

# US Derivatives Regulation: Swap Dealer and MSP Threshold Calculations

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*A Practice Note explaining the joint CFTC and SEC rulemaking under the Dodd-Frank Act establishing definitions of key Title VII terms "swap dealer," "security-based swap dealer," "major swap participant," and "major security-based swap participant." These rules establish thresholds and other criteria that require certain parties to register as one or more of these "registered entities," which are subject to enhanced regulatory oversight under the Dodd-Frank Act because they engage in significant levels of derivatives trading activity.*

On May 23, 2012, the [Commodity Futures Trading Commission](#) (CFTC) and [Securities Exchange Commission](#) (SEC) published joint rules ([77 Fed. Reg. 30596 \(May 23, 2012\)](#)) further defining the terms "swap dealer," "major swap participant," "security-based swap dealer," and "major security-based swap participant," as initially defined in the [Commodity Exchange Act](#) (CEA) and the [Securities Exchange Act of 1934](#) (Exchange Act) ([7 U.S.C. § 1a](#); [15 U.S.C. § 78c\(a\)](#)). These "registered entities" are subject to heightened oversight under the [Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010](#) (Dodd-Frank) Title VII swaps rules.

The joint rules specify, among other things, that a swap dealer is an entity that engages in a [notional amount](#) of at least \$3 billion of non-exempt swap activity annually, subject to an initial annual phase-in threshold of \$8 billion annual notional ([17 C.F.R. §§ 1.3 and 240.3a71-2](#)). Though significantly higher than the originally proposed \$100 million notional threshold, this definition still covers the major institutions engaging in swap activity in the US. Note that the swap dealer threshold has been permanently set at \$8 billion notional (see [Legal Update, CFTC Permanently Sets Swap Dealer De Minimis Threshold at \\$8 Billion Notional](#)).

A swap dealer (SD) is a dealer in non-security-based swaps, which are governed by CFTC regulations. A major swap participant (MSP) engages in significant non-security-based swap activity at a level that falls short of the SD threshold, but which is still significant. Non-security-based swaps include interest rate and commodity swaps and are generally referred to under the Dodd-Frank Act simply as "swaps" (see [Categories of Swaps and Security-Based Swaps for Purposes of MSP/MSBSP Definitions](#)). Note that, to date, there are just over 100 registered swap dealers, while there are currently no registered MSPs.

A security-based swap dealer (SBSD) is a dealer in security-based swaps, which are governed by SEC regulations. A major security-based swap participant (MSBSP) engages in significant security-based swap activity at a level that falls short of the SBSD threshold, but which is still significant. Security-based swaps include most single-name and narrow-index [credit default swaps](#) (CDS) and most standard [total return swaps](#) (TRS) (see [Categories of Swaps and Security-Based Swaps for Purposes of MSP/MSBSP Definitions](#)).

SDs, MSPs, SBSDs, and MSBSPs are subject to a comprehensive framework of regulations under Title VII of the Dodd-Frank Act, including rules on registration, data reporting and recordkeeping, risk-capital, margin collateral collection and segregation, business conduct, and other requirements. For details, see [The Dodd-Frank Act: Requirements for Swap Dealers and MSPs Checklist](#).

For further information on the breakdown between the regulation of non-security-based swaps and security-based swaps (SBS) under Title VII, see [Practice Note, Summary of the Dodd-Frank Act: Swaps and Derivatives: Types of Swaps Under Title VII](#).

## Definitions of Swap Dealer and Security-Based Swap Dealer

The joint rules define "swap dealer" and "security-based swap dealer," as applicable, for purposes of the Dodd-Frank Act, the CEA, and the Exchange Act, as a person who:

- Holds itself out as a dealer in security-based swaps or non-security-based swaps.
- Makes a market in security-based swaps or non-security-based swaps.
- Regularly enters into security-based swaps or non-security-based swaps with counterparties as an ordinary course of business for its own account.
- Engages in activity causing itself to be commonly known in the trade as a dealer or market maker in security-based swaps or non-security-based swaps.

([17 C.F.R. §§ 1.3](#) and [240.3a71-1](#).)

## ***De Minimis* Exemption from Designation as Swap Dealer (SD) and Security-Based Swap Dealer (SBSD)**

However, even if a party satisfies one or more of the four prongs listed above, it may still be exempt from classification as an SD or SBSD if it engages in a *de minimis* notional level of non-exempt swap activity or security-based swap activity. This is known as the *de minimis* exemption. (Subsection (4) of swap dealer definition in [17 C.F.R. § 1.3](#) and [17 C.F.R. § 240.3a71-2](#).)

Positions in swaps and security-based swaps entered into by affiliates that control, are controlled by, or are under common control with the party that is making the SD or SBSD determination for itself must be counted toward the *de minimis* thresholds. The rules interpret the term "control" to mean the direct or indirect possession of the power to direct or cause the direction of the management and policies of a person, either through the ownership of voting securities, by contract, or otherwise. A parent entity must aggregate with its non-exempt swaps all of the non-exempt swaps of any of its subsidiaries that engage in a level of swap dealing that would cause the subsidiary to be an SD or an SBSD. (See Joint Rules Adopting Release, [77 Fed. Reg. at 30631](#), nn.437-438.)

### ***De Minimis* Exemption from Designation as Swap Dealer**

Subsection (4) of the definition of swap dealer in CFTC Regulation 1.3 specifies the *de minimis* notional threshold of swap dealing activity, which takes into account a person's swap dealing activity over the prior 12 months ([17 C.F.R. § 1.3](#)). When a person engages in swap dealing transactions above that threshold, the person meets the swap dealer definition in Section 1a(49) of the CEA ([7 U.S.C. § 1a\(49\)](#)).

The *de minimis* exemption from classification as an SD is available to persons who have entered into less than \$8 billion in notional amount of non-exempt (see [Swaps Excluded from Counting Toward De Minimis Swap Dealer Exemption](#)) non-security-based swap transactions over the previous 12 months.

- Barring CFTC action, the SD threshold was set to automatically lower from \$8 billion to \$3 billion in December 2017.
- However, the CFTC issued an order in October 2016 extending for one year the phase-in of the lower \$3 billion notional threshold level for SD registration. The delay came after an August 15, 2016 [final report](#) on lowering the *de minimis* swap dealer threshold was released by the CFTC that seemed to indicate the agency's reluctance to lower the threshold at that time (see [Legal Update, CFTC Sends Mixed Signals on Lowering Swap Dealer Threshold](#)).
- The CFTC issued a second order in October 2017 maintaining the *de minimis* threshold at \$8 billion for an additional year ([82 Fed. Reg. 50309 \(October 31, 2017\)](#)). The notional threshold was to therefore remain at \$8 billion through at least December 31, 2019 (see [Legal Update, CFTC Extends \\$8 Billion De Minimis Swap Dealer Threshold to December 2019](#)).
- On June 4, 2018, the CFTC proposed indefinitely extending the \$8 billion *de minimis* threshold ([83 Fed. Reg. 27444 \(June 12, 2018\)](#)). The proposal also includes revisions that would expand exemptions for certain swaps from consideration when calculating a party's aggregate gross notional amount of activity for purposes of the *de minimis* threshold. For more information, see [Legal Update, CFTC Proposes Keeping Swap Dealer Threshold at \\$8 Billion](#).
- On November 5, 2018, the CFTC issued a final notice permanently adopting the current \$8 billion *de minimis* notional threshold requirement above which firms must register as SDs (see [Legal Update, CFTC Permanently Sets Swap Dealer De Minimis Threshold at \\$8 Billion Notional](#)).

### **Swaps Excluded from Counting Toward *De Minimis* Swap Dealer Exemption**

As defined in CFTC Regulation 1.3, the following swaps do not count for purposes of determining compliance with the notional *de minimis* exemption from classification as an SD:

- **Loan-related swaps entered into by IDIs.** Swaps entered into by insured depository institutions (IDIs) with customers in connection with origination of loans with that customer (subsections (4) and (5) of SD definition; see [Exclusion for Non-Security-Based Swaps Entered into in Connection with Originating a Loan](#) and [Exclusion for Insured Depository Institution Swaps in Connection with Loans to Customers](#)).
- **Inter-affiliate swaps** (subsection (6)(i) of swap dealer definition).
- **Certain swaps entered into for the purpose of hedging commercial risk.** The definition of hedging in this context is the subject of a CFTC interim final rule (subsection (6)(iii) of swap dealer definition; see [Exclusion for Certain Non-Security-Based Swap Hedges](#)).
- **Foreign exchange (FX) swaps and forwards.** These are excluded from SD and MSP threshold calculations (77 Fed. Reg. 69694 (November 20, 2012); see [Legal Update, FX Swaps and Forwards Exempted from Dodd-Frank Clearing and Exchange Trading Requirements](#)).
- **Swaps entered into as part of a "regular business."** Swaps entered into by a party as a principal (and not an agent) only for its own account, either individually or in a fiduciary capacity, but not as a part of a "regular business" may be excluded (subsection (2) of swap dealer definition). The Adopting Release (77 Fed. Reg. at 30610) accompanying the joint rule (Joint Rule Adopting Release) notes that any of the following qualify as entering into a swap as part of a regular business:
  - entering into a swap for the purpose of satisfying the business or risk management needs of a counterparty (as opposed to entering into swaps to accommodate one's own demand or desire to participate in a particular market), commonly known as market making;
  - maintaining a separate profit-and-loss statement reflecting the results of swap activity or treating swap activity as a separate profit center; or
  - having staff and resources allocated to dealer-type activities with counterparties, including activities relating to credit analysis, customer onboarding, document negotiation, confirmation generation, requests for [novations](#) and amendments, exposure monitoring and collateral calls, covenant monitoring, and reconciliation.

(17 C.F.R. § 1.3.)

#### CFTC No-Action and Other Relief on Threshold Swap Dealer and MSP Calculation Exclusions

The CFTC has issued no-action letters and an exemptive order permitting the following to be excluded from SD and MSP threshold calculations:

- **Certain cross-border swaps with guaranteed affiliates.** The CFTC issued [No-Action Letter 13-64](#), which provides relief to any non-US person that is not a guaranteed or affiliate conduit of a US person for failure to include, in its SD calculation for purposes of the swap dealer definition under subdivision (4) of the swap dealer definition in CFTC Regulation 1.3 (17 C.F.R. § 1.3), a swap executed with a guaranteed affiliate of a US person on or before the date such non-US person is required to register with the CFTC as an SD. The relief is conditioned upon the following:
  - the guaranteed affiliate is affiliated with an SD registered with the CFTC;
  - the guaranteed affiliate has crossed the *de minimis* SD threshold; and
  - the guaranteed affiliate represents in writing, with a copy thereof delivered to the CFTC's Division of Swap Dealer and Intermediary Oversight (DSIO) no later than 48 hours after execution of the swap using the e-mail address [dsionoaction@cftc.gov](mailto:dsionoaction@cftc.gov), that (a) such guaranteed affiliate intends to register as an SD; and (b) the date its registration is required under subsection (4)(iii) of the swap dealer definition in CFTC Regulation 1.3.
- **Certain cross-border swaps with international financial institutions (IFIs).** The CFTC issued [No-Action Letter 18-13](#), permitting non-US persons that are neither guaranteed affiliates nor conduit affiliates of a US person to exclude swaps entered into with international financial institutions or IFIs (see [Legal Update, CFTC Grants Swap Dealer Threshold Relief to Non-US Counterparties to Swaps with International Financial Institutions](#)).
- **Compression-exercise swaps.** See [No-Action Letter 12-62](#).
- **Certain swaps entered into by registered floor traders.** Under [No-Action Letter 19-14](#), if certain conditions are met, registered floor traders do not need to consider DCM and SEF cleared swaps when determining whether the floor trader is an SD (see [Legal Update, CFTC Issues No-Action Relief from Floor Trader Prong of Swap Dealer Definition for Certain Cleared Swaps](#)).

#### CFTC Proposes Expanding Threshold Calculation Exclusions

On June 4, 2018, the CFTC proposed revisions to the *de minimis* exemption that would expand exclusions for certain swaps from consideration when calculating a party's aggregate gross notional amount of activity for purposes of the *de minimis* threshold ([83 Fed. Reg. 27444 \(June 12, 2018\)](#); see [Legal Update, CFTC Proposes Keeping Swap Dealer Threshold at \\$8 Billion](#)). The proposal provides for:

- Expanding the scope of the exclusion for loan-related swaps entered into by IDIs.
- A set of specific factors for consideration when determining whether a swap entered into for the purpose of hedging commercial risk qualifies for the exclusion.
- An exclusion for swaps that result from multilateral portfolio compression exercises.

#### **Exclusion for Non-Security-Based Swaps Entered into in Connection with Originating a Loan**

Subsection (5) of swap dealer definition in CFTC Regulation 1.3 provides an exclusion for swaps entered into by IDIs with customers in connection with originating a loan with that customer. This exclusion applies to swaps that meet all of the following conditions:

- The swap is connected to the financial terms of the loan or is required by loan underwriting criteria to be in place as a condition of the loan in order to hedge the borrower's commodity price risks.
- The swap is entered into within 90 days before or 180 days after the date of the loan agreement or any draw of principal under the loan.
- The loan is within the common meaning of the word "loan."
- The IDI is the sole lender or, if a member of a lending syndicate, is responsible for at least 10% of the loan. If less than 10%, the exclusion is still available if the notional amount of the swap does not exceed the amount of the IDI's participation.

([17 C.F.R. § 1.3](#).)

#### **Exclusion for Insured Depository Institution Swaps in Connection with Loans to Customers**

On March 25, 2019, the CFTC issued a final rule expanding the *de minimis* exception under subsection (4) of the swap dealer definition in CFTC Regulation 1.3 to exclude certain loan-related swaps entered into by SDs that are IDIs.

The final rule is intended to provide for an exclusion from the *de minimis* threshold calculations for certain of IDI's loan-related swaps that might not qualify for the exclusion in subsection (5) of the swap dealer definition. The final rule provides additional circumstances under which an IDI's loan-related swap may be excluded from the *de minimis* calculation, in addition to those provided under the existing IDI swap dealing exclusion in subsection (5) (see [Exclusion for Non-Security-Based Swaps Entered into in Connection with Originating a Loan](#)).

Among other things, the final rule:

- Includes the 90-day restriction of subsection (5) but removes the 180-day restriction, so an IDI no longer must count toward its *de minimis* calculation any swap entered into in connection with a loan after the date of the execution of the loan agreement.
- Specifies that the 90-day restriction does not apply if an executed commitment or forward agreement exists.
- Provides more flexibility in determining whether a swap is entered into "in connection with" a loan, and therefore qualifies for the exclusion, than the conditions in subsection (5).
- Does not include the requirement included in subsection (5) that, for IDIs that are responsible for at least five percent of a loan, the aggregate gross notional amount (AGNA) of swaps entered into in connection with the loan must not exceed the principal amount of the loan that is outstanding.

For details on the final rule, see [Legal Update, CFTC Adds Loan-Related Swaps Entered into by Insured Depository Institutions \(IDIs\) to Exception from De Minimis Swap Dealer Calculation](#).

#### **No-Action Relief for Loan-Related Swaps**

On August 28, 2018, the CFTC issued no-action relief ([No-Action Letter 18-20](#)) to a bank that expanded the scope of the exclusion for the bank and its subsidiaries and affiliates by removing the 180-day requirement for certain of the bank's loan-related swaps (see [Legal Update, CFTC Issues No-Action Relief to Bank Permitting Exclusion of Certain Loan-Related Swaps from De Minimis Swap Dealer Threshold Calculation](#)). CFTC Commissioner Quintenz also released a [statement](#) on the relief that, when taken together with the no-action relief, indicates the possibility of future relief from *de minimis* threshold calculations that may be more broadly applicable.

### Exclusion for Certain Non-Security-Based Swap Hedges

Along with the joint rules, the CFTC released an [interim final rule](#) (IFR) exempting certain non-security-based swaps entered into for the purpose of hedging a physical position from counting toward the *de minimis* SD threshold (see Joint Rules Adopting Release, [77 Fed. Reg. at 30611-14](#)). The SEC has not created a comparable exemption for security-based-swap hedges. The IFR, which appears in subsection (6)(iii) of the swap dealer definition in CFTC Regulation 1.3, provides that swaps will be excluded from the *de minimis* SD threshold when a party enters into a swap for the purpose of offsetting or mitigating the party's commercial risk, and all of the following factors are present:

- The price risk arises from potential changes in the value of:
  - the assets that the person owns, produces, manufactures, processes or merchandises;
  - liabilities that the person owns or anticipates incurring; or
  - services that the person provides or purchases.
- The swap represents a substitute for transactions or positions in a "physical marketing channel" necessary to transfer the ownership of goods, and to move goods from the point of production to the point of consumption.
- The swap is economically appropriate to the reduction of the person's risks in the conduct and management of a commercial enterprise.
- The swap is entered into in accordance with sound commercial practices and is not structured to evade designation as a swap dealer.

(17 C.F.R. § 1.3.)

Most notably, the definition of hedging in the joint rules excludes swap activity engaged in for the purpose of portfolio hedging and anticipatory hedging.

While interest rate swaps are not per se excluded from the *de minimis* count, the IDI exclusion applies to interest rate swaps (see [Exclusion for Non-Security-Based Swaps Entered into in Connection with Originating a Loan](#)).

### Treatment of Cross-Border Swaps for Swap Dealer Threshold Aggregation Purposes

For details on the treatment of cross-border swaps for SD aggregation purposes, including swaps entered into with or by non-US branches of US entities and US branches of non-US entities, see [Practice Note, The Dodd-Frank Act: Cross-Border Application of Swaps Rules: Cross-Border Aggregation Rules for SD and MSP Threshold Calculations](#).

### De Minimis Exemption from Designation as a Security-Based Swap Dealer

An entity is designated as an SBSB under the joint rules if it satisfies any of the four definitional swap dealer requirements (see [Definitions of "Swap Dealer" and "Security-Based Swap Dealer"](#)) and meets or exceeds either of the following thresholds:

- **De Minimis Exemption from Designation as a SBSB in Credit Default Swaps (CDS).** Under the joint rules, parties that have entered into \$8 billion or more of security-based CDS over the previous 12 months will be designated as SBSBs. For this purpose:
  - security-based CDS entered into for the purpose of hedging are included in the determination of the CDS SBSB *de minimis* exemption;
  - the *de minimis* threshold for security-based CDS will be lowered to \$3 billion five years after data begins to be collected for these transactions (the actual date will be published in the *Federal Register* and on the SEC's [website](#)) unless the SEC decides to either raise or lower this threshold before that time (this threshold remains at \$150 million and data is not yet being collected by any security-based swap data repository (SB SDR) for these transactions); and
  - security-based CDS are CDS based on a single debt or equity security (known as "single-name" CDS) or CDS on narrow-based indices (see [Practice Note, Summary of the Dodd-Frank Act: Swaps and Derivatives: Security-Based Swaps](#)).
- **De Minimis Exemption from Designation as a SBSB in All Other Types of Security-Based Swaps in the Aggregate.** The *de minimis* exemption from classification as an SBSB is available to persons who have entered into less than \$400 million in non-CDS SBS in the aggregate over the previous 12 months, subject to the following:
  - an entity does not become an SBSB until it enters into \$400 million of non-CDS SBS during any consecutive 12-month period;
  - when an entity crosses this *de minimis* \$400 million threshold, it becomes an SBSB even if fewer than 12 months have elapsed since that date;

- swaps entered into for the purpose of hedging are included in the determination of this *de minimis* exemption; and
- the *de minimis* threshold for non-CDS security based swaps in the aggregate will be lowered to \$150 million five years after data begins to be collected (the actual date will be published in the *Federal Register* and on the SEC's [website](#)), unless the SEC decides to either raise or lower this threshold before that time (this threshold remains at \$150 million and data is not yet being collected by any SB SDR for these transactions).

(17 C.F.R. § 240.3a71-2.)

### Security-Based Swaps Excluded from Counting Toward *De Minimis* SBSB Exemption

The following SBS are excluded from counting toward a party's notional amount of SBS activity for the purposes of determining compliance with the *de minimis* SBSB threshold:

- Inter-affiliate SBS (17 C.F.R. § 240.3a71-4.).
- SBS entered into by a party as a principal (and not an agent) only for its own account, either individually or in a fiduciary capacity, but not as a part of a "regular business" (17 C.F.R. § 240.3a71-1(b); see [Swaps Excluded from Counting Toward De Minimis Swap Dealer Exemption](#) for more information on this exemption, which is the same for security-based swaps as it is for swaps and appears designed to cover market-making activities.

### Treatment of Cross-Border Swaps for SBSB Threshold Aggregation Purposes

For details on the treatment of cross-border SBS for SBSB aggregation purposes, see [Legal Update, SEC Adopts Cross-Border Security-Based Swaps Rules: Counting Cross-Border SBS Toward SBSB and MSBSP Minimum Thresholds](#).

### Non-US Entities Using Personnel Located in US on SBS Transaction Must Include Transaction in SBSB Determination

Under SEC regulations, a non-US entity that uses personnel located in a US branch or office to arrange, negotiate, or execute a SBS transaction in connection with its SBS-dealing activity must include that transaction in determining whether it must register with the SEC as a SBSB (17 C.F.R. §§ 240.3a71-3 and 240.3a71-5; see [Legal Update, SEC Adopts Final Rule on Security-Based Swaps Arranged, Negotiated, or Executed in the US](#)). The test focuses solely on the location of the person acting on behalf of the non-US person.

## Swaps Entered into with "Special Entities"

Parties that enter into either swaps or SBS with special entities in excess of either of the following amounts are also classified as SDs or SBSBs, as applicable:

- SD: \$25 million in aggregate notional amount of non-security-based swaps, excluding certain swaps entered into with utility special entities (17 C.F.R. § 1.3 (see subsection (4)(i)(A) of swap dealer definition); see [Swaps Entered into with Utility Special Entities](#)).
- SBSB: \$25 million in aggregate notional amount of SBS (17 C.F.R. § 240.3a71-2(a)).

Special entities include:

- Federal agencies.
- States and state agencies.
- Other political subdivisions, including municipalities, cities, and counties.
- Public utilities.
- Employee benefit plans.

(17 C.F.R. §§ 1.3 and 240.3a71-2(a)(3).)

### Swaps Entered into with Utility Special Entities

Under CFTC rules, utility operations-related swaps may be excluded from the \$25 million *de minimis* SD threshold calculation for swaps with special entities under CFTC Regulation 1.3 (17 C.F.R. § 1.3 (see subsection (4)(i)(B)(1) of SD definition); see [Legal Update, CFTC Excludes Utility Swaps from Swap Dealer Calculations](#)). Note that these swaps still count toward the \$8 billion notional threshold for SD designation.



## Anyone May Elect to Be a Swap Dealer; Changes in Swap Dealer Status

Any person that chooses to register as a SD or SBSD will be deemed to be so and will be subject to all applicable regulatory requirements, regardless of whether that person engages in non-exempt swap activity in an amount that is below the applicable *de minimis* threshold or phase-in level ([17 C.F.R. §§ 1.3](#) and [240.3a71-2\(e\)](#)).

If an entity that has relied on the *de minimis* exception from designation as a SD or SBSD is no longer able to do so because its dealing activity newly exceeds one of these thresholds, the entity has two months following the end of the month in which it is no longer able to take advantage of the exception to submit a completed application to register as an SD (with the CFTC) or SBSD (with the SEC). A registered SD or SBSD must be designated as such for at least 12 months before applying to withdraw its registration ([17 C.F.R. §§ 1.3](#) and [240.3a71-2\(b\), \(c\)](#)).

## Definitions of Major Swap Participant (MSP) and Major Security-Based Swap Participant (MSBSP)

Under the joint rules, a person who satisfies any of the following three criteria, but who does not meet the SD or SBSD thresholds, is classified as an MSP or MSBSP, as applicable, if:

- It maintains a "substantial position" (see [Definition of "Substantial Position"](#)) in any of the swap (for designation as an MSP) or SBS (for designation as a MSBSP) categories (see [Categories of Swaps and Security-Based Swaps for Purposes of MSP/MSBSP Definitions](#)), excluding positions held for hedging or mitigating commercial risk and positions maintained by certain employee benefit plans for hedging or mitigating risks in the operation of the plan. For purposes of the MSP/MSBSP calculations, the determination of whether a swap or SBS is entered into for purposes of hedging or mitigating commercial risk:
  - is made by the facts and circumstances of the instance of alleged hedging;
  - takes into account a market participant's overall hedging and risk mitigation strategies; and
  - is made by the parties to a swap at the time a position is first entered into. Potential MSPs can hire third parties to perform the relevant calculations if they wish to do so.
- Its outstanding swaps or SBS create substantial counterparty exposure that could have serious adverse effects on the financial stability of the US banking system or financial markets. "Substantial counterparty exposure" is defined:
  - **for swaps**, as current uncollateralized notional exposure of \$5 billion or more, or \$8 billion or more in current uncollateralized notional exposure plus potential future notional exposure ([17 C.F.R. § 1.3](#)); and
  - **for SBS**, as current uncollateralized notional exposure of \$2 billion or more, or \$4 billion or more in current uncollateralized notional exposure plus potential future notional exposure ([17 C.F.R. § 240.3a67-5](#)).
- It is a financial entity (as defined in [17 C.F.R. §§ 1.3](#) and [240.3a67-6](#)) that:
  - is highly leveraged (as defined in [17 C.F.R. §§ 1.3](#) and [240.3a67-7](#)) relative to the amount of capital such entity holds, which means any entity with a ratio of total liabilities to equity greater than 12:1;
  - is not subject to capital requirements established by an appropriate federal banking agency (as defined in [7 U.S.C.A. § 1a\(2\)](#) and [15 U.S.C. § 78c\(a\)\(72\)](#)); and
  - maintains a substantial position (as defined in [17 C.F.R. §§ 1.3](#) and [240.3a67-3](#)), as applicable, in any of the swap categories (see [Categories of Swaps and Security-Based Swaps for Purposes of MSP/MSBSP Definitions](#)).

([17 C.F.R. §§ 1.3](#) and [240.3a67-1\(a\)](#).)

## Categories of Swaps and Security-Based Swaps for Purposes of MSP/MSBSP Definitions

### Non-Security-Based Swaps (Swaps)

The four non-security-based swap (swap) categories are:

- Rate swaps.
- Credit swaps that are not SBS. These include swaps that are primarily based on default, bankruptcy, and other credit-related risks related to, or based on the total returns on, broad-based indices on instruments of indebtedness (including loans). This definition includes, but is not limited to:

- CDS that are primarily based on one or more broad-based indices related to debt instruments; and
- swaps that are broad-based-index CDS or broad-based-index TRS.
- Equity swaps that are not SBS. These include any swap primarily based on one or more broad-based indices of equity securities, including any TRS on one or more broad-based equity indices.
- Commodity swaps (and their equivalents).

([7 U.S.C. § 1a\(47\)](#) and [17 C.F.R. § 1.3.](#))

These categories are relevant for determination of whether or not an entity is an MSP, but not for a determination of whether the entity is an SD. For purposes of determining whether an entity is an SD, all of that entity's non-security-based swap activity is aggregated, regardless of swap categories.

Note that, for non-security-based swaps, CFTC Regulation 1.3 specifies swap position thresholds for the MSP definition, defining both the term "substantial position" (setting out the minimum thresholds) for different categories of swaps and the term "substantial counterparty exposure." A person holding swap positions above these thresholds meets the definition of an MSP in section 1a(33) of the CEA ([7 U.S.C. § 1a\(33\)](#)).

### Security-Based Swaps

The two SBS categories are:

- "Debt security-based swaps," which means any SBS based, in whole or in part, on one or more instruments of indebtedness (including loans), or on a credit event relating to one or more issuers or securities, including but not limited to any SBS that is a CDS, TRS, debt swap, debt index swap, or credit spread.
- Other SBS.

([17 C.F.R. § 240.3a67-2.](#))

### Definition of "Substantial Position"

The term "substantial position" is defined for both MSPs and MSBSPs using two tests. The first test is meant to account for current uncollateralized swap exposure and the second is meant to account for both current uncollateralized and potential future exposure. A position satisfying either test qualifies as a substantial position under the rules.

#### First Substantial Position Test

The threshold for the first test for both MSPs and MSBSPs is \$1 billion or more of daily average uncollateralized exposure in the applicable category of swaps or SBS during the most recent calendar quarter, except that the threshold in the rate swap category is \$3 billion. Any amount of swap or security-based swap activity that is equal to or in excess of these amounts (but less than SD/SBSD thresholds) causes an entity to be classified as an MSP or MSBSP, as applicable. This test:

- Measures an entity's current uncollateralized exposure by [marking to market](#) the swap or SBS positions using industry standard practices.
- Allows the deduction of the value of collateral posted with respect to the swap or SBS positions.
- Calculates exposure on a net basis, according to the terms of any applicable [master netting agreement](#) (MNA).
- Excludes from counting toward the substantial position thresholds positions entered into for the purpose of hedging commercial risk and hedging employee benefit plan positions.

([17 C.F.R. §§ 1.3](#) and [240.3a67-3.](#))

#### Second Substantial Position Test

The threshold for the second test for both MSPs and MSBSPs is \$2 billion of daily average uncollateralized exposure during the most recent calendar quarter in the applicable swap or SBS category, plus potential future exposure in the applicable swap or SBS category, except that the threshold in the rate swap category is \$6 billion. This second substantial position test determines current uncollateralized exposure in the same manner as the first test and determines potential future exposure by:

- Multiplying the total notional principal amount of the entity's swap or SBS positions by specified risk-factor percentages (ranging from 0.5% to 15% in the case of swaps, and from 6% to 15% in the case of SBS) based on the type of swap or SBS and the duration of the position. These risk



factors are as follows:

Conversion Factor Matrix for Swaps				
Residual Maturity	Interest Rate	Foreign Exchange Rate and Gold	Precious Metals (Except Gold)	Other Commodities
1 Year or Less	0.00	0.01	0.07	0.10
Over 1 to 5 Years	0.005	0.05	0.07	0.12
Over 5 Years	0.015	0.075	0.08	0.15
Residual Maturity	Credit	Equity		
1 Year or Less	0.10	0.06		
Over 1 to 5 Years	0.10	0.08		
Over 5 Years	0.10	0.10		

- Discounting the amount of positions subject to master netting agreements by a factor ranging from 0 to 60%, depending on the effects of the agreement.
- Further discounting the amount of the positions by:
  - 80% for swaps that are cleared or subject to daily mark-to-market margin collateral posting;
  - 90% for cleared SBS; and
  - 80% for SBS that are subject to daily mark-to-market margin collateral posting but are not cleared.

(17 C.F.R. §§ 1.3, 240.3a67-3; see also, Joint Rules Adopting Release, 77 Fed. Reg. at 30668-71.)

### Parents and Subsidiaries

A parent entity or other guarantor (including a financial guarantee insurer) must aggregate the swap positions of subsidiaries of which it is majority owner with its own positions in order to determine whether it is an MSP or MSBSP. This aggregation is performed only to the extent that the counterparties to those positions would have recourse to the parent entity or other guarantor in connection with the position. However, the positions need not be aggregated if the subsidiary is:

- Already subject to capital regulation by the CFTC or SEC.
- A US entity regulated as a bank in the US.

(Joint Rules Adopting Release, 77 Fed. Reg. at 30689.)

Note that an entity that becomes an MSP or MSBSP because of swaps or SBS directly entered into by a subsidiary may delegate operational compliance with so-called transaction-level requirements (see [Practice Note, The Dodd-Frank Act: Cross-Border Application of Swaps Rules: Transaction-Level Requirements](#)) to the subsidiary that is a direct party to the transaction. However, the parent or other guarantor cannot delegate compliance duties with the entity-level requirements applicable to MSPs (see [Practice Note, The Dodd-Frank Act: Cross-Border Application of Swaps Rules: Entity-Level Requirements](#)), such as the requirements related to MSP and MSBSP registration and risk capital. (Joint Rules Adopting Release, 77 Fed. Reg. at 30689.)

### Funds Under Common Management; Disaggregation

The swap and SBS positions of client accounts managed by asset managers or investment advisers are not considered when determining whether these entities are MSPs or MSBSPs. Swap positions held by managed accounts with a common beneficial owner are aggregated with the owner's other positions for the purpose of determining whether the owner is a MSP or MSBSP. However, the joint rules limit the MSP and MSBSP analysis for beneficial owners to focus on where the risk associated with the beneficial owner's positions ultimately resides. For example:

- If the counterparty to a swap or SBS position within a managed account only has recourse to the assets of that account in an event of default under the transaction and lacks recourse to other assets of the beneficial owner, that position is not attributable to the beneficial owner for the

purposes of a MSP or MSBSP aggregation analysis.

- If the counterparty to a swap or SBS position within a managed account has recourse to both the assets of the account and to the beneficial owner, that position is attributable to the beneficial owner for the purposes of a MSP or MSBSP aggregation analysis.

(Joint Rules Adopting Release, [77 Fed. Reg. at 30690](#).)

## Treatment of Cross-Border Swaps for MSP and MSBSP Aggregation Purposes

### Treatment of Cross-Border Swaps for MSP Substantial Position Test

For details on the treatment of cross-border swaps for MSP aggregation purposes, including swaps entered into with or by non-US branches of US entities and US branches of non-US entities, as well as swaps entered into with conduit affiliates of or that are guaranteed by US entities, see [Practice Note, The Dodd-Frank Act: Cross-Border Application of Swaps Rules: Cross-Border Aggregation Rules for SD and MSP Threshold Calculations](#).

### Treatment of Cross-Border Swaps for MSBSP Substantial Position Test

For details on the treatment of cross-border SBS for MSBSP aggregation purposes, including SBS entered into with or by non-US branches of US entities and US branches of non-US entities, as well as SBS entered into with conduit affiliates of or that are guaranteed by US entities, see [Legal Update, SEC Adopts Cross-Border Security-Based Swaps Rules: Counting Cross-Border SBS Toward SBSD and MSBSP Minimum Thresholds](#).

## Further Information

For more information on the final rules defining "swap dealer," "major swap participant," "security-based swap dealer," and "major security-based swap participant," see the CFTC's [fact sheet](#) and [Q&A](#) and the SEC's [fact sheet](#).

For more on the regulation of SDs, MSPs, SBSDs, and MSBSPs under the Dodd-Frank Act, see [The Dodd-Frank Act: Requirements for Swap Dealers and MSPs Checklist](#).

For more information on swap regulation under the Dodd-Frank Act, see [Practice Note, Summary of the Dodd-Frank Act: Swaps and Derivatives](#).

### PRODUCTS

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