Sections 731 and 764 of the Dodd-Frank Act would require the agencies to adopt rules jointly to establish capital requirements and initial and variation margin requirements for such entities on all non-cleared swaps and non-cleared security-based swaps in order to offset the greater risk to such entities and the financial system arising from the use of swaps and security-based swaps that are not cleared.

On September 24, 2014, the agencies published a joint notice of proposed rulemaking in the *Federal Register* for public comment (79 FR 57348). On November 30, 2015, the agencies published a joint notice of final rulemaking in the *Federal Register* (80 FR 74840). The final rule contains requirements subject to the PRA. The reporting requirements are found in sections 237.8(c), 8(d), 8(f)(3), and 9(e) and the recordkeeping requirements are found in sections 237.2 (definition of “eligible master netting agreement,” item 4), 5(c)(2)(i), 7(c), 8(e), 8(f), 8(g), 8(h), 10, and 11(b)(1). These reporting and recordkeeping requirements would apply to 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), 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.. These information collection requirements would implement sections 731 and 764 of the Dodd-Frank Act.

### *Reporting Requirements*

Section 237.8 establishes standards for initial margin models. These standards include (1) a requirement that the covered swap entity receive prior approval from the relevant agency based on demonstration that the initial margin model meets specific requirements (237.8(c)(1) and (2)); (2) a requirement that a covered swap entity notify the relevant agency in writing 60 days before extending use of the model to additional product types, making certain changes to the initial margin model, or making material changes to modeling assumptions (237.8(c)(3)); (3) a variety of quantitative requirements, including requirements that the covered swap entity validate and demonstrate the reasonableness of its process for modeling and measuring hedging benefits, demonstrate to the satisfaction of the relevant agency that the omission of any risk factor from the calculation of its initial margin is appropriate, demonstrate to the satisfaction of the relevant agency that incorporation of any proxy or approximation used to capture the risks of the covered swap entity’s non-cleared swaps or non-cleared security-based swaps is appropriate, periodically review and, as necessary, revise the data used to calibrate the initial margin model to ensure that the data incorporate an appropriate period of significant financial stress (237.8(d)(5), (10), (11), (12), and (13)). Also, if the validation process reveals any material problems with the initial margin model, the covered swap entity must promptly notify the agency of the problems, describe to the agency any remedial actions being taken, and adjust the initial margin model to ensure an appropriately conservative amount of required initial margin is being calculated (237.8(f)(3)).

Section 237.9(e) allows a covered swap entity to request that the prudential regulators make a substituted compliance determination and must provide the reasons therefore and other required supporting documentation. A request for a substituted compliance determination must include a description of the scope and objectives of the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps; the specific provisions of the foreign regulatory framework for non-cleared swaps and security-based swaps (scope of transactions covered; determination of the amount of initial and variation margin required; timing of margin requirements; documentation requirements; forms of eligible collateral; segregation and rehypothecation requirements; and approval process and standards for models); 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 and security-based swap regulatory framework; and any other descriptions and documentation that the prudential regulators determine are appropriate. A covered swap entity may make a request under this section only if directly supervised by the authorities administering the foreign regulatory framework for non-cleared swaps and non-cleared security-based swaps.

#### *Recordkeeping Requirements*

Section 237.2 defines terms used in the proposed rule, including the definition of “eligible master netting agreement,” which provides that a covered swap entity that relies on the agreement for purpose of calculating the required margin must (1) conduct sufficient legal review of the agreement to conclude with a well-founded basis that the agreement meets specified criteria and (2) establish and maintain written procedures for monitoring relevant changes in law and to ensure that the agreement continues to satisfy the requirements of this section. The term “eligible master netting agreement” is used elsewhere in the proposed rule to specify instances in which a covered swap entity may (1) calculate variation margin on an aggregate basis across multiple non-cleared swaps and security-based swaps and (2) calculate initial margin requirements under an initial margin model for one or more swaps and security-based swaps.

Section 237.5(c)(2)(i) specifies that a covered swap entity shall not be deemed to have violated its obligation to collect or post margin from or to a counterparty if the covered swap entity has 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 agency that it has made appropriate efforts to collect or post the required margin.

Section 237.7(c) requires the custodian to 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, 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 relevant jurisdictions, including in the event of bankruptcy,

insolvency, or a similar proceeding. 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 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 would be sufficient to meet the requirements of section 237.3 and 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 would be sufficient to meet the requirements of section 237.3.

Section 237.8 establishes standards for initial margin models. These standards include (1) a requirement that a covered swap entity review its initial margin model annually (237.8(e)); (2) a requirement that the covered swap entity validate its initial margin model initially and on an ongoing basis, describe to the relevant agency any remedial actions being taken, and report internal audit findings regarding the effectiveness of the initial margin model to the covered swap entity's board of directors or a committee thereof (237.8(f)(2), (3), and (4)); (3) a requirement that the covered swap entity adequately document all material aspects of its initial margin model (237.8(g)); and (4) that 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 (237.8(h)).

Section 237.10 requires a covered swap entity to execute trading documentation with each counterparty that is either a swap entity or financial end user regarding credit support arrangements that (1) provides 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; and (2) specifies the methods, procedures, value of each non-cleared swap or non-cleared security-based swap for purposes of calculating variation margin requirements, and the procedures for resolving any disputes concerning valuation.

Section 237.11(b)(1) provides that 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. A covered swap entity shall calculate the amount of initial margin that would be required to be posted to an affiliate that is a financial end user with material swaps exposure pursuant to section 237.3(b) and provide documentation of such amount to each affiliate on a daily basis.

### **Time Schedule for Information Collection**

The information collection requirements in sections 237.22(a)(1) and 237.22(e) are event-generated.

## Legal Status

The Board's Legal Division has determined that sections 731 (7 U.S.C. § 6s) and 764 (15 U.S.C. § 78o-10) of Dodd-Frank expressly authorize the prudential regulators to adopt rules jointly for swap entities under their respective jurisdictions by imposing (1) capital requirements and (2) initial and variation margin requirements on all non-cleared swaps. Section 721(a)(39) of Dodd-Frank (7 U.S.C. § 1a(39)) defines the Board as the "prudential regulator" for the covered swap entities. Section 731(j)(3) provides that each registered swap dealer and major swap participant "shall disclose to the Commission [CFTC] and to the prudential regulator for the swap dealer or major swap participant, as applicable, information concerning (1) terms and conditions of its swaps; (2) swap trading operations, mechanisms, and practices; (3) financial integrity protections relating to swaps; and (4) other information relevant to its trading in swaps." Section 731(j)(4) provides that each registered swap dealer and major swap participant "shall (1) establish and enforce internal systems and procedures to obtain any necessary information to perform any of the functions described in this section; and (2) provide the information to the [CFTC] and to the prudential regulator for the swap dealer or major swap participant, as applicable, on request." Sections 764(j)(3) and 764(j)(4) provide the equivalent authorizations for each *security-based* swap dealer and major *security-based* swap participant. Section 716 of Dodd-Frank expressly authorizes the "appropriate Federal banking agency, after consulting with and considering the views of [the CFTC or SEC, as appropriate]" to permit a covered swap entity under its jurisdiction "an appropriate transition period to effect such divestiture or cessation of activities" as may be required under the swaps provisions of the Act for "up to 24 months," with an opportunity for an extension "for a period of up to 1 additional year" (15 U.S.C. § 8305(f)). Section 237.22 of the Board's Regulation KK implements this transition provision (12 CFR 237.22).

The obligation to comply with Subpart A's recordkeeping and reporting requirements is (1) with respect to an Eligible Master Netting Agreement (237.2), required in order for a covered swap entity to obtain the benefit of calculating margin requirements on a net basis across non-cleared swaps with a counterparty; (2) with respect to the Satisfaction of Collecting and Posting Requirements (237.5(c)(2)(i)), required in order for a covered swap entity not to be deemed to have violated its obligation to collect or post margin from or to a counterparty with respect to an open swap; (3) with respect to the Segregation of Collateral, Documentation of Margin Matters, and Posting of Initial Margin with Affiliates provisions (237.7(c), 10, and 11(b)(1)), mandatory for all covered swap entities; (4) with respect to the Initial Margin Model provisions (237.8(c)-(h)), required in order for a covered swap entity to obtain the benefit of using a model to calculate initial margin requirements; and (5) with respect to the Substituted Compliance Determination provision (237.9(e)), required in order for foreign covered swap entities to obtain the benefit of remaining subject to a regulatory framework that has been determined to be comparable to the joint final rule. The obligation to comply with the reporting requirements in Subpart B is required in order for state member banks or uninsured branches and agencies of foreign banks to obtain the benefit of utilizing a transition period (or extension of a transition period) under section 716.

Five of the above-described categories of information collection reflect records maintained at the institutions, and so issues of confidentiality normally would not arise. They

are (1) Eligible Master Netting Agreement, (2) Satisfaction of Collecting and Posting Requirements, (3) Segregation of Collateral, (4) Documentation of Margin Matters, and (5) Posting of Initial Margin with Affiliates. Should such information be obtained by the Board in the course of an examination, it would be exempt from disclosure under exemption 8 of Freedom of Information Act (FOIA) (5 U.S.C. § 552(b)(8)). In addition, some or (more likely) all of such information may be highly sensitive “commercial or financial” information protected from disclosure under exemption 4 of FOIA, under the standards set forth in *National Parks and Conservation Association v. Morton*, 498 F.2d 765 (D.C. Cir. 1974). The information submitted by a covered swap entity to the Board for its approval of an Initial Margin Model would consist of confidential, highly sensitive proprietary modeling information. Such information would be protected from disclosure under exemption 4. Such information also is subject to withholding under FOIA exemption 8 as it is collected in the course of supervisory oversight of the institution and its activities. Portions of the information provided by the covered swap entity to the Board regarding a Substituted Compliance Determination could be of a highly sensitive nature regarding the nature and extent of foreign regulatory supervision over the counterparty and so be subject to withholding under FOIA exemption 4.

Any initial request for a transition period submitted under section 237.22(a)(1), or for an extension of the transition period under section 237.22(e) must, at a minimum, include the following information: (1) the length of the transition period requested; (2) 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 section 237.22(d); and (3) a detailed explanation of the insured depository institution’s plan for conforming its activities to the requirements of section 716. Such information is the type of confidential commercial and financial information that may be withheld under Exemption 4 of the FOIA (5 U.S.C. § 552(b)(4)). As required information, it may be withheld under Exemption 4 only if public disclosure could result in substantial competitive harm to the submitting institution, under *National Parks and Conservation Association v. Morton*, 498 F.2d 765 (D.C. Cir. 1974). Should such information be obtained by the Board in the course of an examination, it may be withheld under exemption 8 of FOIA (5 U.S.C. § 552(b)(8)).

### **Consultation Outside the Agency and Discussion of Public Comment**

On May 11, 2011, the agencies published a joint notice of proposed rulemaking (the original proposal) in the *Federal Register* (76 FR 27564) for public comment. The comment period was extended until July 11, 2011, to allow interested parties more time to analyze the issues and prepare their comments. On September 24, 2014, the agencies published a joint notice of proposed rulemaking (the revised proposal) in the *Federal Register* (79 FR 57348) for public comment. The comment period for this notice expired on November 24, 2014. The agencies received a number of comments on the custody agreement in section 237.7(c). No PRA burden was taken in the proposed rule; however, based on the comments received, the agencies will take recordkeeping burden for this section. Also, the agencies received a number of comments on the posting of initial margin by an affiliate of a covered swap entity with respect to swaps between the covered swap entity and the affiliate. Based on the comments received, the agencies created a new section 237.11, and the agencies will take recordkeeping burden for section 237.11(b)(1). The agencies did not receive any specific comments on the PRA analysis.

On November 30, 2015, the agencies published a joint notice of final rulemaking in the *Federal Register* (80 FR 74840). The final rule is effective on April 1, 2016.

### Estimate of Respondent Burden

The current annual burden is estimated to be 98 hours. The Board estimates the proposed annual burden to be 36,964 hours, an increase of 36,866 hours, due to the new reporting and recordkeeping requirements. The reporting and recordkeeping requirements represent less than 1 percent of the total Federal Reserve System’s paperwork burden.

<b>FR KK Current</b>	<i>Number of respondents<sup>4</sup></i>	<i>Annual frequency</i>	<i>Estimated average hours per response</i>	<i>Estimated annual burden hours</i>
<b>Initial</b>				
Reporting – Subpart B, sections 237.22(a)(1) and 237.22(e)	12	1	7	84
<b>Ongoing</b>				
Reporting – Subpart B, sections 237.22(a)(1) and 237.22(e)	2	1	7	<u>14</u>
<i>Total</i>				98

<sup>4</sup> Of these respondents, none are considered small entities as defined by the Small Business Administration (i.e., entities with less than \$550 million in total assets) [www.sba.gov/contracting/getting-started-contractor/make-sure-you-meet-sba-size-standards/table-small-business-size-standards](http://www.sba.gov/contracting/getting-started-contractor/make-sure-you-meet-sba-size-standards/table-small-business-size-standards).



<b>FR KK Proposed</b>	<i>Number of respondents</i>	<i>Annual frequency</i>	<i>Estimated average hours per response</i>	<i>Estimated annual burden hours</i>
<b>Reporting Burden</b>				
Subpart A, sections 237.8(c) and 237.8(d)	50	1	240	12,000
Subpart A, section 237.8(f)(3)	50	1	50	2,500
Subpart A, section 237.9(e)	50	3	10	1,500
Subpart B, sections 237.22(a)(1) and 237.22(e)	2	1	7	<u>14</u>
<i>Total Reporting Burden</i>				16,014
<b>Recordkeeping Burden</b>				
Subpart A, sections 237.2 (definition of “eligible master netting agreement,” item 4), 237.8(g), and 237.10	50	1	5	250
Subpart A, section 237.5(c)(2)(i)	50	1	4	200
Subpart A, section 237.7(c)	50	1	100	5,000
Subpart A, sections 237.8(e) and 237.8(f)	50	1	40	2,000
Subpart A, section 237.8(h)	50	1	20	1,000
Subpart A, section 237.11(b)(1)	50	250	1	<u>12,500</u>
<i>Total Recordkeeping Burden</i>				20,950
				<i>Total</i>
				36,964
				<i>Change</i>
				36,866

The total cost to the public for this information collection is estimated to increase from \$5,209 to \$1,964,637 with the proposed revisions.<sup>5</sup>

<sup>5</sup> Total cost to the public was estimated using the following formula: percent of staff time, multiplied by annual burden hours, multiplied by hourly rates (30% Office & Administrative Support at \$17, 45% Financial Managers at \$65, 15% Lawyers at \$66, and 10% Chief Executives at \$89). Hourly rates for each occupational group are the (rounded) mean hourly wages from the Bureau of Labor and Statistics (BLS), *Occupational Employment and Wages May 2015*, published March 30, 2016 [www.bls.gov/news.release/ocwage.t01.htm](http://www.bls.gov/news.release/ocwage.t01.htm). Occupations are defined using the BLS Occupational Classification System, [www.bls.gov/soc/](http://www.bls.gov/soc/).

**Sensitive Questions**

This collection of information contains no questions of a sensitive nature, as defined by OMB guidelines.

**Estimate of Cost to the Federal Reserve System**

The cost to the Federal Reserve System is negligible.