COMMODITY FUTURES TRADING COMMISSION

17 CFR Chapter I

Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Domiciled in the French Republic and Federal Republic of Germany and Subject to Capital and Financial Reporting Requirements of the European Union

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed order and request for comment.

SUMMARY: The Commodity Futures Trading Commission is soliciting public comment on an application submitted by the Institute of International Bankers, International Swaps and Derivatives Association, and Securities Industry and Financial Markets Association requesting that the Commission determine that the capital and financial reporting laws and regulations of the European Union applicable to CFTC-registered swap dealers organized and domiciled in the French Republic and Federal Republic of Germany provide sufficient bases for an affirmative finding of comparability with respect to the Commission's swap dealer capital and financial reporting requirements adopted under the Commodity Exchange Act. The Commission is also soliciting public comment on a proposed order providing for the conditional availability of substituted compliance in connection with the application.

DATES: Comments must be received on or before August 28, 2023.

ADDRESSES: You may submit comments, identified by ''EU Swap Dealer Capital Comparability Determination,'' by any of the following methods:

- *CFTC Comments Portal: https://comments.cftc.gov.* Select the ''Submit Comments'' link for this proposed order and follow the instructions on the Public Comment Form.
- *Mail:* Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.
- *Hand Delivery/Courier:* Follow the same instructions as for Mail, above.

Please submit your comments using only one of these methods. To avoid possible delays with mail or in-person deliveries, submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *https://comments.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (''FOIA''), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in Commission Regulation 145.9.[1]

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from *https://comments.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the proposed determination and order will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the FOIA.

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SUPPLEMENTARY INFORMATION: The Commodity Futures Trading Commission (''Commission'' or ''CFTC'') is soliciting public comment on an application dated September 24, 2021 (the ''EU Application'') submitted by the Institute of International Bankers, International Swaps and Derivatives Association, and Securities Industry and Financial Markets Association (together, the ''Applicants'').[2] The Applicants request that the Commission determine that registered nonbank swap dealers [3] (''nonbank SDs'') organized and domiciled within the European Union (''EU'') (''EU nonbank SDs'') may satisfy certain capital and financial reporting requirements under the Commodity Exchange Act (''CEA'') [4] by being subject to, and complying with, comparable capital and financial reporting requirements under EU laws and regulations. As described below, the EU Application addresses nonbank SDs located in the French Republic (''France'') and the Federal Republic of Germany (''Germany''), the two member states of the EU (''EU Member States'') in which EU nonbank SDs currently registered with the Commission are located.[5] The Commission also is soliciting public comment on a proposed order under which EU nonbank SDs organized and domiciled in France and Germany would be able, subject to defined conditions, to comply with certain CFTC nonbank SD capital and financial reporting requirements in the manner set forth in the proposed order.

I. Introduction

A. Regulatory Background—Swap Dealer and Major Swap Participant Capital and Financial Reporting Requirements

Section 4s(e) of the CEA [6] directs the Commission and ''prudential regulators'' [7] to impose capital requirements on all SDs and major swap participants (''MSPs'') registered with the Commission.[8] Sections 4s(e) of the

[1] 17 CFR 145.9. Commission regulations referred to in this release are found at 17 CFR chapter I, and are accessible on the Commission's website: *https://www.cftc.gov/LawRegulation/CommodityExchangeAct/index.htm.*

[2] *See* Letter dated September 24, 2021 from Stephanie Webster, General Counsel, Institute of International Bankers, Steven Kennedy, Global Head of Public Policy, International Swaps and Derivatives Association, and Kyle Brandon, Managing Director, Head of Derivatives Policy, Securities Industry and Financial Markets Association. The EU Application is available on the Commission's website at: *https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm.*

[3] As discussed in Section I.A. immediately below, the Commission has the authority to impose capital requirements on registered swap dealers (''SDs'') that are not subject to regulation by a U.S. prudential regulator (*i.e.,* nonbank SDs).

[4] 7 U.S.C. 1 *et seq.* The CEA may be accessed through the Commission's website at: *https://www.cftc.gov/LawRegulation/CommodityExchangeAct/index.htm.*

[5] As further discussed below, there are currently four EU nonbank SDs registered with the Commission: BofA Securities Europe SA and Goldman Sachs Paris Inc. et Cie are organized and domiciled in France; Citigroup Global Markets Europe AG and Morgan Stanley Europe SE are organized and domiciled in Germany.

[6] 7 U.S.C. 6s(e).

[7] The term ''prudential regulator'' is defined in the CEA to mean the Board of Governors of the Federal Reserve System (''Federal Reserve Board''); the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Farm Credit Administration; and the Federal Housing Finance Agency. *See* 7 U.S.C. 1a(39).

[8] Subject to certain exceptions, the term ''swap dealer'' is generally defined as any person that (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps

CEA also directs the Commission and prudential regulators to adopt regulations imposing initial and variation margin requirements on swaps entered into by SDs and MSPs that are not cleared by a registered derivatives clearing organization (''uncleared swaps'').

Section 4s(e) applies a bifurcated approach with respect to the above Congressional directives, requiring each SD and MSP that is subject to the regulation of a prudential regulator (''bank SD'' and ''bank MSP,'' respectively) to meet the minimum capital requirements and uncleared swaps margin requirements adopted by the applicable prudential regulator, and requiring each SD and MSP that is not subject to the regulation of a prudential regulator (''nonbank SD'' and ''nonbank MSP,'' respectively) to meet the minimum capital requirements and uncleared swaps margin requirements adopted by the Commission.[9] Therefore, the Commission's authority to impose capital requirements and margin requirements for uncleared swap transactions extends to nonbank SDs and nonbank MSPs, including nonbanking subsidiaries of bank holding companies regulated by the Federal Reserve Board.[10]

The prudential regulators implemented Section 4s(e) in 2015 by amending existing capital requirements applicable to bank SDs and bank MSPs to incorporate swap transactions into their respective bank capital frameworks, and by adopting rules imposing initial and variation margin requirements on bank SDs and bank MSPs that engage in uncleared swap transactions.[11] The Commission adopted final rules imposing initial and variation margin obligations on nonbank SDs and nonbank MSPs for uncleared swap transactions on January 6, 2016.[12] The Commission also approved final capital requirements for nonbank SDs and nonbank MSPs on July 24, 2020, which were published in the **Federal Register** on September 15, 2020 with a compliance date of October 6, 2021 (''CFTC Capital Rules'').[13]

Section 4s(f) of the CEA addresses SD and MSP financial reporting requirements.[14] Section 4s(f) of the CEA authorizes the Commission to adopt rules imposing financial condition reporting obligations on all SDs and MSPs (*i.e.,* nonbank SDs, nonbank MSPs, bank SDs, and bank MSPs). Specifically, Section 4s(f)(1)(A) of the CEA provides, in relevant part, that each registered SD and MSP must make financial condition reports as required by regulations adopted by the Commission.[15] The Commission's financial reporting obligations were adopted with the Commission's nonbank SD and nonbank MSP capital requirements, and have a compliance date of October 6, 2021 (''CFTC Financial Reporting Rules'').[16]

B. Commission Capital Comparability Determinations for Non-U.S. Nonbank Swap Dealers and Non-U.S. Nonbank Major Swap Participants

Commission Regulation 23.106 establishes a substituted compliance framework whereby the Commission may determine that compliance by a non-U.S. domiciled nonbank SD or non-U.S. domiciled nonbank MSP with its home country's capital and financial reporting requirements will satisfy all or parts of the CFTC Capital Rules and all or parts of the CFTC Financial Reporting Rules (such a determination referred to as a ''Capital Comparability Determination'').[17] The availability of such substituted compliance is conditioned upon the Commission issuing a determination that the relevant foreign jurisdiction's capital adequacy and financial reporting requirements, and related financial recordkeeping requirements, for non-U.S. nonbank SDs and/or non-U.S. nonbank MSPs are comparable to the corresponding CFTC Capital Rules and CFTC Financial Reporting Rules. The Commission will issue a Capital Comparability Determination in the form of a Commission order (''Capital Comparability Determination Order'').[18]

The Commission's approach for conducting a Capital Comparability Determination with respect to the CFTC Capital Rules and the CFTC Financial Reporting Rules is a principles-based, holistic approach that focuses on whether the applicable foreign jurisdiction's capital and financial reporting requirements achieve comparable outcomes to the corresponding CFTC requirements.[19] In this regard, the approach is not a line-by-line assessment or comparison of a foreign jurisdiction's regulatory requirements with the Commission's requirements.[20] In performing the analysis, the Commission recognizes that jurisdictions may adopt differing approaches to achieving comparable outcomes, and the Commission will focus on whether the foreign jurisdiction's capital and financial reporting requirements are comparable to the Commission's in purpose and effect, and not whether they are comparable in every aspect or contain identical elements.

A person requesting a Capital Comparability Determination is required to submit an application to the Commission containing: (i) a description of the objectives of the relevant foreign jurisdiction's capital adequacy and financial reporting requirements applicable to entities that are subject to the CFTC Capital Rules and the CFTC Financial Reporting Rules; (ii) a description (including specific legal and regulatory provisions) of how the relevant foreign jurisdiction's capital adequacy and financial reporting requirements address

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with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps. *See* 7 U.S.C. 1a(49). The term ''major swap participant'' is generally defined as any person who is not an SD, and (i) subject to certain exclusions, maintains a substantial position in swaps for any of the major swap categories as determined by the Commission; (ii) whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or (iii) maintains a substantial position in outstanding swaps in any major swap category as determined by the Commission. *See* 7 U.S.C. 1a(33).

[9] 7 U.S.C. 6s(e)(2).

[10] 7 U.S.C. 6s(e)(1) and (2).

[11] *See Margin and Capital Requirements for Covered Swap Entities,* 80 FR 74840 (Nov. 30, 2015).

[12] *See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants,* 81 FR 636 (Jan. 6, 2016).

[13] *See Capital Requirements of Swap Dealers and Major Swap Participants,* 85 FR 57462 (Sept. 15, 2020).

[14] 7 U.S.C. 6s(f).

[15] 7 U.S.C. 6s(f)(1)(A).

[16] *See* 85 FR 57462.

[17] 17 CFR 23.106. Commission Regulation 23.106(a)(1) provides that a request for a Capital Comparability Determination may be submitted by a non-U.S. nonbank SD or a non-U.S. nonbank MSP, a trade association or other similar group on behalf of its SD or MSP members, or a foreign regulatory authority that has direct supervisory authority over one or more non-U.S. nonbank SDs or non-U.S. nonbank MSPs. In addition, Commission regulations provide that any non-U.S. nonbank SD or non-U.S. nonbank MSP that is dually-registered with the Commission as a futures commission merchant (''FCM'') is subject to the capital requirements of Commission Regulation 1.17 (17 CFR 1.17) and may not petition the Commission for a Capital Comparability Determination. *See* 17 CFR 23.101(a)(5) and (b)(4), respectively. Furthermore, non-U.S. bank SDs and non-U.S. bank MSPs may not petition the Commission for a Capital Comparability Determination with respect to their respective financial reporting requirements under Commission Regulation 23.105(p) (17 CFR 23.105(p)). Commission staff has issued, however, a time-limited no-action letter stating that the Market Participants Division will not recommend enforcement action against a non-U.S. bank SD that files with the Commission certain financial information that is provided to its home country regulator in lieu of certain financial reports required by Commission Regulation 23.105(p). *See* CFTC Staff Letter 21–18, issued on August 31, 2021.

[18] 17 CFR 23.106(a)(3).

[19] *See* 85 FR 57462 at 57521.

[20] *Id.*

the elements of the CFTC Capital Rules and CFTC Financial Reporting Rules, including, at a minimum, the methodologies for establishing and calculating capital adequacy requirements and whether such methodologies comport with any international standards; and (iii) a description of the ability of the relevant foreign regulatory authority to supervise and enforce compliance with the relevant foreign jurisdiction's capital adequacy and financial reporting requirements. The applicant must also submit, upon request, such other information and documentation as the Commission deems necessary to evaluate the comparability of the capital adequacy and financial reporting requirements of the foreign jurisdiction.[21]

The Commission may consider all relevant factors in making a Capital Comparability Determination, including: (i) the scope and objectives of the relevant foreign jurisdiction's capital and financial reporting requirements; (ii) whether the relevant foreign jurisdiction's capital and financial reporting requirements achieve comparable outcomes to the Commission's corresponding capital requirements and financial reporting requirements; (iii) the ability of the relevant foreign regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's capital adequacy and financial reporting requirements; and (iv) any other facts or circumstances the Commission deems relevant, including whether the Commission and foreign regulatory authority or authorities have a memorandum of understanding (''MOU'') or similar arrangement that would facilitate supervisory cooperation.[22]

In performing the comparability assessment for foreign nonbank SDs, the Commission's review will include the extent to which the foreign jurisdiction's requirements address: (i) the process of establishing minimum capital requirements for nonbank SDs and how such process addresses risk, including market risk and credit risk of the nonbank SD's on-balance sheet and off-balance sheet exposures; (ii) the types of equity and debt instruments that qualify as regulatory capital in meeting minimum requirements; (iii) the financial reports and other financial information submitted by a nonbank SD to its relevant regulatory authority and whether such information provides the regulatory authority with the means necessary to effectively monitor the financial condition of the nonbank SD; and (iv) the regulatory notices and other communications between a nonbank SD and its foreign regulatory authority that address potential adverse financial or operational issues that may impact the firm. With respect to the ability of the relevant foreign regulatory authority to supervise and enforce compliance with the foreign jurisdiction's capital adequacy and financial reporting requirements, the Commission's review will include a review of the foreign jurisdiction's surveillance program for monitoring nonbank's SDs compliance with such capital adequacy and financial reporting requirements, and the disciplinary process imposed on firms that fail to comply with such requirements.

In performing the comparability assessment for foreign nonbank MSPs,[23] the Commission's review will include the extent to which the foreign jurisdiction's requirements address: (i) the process of establishing minimum capital requirements for a nonbank MSP and how such process establishes a minimum level of capital to ensure the safety and soundness of the nonbank MSP; (ii) the financial reports and other financial information submitted by a nonbank MSP to its relevant regulatory authority and whether such information provides the regulatory authority with the means necessary to effectively monitor the financial condition of the nonbank MSP; and (iii) the regulatory notices and other communications between a nonbank MSP and its foreign regulatory authority that address potential adverse financial or operational issues that may impact the firm. With respect to the ability of the relevant foreign regulatory authority to supervise and enforce compliance with the foreign jurisdiction's capital adequacy and financial reporting requirements, the Commission's review will include a review of the foreign jurisdiction's surveillance program for monitoring nonbank MSPs' compliance with such capital adequacy and financial reporting requirements, and the disciplinary process imposed on firms that fail to comply with such requirements.

Commission Regulation 23.106 further provides that the Commission may impose any terms or conditions that it deems appropriate in issuing a Capital Comparability Determination.[24] Any specific terms or conditions with respect to capital adequacy or financial reporting requirements will be set forth in the Commission's Capital Comparability Determination Order. As a general condition to all Capital Comparability Determination Orders, the Commission expects to require notification from applicants of any material changes to information submitted by the applicants in support of a comparability finding, including, but not limited to, changes in the relevant foreign jurisdiction's supervisory or regulatory regime.

The Commission's capital adequacy and financial reporting requirements are designed to address and manage risks that arise from a firm's operation as a SD or MSP. Given their functions, both sets of requirements and rules must be applied on an entity-level basis (meaning that the rules apply on a firm-wide basis, irrespective of the type of transactions involved) to effectively address risk to the firm as a whole. Therefore, in order to rely on a Capital Comparability Determination, a nonbank SD or nonbank MSP domiciled in the foreign jurisdiction and subject to supervision by the relevant regulatory authority (or authorities) in the foreign jurisdiction must file a notice with the Commission of its intent to comply with the applicable capital adequacy and financial reporting requirements of the foreign jurisdiction set forth in the Capital Comparability Determination in lieu of all or parts of the CFTC Capital Rules and/or CFTC Financial Reporting Rules.[25] Notices must be filed electronically with the Commission's Market Participants Division (''MPD'').[26] The filing of a notice by a non-U.S. nonbank SD or non-U.S. nonbank MSP provides MPD staff, acting pursuant to authority delegated by the Commission,[27] with the opportunity to engage with the firm and to obtain representations that it is subject to, and complies with, the laws and regulations cited in the Capital Comparability Determination and that it will comply with any listed conditions. MPD will issue a letter under its delegated authority from the Commission confirming that the non-U.S. nonbank SD or non-U.S. nonbank MSP may comply with foreign laws and regulations cited in the Capital Comparability Determination in lieu of

[21] 17 CFR 23.106(a)(2).

[22] *See* 17 CFR 23.106(a)(3) and 85 FR 57520–57522.

[23] Commission Regulation 23.101(b) requires a nonbank MSP to maintain positive tangible net worth. There are no MSPs currently registered with the Commission. 17 CFR 23.101(b).

[24] *See* 17 CFR 23.106(a)(5).

[25] 17 CFR 23.106(a)(4).

[26] Notices must be filed in electronic form to the following email address: *MPDFinancialRequirements@cftc.gov.*

[27] *See* 17 CFR 140.91(a)(11).

complying with the CFTC Capital Rules and the CFTC Financial Reporting Rules upon MPD's determination that the firm is subject to and complies with the applicable foreign laws and regulations, is subject to the jurisdiction of the applicable foreign regulatory authority (or authorities), and can meet any conditions in the Capital Comparability Determination.

Each non-U.S. nonbank SD and/or non-U.S. nonbank MSP that receives, in accordance with the applicable Commission Capital Comparability Determination Order, confirmation from the Commission that it may comply with a foreign jurisdiction's capital adequacy and/or financial reporting requirements will be deemed by the Commission to be in compliance with the corresponding CFTC Capital Rules and/or CFTC Financial Reporting Rules.[28] Accordingly, if a nonbank SD or nonbank MSP fails to comply with the foreign jurisdiction's capital adequacy and/or financial reporting requirements, the Commission may initiate an action for a violation of the corresponding CFTC Capital Rules and or CFTC Financial Reporting Rules.[29] In addition, a non-U.S. nonbank SD or non-U.S. nonbank MSP that receives confirmation of its ability to use substituted compliance remains subject to the Commission's examination and enforcement authority.[30]

The Commission will consider an application for a Capital Comparability Determination to be a representation by the applicant that the laws and regulations of the foreign jurisdiction that are submitted in support of the application are finalized and in force, that the description of such laws and regulations is accurate and complete, and that, unless otherwise noted, the scope of such laws and regulations encompasses the relevant non-U.S. nonbank SDs and/or non-U.S. nonbank MSPs domiciled in the foreign jurisdiction.[31] A non-U.S. nonbank SD or non-U.S. nonbank MSP that is not legally required to comply with a foreign jurisdiction's laws or regulations determined to be comparable in a Capital Comparability Determination may not voluntarily comply with such laws or regulations in lieu of compliance with the CFTC Capital Rules or the CFTC Financial Reporting Rules. Each non-U.S. nonbank SD or non-U.S. nonbank MSP that seeks to rely on a Capital Comparability Determination Order is responsible for determining whether it is subject to the foreign laws and regulations found comparable in the Capital Comparability Determination and the Capital Comparability Determination Order.

C. Application for a Capital Comparability Determination for Certain EU Nonbank Swap Dealers

The Applicants submitted the EU Application requesting that the Commission issue a Capital Comparability Determination finding that an EU nonbank SD's compliance with the capital requirements of the EU and the financial reporting requirements of the EU, as specified in the EU Application, satisfies corresponding CFTC Capital Rules and the CFTC Financial Reporting Rules applicable to a nonbank SD under Sections 4s(e)–(f) of the CEA and Commission Regulations 23.101 and 23.105.[32] There are currently four EU nonbank SDs registered with the Commission: BofA Securities Europe SA and Goldman Sachs Paris Inc. et Cie are organized and domiciled in France; Citigroup Global Markets Europe AG and Morgan Stanley Europe SE are organized and domiciled in Germany.

The capital and financial reporting framework applicable to EU financial institutions is established by EU regulations and directives. Specifically, the Capital Requirements Regulation [33] and the Capital Requirements Directive [34] set forth capital and financial reporting requirements applicable to entities defined as ''credit institutions'' or ''investment firms,'' including EU nonbank SDs.

The term ''credit institution'' includes an entity engaged in taking deposits or other repayable funds from the public and granting credits for its own account (''Banking Activities'').[35] An entity engaged in Banking Activities is subject to the capital and financial reporting requirements of CRR and CRD.

The term ''credit institution'' also includes an entity engaged in (i) dealing for its own account, (ii) underwriting financial instruments, or (iii) placing financial instruments on a firm commitment basis (collectively, ''Investment Activities''), provided that the entity also meets certain defined financial thresholds set forth in the definition.[36] Specifically, an entity engaged in Investment Activities that maintains a total value of consolidated assets equal to or in excess of EUR 30 billion is required to be authorized as a ''credit institution'' and is subject to the capital and financial reporting requirements of CRR and CRD.[37]

Credit institutions that qualify as ''significant supervised entities'' are subject to the direct prudential supervision of the European Central Bank (''ECB'').[38] Credit institutions that

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[28] 17 CFR 23.106(a)(4).

[29] *Id.*

[30] *Id.*

[31] The Commission has provided the Applicants with an opportunity to review for accuracy and completeness, and comment on, the Commission's description of relevant EU laws and regulations on which this proposed Capital Comparability Determination is based. The Commission relies on this review and any corrections received from the Applicants in making its proposal. Thus, to the extent that the Commission relies on an inaccurate description of foreign laws and regulations submitted by the Applicants, the comparability determination may not be valid.

[32] EU Application, p. 1. There are currently no MSPs registered with the Commission, and the Applicants have not requested that the Commission issue a Capital Comparability Determination concerning EU nonbank MSPs. Accordingly, the Commission's Capital Comparability Determination and proposed Capital Comparability Determination Order do not address EU nonbank MSPs.

[33] *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012,* as amended (''Capital Requirements Regulation'' or ''CRR'').

[34] *Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC,* as amended (''Capital Requirements Directive'' or ''CRD'').

[35] CRR, Article 4(1)(1) (defining the term ''credit institution'').

[36] *Id.*

[37] *Id.* and CRD, Articles 8 and 8a (requiring an entity that engages in Investment Activities and meets the financial thresholds to submit an application for authorization as a ''credit institution'' under the relevant provisions of the applicable national law).

CRR, Article 4(1)(1) provides that an entity carrying out Investment Activities meets the financial threshold for authorization as a credit institution if: (i) the total value of the consolidated assets of the entity is equal to or in excess of EUR 30 billion; (ii) the total value of the assets of the entity is less than EUR 30 billion, and the entity is part of a group in which the total value of the consolidated assets of all entities in that group that individually have total assets of less than EUR 30 billion and that engage in Investment Activities is equal to or in excess of EUR 30 billion; or (iii) the total value of the assets of the entity is less than EUR 30 billion, and the entity is part of a group in which the total value of the consolidated assets of all entities in the group that engage in Investment Activities is equal to or in excess of EUR 30 billion, where the consolidated supervisor, in consultation with the supervisory college, decides that the entity must be authorized as a credit institution in order to address potential risks of circumvention and potential risks for financial stability of the EU.

[38] *See generally, Council Regulation (EU) 1024/2013 of 15 October 2013 Conferring Specific Tasks to the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions* (''SSM Regulation'') and *Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 Establishing the Framework for Cooperation within the Single Supervisory Mechanism Between the European Central Bank and the National Competent Authorities and with National Designated Authorities* (''SSM Framework Regulation'').

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are ''less significant supervised entities'' are prudentially supervised by the applicable prudential supervisory authority in the entity's home EU Member State (''national competent authority'').[39] The term ''competent authority'' is used in this document to refer to the ECB or the national competent authority, as appropriate.

The term ''investment firm'' is defined as an entity authorized under the Markets in Financial Instruments Directive,[40] and whose regular business is the provision of one or more investment services to third parties and/or the performance of one or more investment-related activities on a professional basis (including Investment Activities as defined above).[41] An investment firm that engages in Investment Activities and maintains total consolidated assets of at least EUR 15 billion is also subject to the capital and financial reporting requirements of CRR and CRD.[42] The investment firm, however, is not required to be authorized as a ''credit institution'' under the relevant provisions of the applicable national law in the EU Member State and is prudentially supervised by the national competent authority.

Lastly, an entity defined as an ''investment firm'' that does not engage in Investment Activities, or that engages in Investment Activities but does not meet the criteria of either maintaining consolidated assets of at least EUR 15 billion or maintaining consolidated assets of at least EUR 5 billion and meeting certain criteria of significance and interconnectedness, is not subject to CRR and CRD.[43] Such an investment firm is subject to new capital and financial reporting requirements established by IFR and IFD, which EU Member States were required to adopt and apply by June 26, 2021.[44] The new IFR and IFD capital and financial reporting requirements are tailored to the risks faced and posed by smaller investment firms that operate differently from banking entities and larger investment firms. Such smaller investment firms are also prudentially supervised by the national competent authority.

The four EU nonbank SDs currently registered with the Commission are subject to CRR and CRD.[45] The EU Application does not include an analysis of the comparability of the capital and financial reporting rules under the IFR and IFD to the CFTC Capital Rules and CFTC Financial Reporting Rules. Therefore, the Commission is not assessing the comparability of the capital and financial reporting requirements imposed by IFR and IFD on smaller investment firms with the CFTC Capital Rules and CFTC Financial Reporting Rules. Thus, an EU nonbank SD, or a future EU nonbank SD applicant, that is subject to the IFR and IFD framework and seeks substituted compliance for some or all of the CFTC Capital Rules and CFTC Financial Reporting Rules must submit an application to the Commission in accordance with Commission Regulation 23.106.[46] The application must include a description of how IFR and IFD address the elements of the Commission's capital adequacy and financial reporting requirements for nonbank SDs, including, at a minimum, the methodologies for establishing and calculating capital adequacy requirements.[47]

In addition, as noted above, the four EU nonbank SDs that are currently registered with the Commission are domiciled in the EU Member States of France and Germany. As further described below, the Commission's analysis therefore involves an assessment of how certain EU directives were implemented into the national laws of France and Germany. The Commission has not reviewed the implementation of the relevant EU directives in other EU Member States. Therefore, an entity organized and domiciled in an EU Member State other than France or Germany that seeks to register with the Commission as an SD and to comply with some or all of the Commission's capital and financial reporting rules via substituted compliance would have to submit an application for a Capital Comparability Determination under Commission Regulation 23.106. Commission staff expects that it will engage with such entities during the registration process

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The criteria for determining whether credit institutions are considered ''significant supervised entities'' include size, economic importance for the specific EU Member State or the EU economy, significance of cross-border activities, and request for or receipt of direct public financial assistance. *See* SSM Regulation, Article 6 and SSM Framework Regulation, Articles 39–44 and 50–62.

[39] SSM Regulation, Article 6. Less significant entities are supervised by their national competent authorities in close cooperation with the ECB. With respect to the prudential supervision of less significant entities, the ECB has the power to issue regulations, guidelines or general instructions to the national competent authorities. SSM Regulation, Article 6(5)(a). At any time, the ECB can also decide to directly supervise a less significant entity to ensure that high supervisory standards are applied consistently. SSM Regulation, Article 6(5)(b).

[40] *Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU* (''Markets in Financial Instruments Directive'' or ''MiFID'').

[41] CRR, Article 4(1)(2) cross-referencing Article 4(1)(1) of MiFID.

[42] *See Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014* (''Investment Firms Regulation'' or ''IFR''), Article 1(1) and (1)(2) (indicating that an investment firm that engages in Investment Activities is subject to CRR (and by cross-reference to CRD) if any of the following applies: (i) the total value of the consolidated assets of the investment firm is equal to or exceeds EUR 15 billion; (ii) the total value of the consolidated assets of the investment firm is less than EUR 15 billion, and the investment firm is part of a group in which the total value of the consolidated assets of all investment firms in the group that individually have total assets of less than EUR 15 billion and that engage in Investment Activities is equal to or exceeds EUR 15 billion; or (iii) the total value of the consolidated assets of the investment firm is equal to or exceeds EUR 5 billion, the investment firm engages in Investment Activities, and the competent authority has determined that the investment firm should be subject to CRR based on criteria set forth in Article 5 of Directive (EU) 2019/2034). *See also, Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU* (''Investment Firms Directive'' or ''IFD''), Article 5 (providing that the competent authority may decide to apply the requirements of CRR to an investment firm whose consolidated assets are equal or exceed EUR 5 billion and that engages in Investment Activities if one or more of the following criteria apply: (i) the investment firm engages in Investment Activities on a scale that the failure or distress of the investment firm could lead to systemic risk; (ii) the investment firm is a clearing member; and/or (iii) the competent authority considers it to be justified in light of the size, nature, scale and complexity of the activities of the investment firm considering the importance of the investment firm for the economy of the EU or of the relevant EU Member State, the significance of the investment firm's cross-border activities, and the interconnectedness of the investment firm with the financial system).

[43] *See* IFD, Article 5 (setting forth the criteria that may justify a decision by the competent authority to apply the requirements of CRR to an investment firm that engages in Investment Activities and whose consolidated assets equal or exceed EUR 5 billion).

[44] IFR, Article 66 and IFD, Article 67.

[45] BofA Securities Europe SA, Citigroup Global Markets Europe AG and Morgan Stanley Europe SE have been authorized as credit institutions. The three EU nonbank SDs also qualify as ''significant supervised entities'' subject to the direct supervision of the ECB. Goldman Sachs Paris Inc. et Cie has a pending application for authorization as a credit institution. CRD, Article 8a allows entities engaged in Investment Activities to continue carrying out such activities until they obtain authorization as credit institutions. The Applicants represented that Goldman Sachs Paris Inc et Cie would likely be a categorized as a ''less significant supervised entity'' and subject to direct supervision by the national competent authority. According to the Applicants, however, the ECB is still considering whether it may exercise direct supervisory authority over the entity, pursuant to SSM Regulation, Article 6. *See* Responses to Staff Questions of May 15, 2023.

[46] 17 CFR 23.106.

[47] Commission Regulation 23.106(a)(2)(ii). 17 CFR 23.106(a)(2)(ii).

and rely to the extent practicable on the analysis performed in this document to assess the comparability of the applicant's home country capital and financial reporting requirements with the Commission's corresponding requirements.

As noted above, the EU nonbank SDs currently registered with the Commission are subject to CRR and CRD. CRR, as a regulation, is binding in its entirety and directly applicable in all EU Member States.[48] CRD, as a directive, was required to be transposed into EU Member States' national law.[49] France implemented CRD in various provisions of its Monetary and Financial Code (''MFC'') [50] and through several ministerial orders, including Ministerial Order on Capital Buffers [51] and Ministerial Order on Internal Control.[52] France also adopted Ministerial Order on Distribution Restrictions [53] and amended relevant national law provisions, including the above-referenced ministerial orders, to implement CRD V.[54] Germany implemented CRD via amendments to the Banking Act (Kreditwesengesetz, ''KWG'') and its subordinate statutory instruments.[55] In addition, Germany adopted and published the Risk Reduction Act (Risikoreduzierungsgesetz, ''RiG'') on December 14, 2020 to implement CRD V, with most of the relevant changes becoming effective on December 28, 2020. CRR and CRD as implemented in French and German law are collectively referred to hereafter as the ''EU Capital Rules.''

The Applicants also represent that in addition to CRR and CRD, the Bank Recovery and Resolution Directive (''BRRD'') includes relevant EU capital requirements.[56] BRRD establishes a framework for recovery and resolution of credit institutions and investment firms, and mandates that EU Member States require such institutions to satisfy ''a minimum requirement for own funds and eligible liabilities'' (''MREL'') if they meet certain requirements.[57] France implemented BRRD primarily via amendments to the MFC.[58] Germany transposed BRRD into national law by the Recovery and Resolution Act (Sanierungs und Abwicklungsgesetz, ''SAG'').[59]

The Applicants further represent that with respect to supervisory financial reporting, Commission Implementing Regulation (EU) 2021/451 [60] supplements CRR with implementing technical standards (''CRR Reporting ITS'') specifying, among other things, uniform formats and frequencies for the financial reporting required under CRR.[61] In addition, the ECB has adopted a regulation setting forth a common minimum set of financial information that should be reported by credit institutions subject to CRR, including EU nonbank SDs, on the basis of the CRR Reporting ITS (''ECB FINREP Regulation'').[62] The Applicants also represent that Directive 2013/34/EU [63] contains provisions related to financial reporting, including a mandate that entities of a certain size be required to prepare annual audited financial statements and a management report.[64] CRR, CRR Reporting ITS, ECB FINREP Regulation, relevant provisions of CRD regarding certain notice requirements as implemented in French and German law, and the relevant provisions of the Accounting Directive as implemented in French and German law are collectively referred to hereafter as the ''EU Financial Reporting Rules.''

The Applicants also note that the U.S. Securities and Exchange Commission (''SEC'') has issued orders permitting an SEC-registered nonbank security-based swap dealer domiciled in France or

[48] *Consolidated Version of the Treaty on the Functioning of the European Union,* OJ (C 326) 171, Oct. 26, 2012 (''TFEU''), Article 288. Accordingly, CRR is directly applicable and binding law in France and Germany, the two EU Member States where EU nonbank SDs are currently organized and operating. Most CRR requirements, including provisions introduced by *Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013* (''CRR II''), have been in effect since June 28, 2021, with some provisions having an earlier effective date. CRR II, Article 3. Several provisions have a delayed effective date. These include market risk-related amendments to CRR, Article 106 (Internal Hedges) and new Article 204a (Eligible Types of Equity Derivatives), which will come into effect on June 28, 2023. *Id.*

[49] TFEU, Article 288 (stating that a directive is binding as to the result to be achieved upon each EU Member State to which the directive is addressed, and further provides, however, that each EU Member State elects the form and method of implementing the directive). In this connection, EU Member States were required to implement and start applying amendments to CRD, introduced by *Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures* (''CRD V'') by December 29, 2020. Some CRD V provisions were subject to delayed implementation deadlines of June 28, 2021 and January 1, 2022, but all CRD V provisions are currently effective. CRD V, Article 2.

[50] In particular, MFC, Articles L.511–41 to L.511–50–1 contain provisions relating to prudential requirements applicable to credit institutions. In addition, MFC, Articles L.612–1 to L.612–50 relate to the role, functioning, and powers of the national competent authority.

[51] *Arrêté of 3 November 2014 Relating to Capital Buffers of Banking Services Providers and Investment Firms Other Than Portfolio Management Companies.*

[52] *Arrêté of 3 November 2014 on Internal Control of Companies in the Banking, Payment Services and Investment Services Sector Subject to the Control of Autorité de Contrôle Prudentiel et de Résolution.*

[53] *Arrêté of 25 February 2021 Relating to Distribution Restrictions Applicable to Credit Institutions, Financial Companies and Certain Investment Firms.*

[54] Specifically, to implement CRD V, France amended the MFC via *Ordinance No. 2020–1635 of December 21, 2020* and *Decree No. 2020–1637 of December 22, 2020,* with most of the relevant changes becoming effective on December 29, 2020. France also introduced consecutive amendments to *Ministerial Order on Capital Buffers* and *Ministerial Order on Internal Control,* with the latest changes effective as of August 1, 2021.

[55] Specifically, the KWG includes, among other things, provisions related to capital adequacy requirements, including provisions granting power the Federal Ministry of Finance to issue statutory instruments to provide details on capital adequacy requirements (Section 10(1)), provisions specifying the basis for imposing higher capital requirements (Section 10(3)), provisions setting forth requirements related to capital buffers (Sections 10c to 10i) and provisions describing the powers of the competent authority (Sections 6b, 56, 60b).

[56] *Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council. See* EU Application, p. 5.

[57] EU Member States were required to transpose BRRD into national law and start applying the implementing measures from January 1, 2015. BRRD, Article 130. BRRD was amended by *Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive 2014/59/EU as regards loss-absorbing and recapitalization capacity of credit institutions and investment firms and Directive 98/26/EC* (''Bank Recovery and Resolution Directive II'' or ''BRRD II'') and EU Member States were required to start applying national law measures implementing BRRD II by December 28, 2020. BRRD II, Article 3. BRRD as amended by BRRD II will be referred to as ''BRRD'' in this document, unless otherwise stated.

[58] Among other provisions, MFC Article L.613–44 relates in particular to the MREL requirement and Article R.613–46–1 defines the conditions that items and instruments need to meet to qualify as ''eligible liabilities.''

[59] In particular, SAG, Section 49(1) and (2) relate to the MREL requirement.

[60] *Commission Implementing Regulation (EU) 2021/451 of 17 December 2020 laying down implementing technical standards for the application of Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to supervisory reporting of institutions and repealing Implementing Regulation (EU) No 680/2014.*

[61] EU Application, p. 21 and Responses to Staff Questions of May 15, 2023.

[62] *Regulation (EU) 2015/534 of the European Central Bank of 17 March 2015 on reporting of supervisory financial information.*

[63] *Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/394/EEC* (''Accounting Directive'').

[64] EU Application, p. 5. Accounting Directive, Articles 4, 19 and 34.

Germany (''EU nonbank SBSD'') to satisfy SEC capital [65] and financial reporting requirements via substituted compliance with applicable French and German capital and financial reporting.[66] The French Order and German Order conditioned substituted compliance for capital requirements on an EU nonbank SBSD complying with specified laws and regulations, including CRR, CRD, and BRRD, and also maintaining total liquid assets in an amount that exceeds the EU nonbank SBSD's total liabilities by at least $100 million and by at least $20 million after applying certain deductions to the value of the liquid assets to reflect market, credit, and other potential risks to the value of the assets.[67]

II. General Overview of Commission and EU Nonbank Swap Dealer Capital Rules

A. General Overview of the CFTC Nonbank Swap Dealer Capital Rules

The CFTC Capital Rules provide nonbank SDs with three alternative capital approaches: (i) the Tangible Net Worth Capital Approach (''TNW Approach''); (ii) the Net Liquid Assets Capital Approach (''NLA Approach''); and (iii) the Bank-Based Capital Approach (''Bank-Based Approach'').[68]

Nonbank SDs that are ''predominantly engaged in non-financial activities'' may elect the TNW Approach.[69] The TNW Approach requires a nonbank SD to maintain a level of ''tangible net worth'' [70] equal to or greater than the higher of: (i) $20 million plus the amount of the nonbank SD's ''market risk exposure requirement'' [71] and ''credit risk exposure requirement'' [72] associated with the nonbank SD's swap and related hedge positions that are part of the nonbank SD's swap dealing activities; (ii) 8 percent of the nonbank SD's ''uncleared swap margin'' amount; [73] or (iii) the amount of capital required by a registered futures association of which the nonbank SD is a member.[74] The TNW Approach is intended to ensure the safety and soundness of a qualifying nonbank SD by requiring the firm to maintain a minimum level of tangible net worth that is based on the nonbank SD's swap dealing activities to provide a sufficient level of capital to absorb losses resulting from its swap dealing and other business activities.

The TNW approach requires a nonbank SD to compute its market risk exposure requirement and credit risk exposure requirement using standardized capital charges set forth in SEC Rule 18a–1 [75] that are applicable to entities registered with the SEC as SBSDs or standardized capital charges set forth in Commission Regulation 1.17 applicable to entities registered as FCMs or entities dually-registered as an FCM and nonbank SD.[76] Nonbank SDs that have received Commission or NFA approval pursuant to Commission Regulation 23.102 may use internal models to compute market risk and/or credit risk capital charges in lieu of the SEC or CFTC standardized capital charges.[77]

A nonbank SD that elects the NLA Approach is required to maintain ''net capital'' in an amount that equals or exceeds the greater of: (i) $20 million; (ii) 2 percent of the nonbank SD's uncleared swap margin amount; or (iii) the amount of capital required by NFA.[78] The NLA Approach is intended to ensure the safety and soundness of a nonbank SD by requiring the firm to maintain at all times at least one dollar of highly liquid assets to cover each dollar of the nonbank SD's liabilities.

A nonbank SD is required to reduce the value of its highly liquid assets by the market risk exposure requirement and/or the credit risk exposure requirement in computing its net capital.[79] A nonbank SD that does not have Commission or NFA approval to use internal models must compute its market risk exposure requirement and/

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[65] Section 15F(e)(1)(B) of the Exchange Act (15 U.S.C. 78o–10) directs the SEC to adopt capital rules for security-based swap dealers (''SBSDs'') that do not have a prudential regulator.

[66] *See Amended and Restated Order Granting Conditional Substituted Compliance in Connection with Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the Federal Republic of Germany; Amended Orders Addressing Non-U.S. Security-Based Swap Entities Subject to Regulation in the French Republic or the United Kingdom; and Order Extending the Time to Meet Certain Conditions Relating to Capital and Margin,* 86 FR 59797 (Oct. 28, 2021) (''German Order''); *Order Granting Conditional Substituted Compliance in Connection with Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the French Republic,* 86 FR 41612 (Aug. 8, 2021) (''French Order''); *and Order Specifying the Manner and Format of Filing Unaudited Financial and Operational Information by Security-Based Swap Dealers and Major Security-Based Swap Participants that are not U.S. Persons and are Relying on Substituted Compliance with Respect to Rule 18a–7,* 86 FR 59208 (Oct. 26, 2021) (''SEC Order on Manner and Format of Filing Unaudited Financial and Operational Information'').

[67] The conditioning of the German and French substituted compliance orders on EU nonbank SBSDs maintaining liquid assets in an amount that exceeds the EU nonbank SBSD's total liabilities by at least $100 million and by at least $20 million after applying certain deductions to the value of the liquid assets reflects that the SEC's capital rule for nonbank SBSDs is a liquidity-based requirement and that the SEC capital requirements are not based on the Basel bank capital standards. *See* 17 CFR 240.18a–1(a)(1) (requiring a SBSD to maintain, in relevant part, net capital of $20 million or, if approved to use capital models, $100 million of tentative net capital and $20 million of net capital).

[68] 17 CFR 23.101.

[69] 17 CFR 23.101(a)(2). The term ''predominantly engaged in non-financial activities'' is defined in Commission Regulation 23.100 and generally provides that: (i) the nonbank SD's, or its parent entity's, annual gross financial revenues for either of the previous two completed fiscal years represents less than 15 percent of the nonbank SD's or the nonbank SD's parent's, annual gross revenues for all operations (*i.e.,* commercial and financial) for such years; and (ii) the nonbank SD's, or its parent entity's, total financial assets at the end of its two most recently completed fiscal years represents less than 15 percent of the nonbank SD's, or its parent's, total consolidated financial and nonfinancial assets as of the end of such years. 17 CFR 23.100.

[70] The term ''tangible net worth'' is defined in Commission Regulation 23.100 and generally means the net worth (*i.e.,* assets less liabilities) of a nonbank SD, computed in accordance with applicable accounting principles, with assets further reduced by a nonbank SD's recorded goodwill and other intangible assets. 17 CFR 23.100.

[71] The terms ''market risk exposure'' and ''market risk exposure requirement'' are defined in Commission Regulation 23.100 and generally mean the risk of loss in a financial position or portfolio of financial positions resulting from movements in market prices and other factors. 17 CFR 23.100. Market risk exposure is the sum of: (i) general market risks including changes in the market value of a particular asset that results from broad market movements, which may include an additive for changes in market value under stressed conditions; (ii) specific risk, which includes risks that affect the market value of a specific instrument but do not materially alter broad market conditions; (iii) incremental risk, which means the risk of loss on a position that could result from the failure of an obligor to make timely payments of principal and interest; and (iv) comprehensive risk, which is the measure of all material price risks of one or more portfolios of correlation trading positions.

[72] The term ''credit risk exposure requirement'' is defined in Commission Regulation 23.100 and generally reflects the amount at risk if a counterparty defaults before the final settlement of a swap transaction's cash flows. 17 CFR 23.100.

[73] The term ''uncleared swap margin'' is defined in Commission Regulation 23.100 to generally mean the amount of initial margin that a nonbank SD would be required to collect from each counterparty for each outstanding swap position of the nonbank SD. 17 CFR 23.100. A nonbank SD must include all swap positions in the calculation of the uncleared swap margin amount, including swaps that are exempt or excluded from the scope of the Commission's uncleared swap margin regulations. A nonbank SD must compute the uncleared swap margin amount in accordance with the Commission's margin rules for uncleared swaps. *See* 17 CFR 23.154.

[74] The National Futures Association (''NFA'') is currently the only entity that is a registered futures association. The Commission will refer to NFA in this document when referring to the requirements or obligations of a registered futures association.

[75] 17 CFR 240.18a–1.

[76] 17 CFR 23.101(a)(2)(ii)(A).

[77] *Id.*

[78] 17 CFR 23.101(a)(1)(ii)(A). ''Net capital'' consists of a nonbank SD's highly liquid assets (subject to haircuts) less all of the firm's liabilities, excluding certain qualified subordinated debt. *See* 17 CFR 240.18a–1 for the calculation of ''net capital.''

[79] *See* 17 CFR 240.18a–1(c) and (d).

or credit risk exposure requirement using the standardized capital charges contained in SEC Rule 18a–1 as modified by the Commission's rule.[80]

A nonbank SD that has obtained Commission or NFA approval, may use internal market risk and/or credit risk models to compute market risk and/or credit risk capital charges in lieu of the standardized capital charges.[81] A nonbank SD that is approved to use internal market risk and/or credit risk models is further required to maintain a minimum of $100 million of ''tentative net capital.'' [82]

The Commission's NLA Approach is consistent with the SEC's SBSD capital rule, and is based on the Commission's capital rule for FCMs and the SEC's capital rule for securities broker-dealers (''BDs''). The quantitative and qualitative requirements for NLA Approach internal market and credit risk models are also consistent with the quantitative and qualitative requirements of the Commission's Bank-Based Approach as described below.

The Commission's Bank-Based Approach for computing regulatory capital for nonbank SDs is based on certain capital requirements imposed by the Federal Reserve Board for bank holding companies.[83] The Bank-Based Approach also is consistent with the Basel Committee on Banking Supervision's (''BCBS'') international framework for bank capital requirements.[84] The Bank-Based Approach requires a nonbank SD to maintain regulatory capital equal to or in excess of each of the following requirements: (i) $20 million of common equity tier 1 capital; (ii) an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital (including qualifying subordinated debt) equal to or greater than 8 percent of the nonbank SD's risk-weighted assets (provided that common equity tier 1 capital comprises at least 6.5 percent of the 8 percent minimum requirement); (iii) an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital equal to or greater than 8 percent of the nonbank SD's uncleared swap margin amount; and (iv) an amount of capital required by NFA.[85] The Bank-Based Approach is intended to ensure that the safety and soundness of a nonbank SD by requiring the firm to maintain at all times qualifying capital in an amount sufficient to absorb unexpected losses, expenses, decrease in firm assets, or increases in firm liabilities without the firm becoming insolvent.

The terms used in the Commission's Bank-Based Approach are defined by reference to regulations of the Federal Reserve Board.[86] Specifically, the term ''common equity tier 1 capital'' is defined for purposes of the CFTC Capital Rules to generally mean the sum of a nonbank SD's common stock instruments and any related surpluses, retained earnings, and accumulated other comprehensive income.[87] The term ''additional tier 1 capital'' is defined to include equity instruments that are subordinated to claims of general creditors and subordinated debt holders, but contain certain provisions that are not available to common stock, such as the right of nonbank SD to call the instruments for redemption or to convert the instruments to other forms of equity.[88] The term ''tier 2 capital'' is defined to include certain types of instruments that include both debt and equity characteristics (*e.g.,* certain perpetual preferred stock instruments and subordinated term debt instruments).[89] Subordinated debt also must meet certain requirements to qualify as tier 2 capital, including that the term of the subordinated debt instrument is for a minimum of one year (with the exception of approved revolving subordinated debt agreements which may have a maturity term that is less than one year), and the debt instrument is an effective subordination of the rights of the lender to receive any payment, including accrued interest, to other creditors.[90]

Common equity tier 1 capital, additional tier 1 capital, and tier 2 capital are unencumbered and generally long-term or permanent forms of capital that help ensure that a nonbank SD will be able to absorb losses resulting from its operations and maintain confidence in the nonbank SD as a going concern. In addition, in setting an equity ratio requirement, this limits the amount of asset growth and leverage a nonbank SD can incur, as a nonbank SD must fund its asset growth with a certain percentage of regulatory capital.

A nonbank SD also must compute its risk-weighted assets using standardized capital charges or, if approved, internal models. Risk-weighting assets involves adjusting the notional or carrying value of each asset based on the inherent risk of the asset. Less risky assets are adjusted to lower values (*i.e.,* have less risk-weight) than more risky assets. As a result, nonbank SDs are required to hold lower levels of regulatory capital for less risky assets and higher levels of regulatory capital for riskier assets.

Nonbank SDs not approved to use internal models to risk-weight their assets must compute market risk capital charges using the standardized charges contained in Commission Regulation 1.17 and SEC Rule 18a–1, and must compute their credit risk charges using the standardized capital charges set forth in regulations of the Federal Reserve Board for bank holding companies in Subpart D of 12 CFR part 217.[91]

Standardized market risk charges are computed under Commission Regulation 1.17 and SEC Rule 18a–1 by multiplying, as appropriate to the specific asset schedule, the notional value or market value of the nonbank SD's proprietary financial positions (such as swaps, security-based swaps, futures, equities, and U.S. Treasuries) by fixed percentages set forth in the Regulation or Rule.[92] Standardized credit risk charges require the nonbank SD to multiply on-balance sheet and off-balance sheet exposures (such as receivables from counterparties, debt instruments, and exposures from derivatives) by predefined percentages set forth in the applicable Federal Reserve Board regulations contained in Subpart D of 12 CFR part 217.

A nonbank SD also may apply to the Commission or NFA for approval to use internal models to compute market risk exposure and/or credit risk exposure for

[80] *See* 17 CFR 23.101(a)(1)(ii).

[81] *See* 17 CFR 23.102.

[82] 17 CFR 23.101(a)(1)(ii)(A)(*1*). The term ''tentative net capital'' is defined in Commission Regulation 23.101(a)(1)(ii)(A)(*1*) by reference to SEC Rule 18a–1 and generally means a nonbank SD's net capital prior to deducting market risk and credit risk capital charges.

[83] *See* 17 CFR 23.101(a)(1)(i).

[84] The BCBS is the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Institutions represented on the BCBS include the Federal Reserve Board, the European Central Bank, Deutsche Bundesbank, Bank of England, Bank of France, Bank of Japan, Banco de Mexico, and Bank of Canada. The BCBS framework is available at *https://www.bis.org/basel_framework/index.htm.*

[85] 17 CFR 23.101(a)(1)(i).

[86] *Id.* Commission Regulation 23.101(a)(1)(i) references Federal Reserve Board Rule 217.20 for purposes of defining the terms used in establishing the minimum capital requirements under the Bank-Based Approach. 17 CFR 23.101(a)(1)(i) and 12 CFR 217.20.

[87] *See* 12 CFR 217.20(b).

[88] *See* 12 CFR 217.20(c).

[89] *See* 12 CFR 217.20(d).

[90] The subordinated debt must meet the requirements set forth in SEC Rule 18a–1d (17 CFR 240.18a–1d). *See* 17 CFR 23.101(a)(1)(i)(B) providing that the subordinated debt used by a nonbank SD to meet its minimum capital requirement under the Bank-Based Approach must satisfy the conditions for subordinated debt under SEC Rule 18a–1d.

[91] *See* 17 CFR 23.101(a)(1)(i)(B) and the definition of the term *BHC risk-weighted assets* in 17 CFR 23.100.

[92] *See* 17 CFR 1.17(c)(5) and 17 CFR 240.15c3–1(c)(2).

purposes of determining its total risk-weighted assets.[93] Nonbank SDs approved to use internal models for the calculation of credit risk or market risk, or both, must follow the model requirements set forth in Federal Reserve Board regulations for bank holding companies codified in Subpart E and F, respectively, of 12 CFR part 217. Credit risk and market risk capital charges computed with internal models require the estimation of potential losses, with a certain degree of likelihood, within a specified time period, of a portfolio of assets. Internal models allow for consideration of potential co-movement of prices across assets in the portfolio, leading to offsets of gains and losses. Internal credit risk models can also further include estimation of the likelihood of default of counterparties.

B. General Overview of EU Capital Rules for EU Nonbank SDs

The Applicants state that the EU Capital Rules impose bank-like capital requirements on an EU nonbank SD that are consistent with the BCBS framework for international bank-based capital standards.[94] The Applicants further state that the EU Capital Rules are intended to require each EU nonbank SD to hold a sufficient amount of qualifying equity capital and subordinated debt based on the EU nonbank SD's activities, to absorb decreases in the value of firm assets, increases in the value of firm liabilities, and to cover losses from business activities, including possible counterparty defaults and margin collateral shortfalls associated with swap dealing activities, without the firm becoming insolvent.[95]

The EU Capital Rules require each EU nonbank SD to hold and maintain regulatory capital in the form of qualifying common equity tier 1 capital, additional tier 1 capital, and tier 2 capital in an aggregate amount that equals or exceeds 8 percent of the EU nonbank SD's total risk exposure amount, which is calculated as a sum of the firm's risk-weighted assets and exposures.[96] Common equity tier 1 capital must comprise a minimum of 4.5 percent of the 8 percent capital ratio,[97] and tier 1 capital (which is the aggregate of common equity tier 1 capital and additional tier 1 capital) must comprise a minimum of 6 percent of the total 8 percent capital ratio.[98] Tier 2 capital may comprise a maximum of 2 percent of the total 8 percent capital ratio.[99]

Under the EU Capital Rules, common equity tier 1 capital is composed of common equity capital instruments, retained earnings, accumulated other comprehensive income, and other reserves of the EU nonbank SD.[100] Additional tier 1 capital is composed of capital instruments other than common equity and retained earnings (*i.e.,* common equity tier 1 capital), and includes certain long-term convertible debt securities.[101] Tier 2 capital instruments, which provide an additional layer of supplementary capital, include other reserves, hybrid capital instruments, and certain subordinated debt.[102]

To qualify as tier 2 regulatory capital, capital instruments and subordinated debt must meet certain conditions including that: (i) the capital instruments are issued by the EU nonbank SD and are fully paid-up; (ii) the capital instruments are not purchased by the EU nonbank SD or its subsidiaries; (iii) the claims on the principal amount of the capital instruments rank below any claim from instruments that are ''eligible liabilities,'' [103] meaning that they are effectively subordinated to claims of all non-subordinated creditors of the EU nonbank SD; (iv) the capital instruments have an original maturity of at least five years; and (v) the provisions governing the capital instruments do not include any incentive for the principal amount to be redeemed or repaid by the EU nonbank SD prior to the capital instruments' respective maturities.[104]

In addition to the requirement to maintain total regulatory capital in an amount equal to or in excess of 8 percent of its risk-weighted assets, the EU Capital Rules also require an EU nonbank SD to maintain a capital conservation buffer composed exclusively of common equity tier 1 capital in an amount equal to 2.5 percent of the firm's total risk-weighted assets.[105] The common equity tier 1 capital used to meet the 2.5 percent capital conservation buffer must be separate and independent of the 4.5 percent of common equity tier 1 capital used to meet the 8 percent core capital requirement.[106]

[93] *See* 17 CFR 23.102.

[94] *See* EU Application, p. 10.

[95] *See* EU Application, pp. 5–6, 10 and 15.

[96] CRR, Articles 26, 28, 50–52, 61–63 and 92.

[97] *Id.,* Article 92(1)(a).

[98] *Id.,* Article 92(1)(b).

[99] *Id.,* Article 92(1)(c), which provides that the total capital ratio must be equal to or greater than 8 percent, with a minimum common equity and additional tier 1 capital comprising at least 6 percent of the 8 percent minimum requirement. In addition to the requirement to maintain minimum capital ratios, an EU nonbank SD will not be authorized as a credit institution by its competent authorities unless it maintains at least EUR 5 million of common equity tier 1 capital. CRD, Article 12.

[100] CRR, Articles 26 and 28. Retained earnings, accumulated other comprehensive income and other reserves qualify as common equity tier 1 capital only where the funds are available to the EU nonbank SD for unrestricted and immediate use to cover risks or losses as such risks or losses occur. *See* CRR, Article 26(1).

[101] *Id.,* Articles 50–52.

[102] *Id.,* Articles 62–63.

[103] ''Eligible liabilities'' are non-capital instruments, including instruments that are directly issued by the EU nonbank SD and fully paid up with remaining maturities of at least a year. CRR, Articles 72a and 72b. In addition, the liabilities cannot be owned, secured, or guaranteed, by the EU nonbank SD itself, and the EU nonbank SD cannot have either directly or indirectly funded their purchase. CRR, Article 72b.

[104] *Id.,* Article 63 (listing the conditions that capital instruments must meet to qualify as tier 2 instruments) and Articles 72a–72b (listing the conditions that liabilities must meet to qualify as eligible liabilities). *See also* infra note 123.

[105] CRD, Articles 129. CRD, Article 129(1) directs EU Member States to impose a capital conservation buffer on certain institutions, including the four EU nonbank SDs that are currently registered with the Commission, that requires each institution to maintain a capital conservation buffer of common equity tier 1 capital equal to 2.5 percent of the institution's total risk exposure amount. CRD, Article 129(1) was transposed into French law by Article L.511–41–1–A of the French MFC and Article 2 of Ministerial Order on Capital Buffers and was transposed into German law by Section 10c(1) of KWG.

[106] *Id.* In effect, the EU Capital Rules require an EU nonbank SD to hold common equity tier 1 capital equal to or in excess of 7 percent of the firm's risk-weighted assets, and total capital equal to or in excess of 10.5 percent of the firm's risk-weighted assets.

In addition, an EU nonbank SD may also be subject to: (i) an institution-specific capital countercyclical buffer, if the EU Member States in which the EU nonbank SD has exposures have implemented a capital countercyclical buffer; (ii) a global systemically important institution (''G–SII'') or other systemically important institution (''O–SII'') buffer, if the EU nonbank SD has been designated as a G–SII or O–SII; and (iii) a systemic risk buffer if the EU Member State in which the EU nonbank SD is domiciled, or at least one EU Member State in which the EU nonbank SD has exposures, has implemented a systemic risk buffer. *See* CRD, Articles 130, 131 and 133. To meet these additional capital buffer requirements, the EU nonbank SD must maintain a level of common equity tier 1 capital that is in addition to the common equity tier 1 capital required to meet its core capital requirement of 4.5 percent of its risk-weighted assets and the common equity tier 1 capital required to meet its capital conservation buffer. *See* CRR, Article 92(1) and CRD, Article 130(5). The total amount of common equity tier 1 capital required to meet all applicable capital buffer requirements is referred to as the ''combined buffer requirement.'' CRD, Article 128. In practice, several EU Member States, including France and Germany, have implemented countercyclical capital buffers with rates ranging from 0.5 percent to 2.5 percent of risk-weighted assets and several EU Member States, including Germany, have implemented systemic risk buffers with rates ranging from 0.5 to 9 percent of risk-weighted assets, varying across subsets of exposures. Germany's systemic risk buffer applies only with respect to exposures secured by residential property. In addition, as of

The EU Capital Rules further impose a 3 percent leverage ratio floor on EU nonbank SDs as an additional element of the capital requirements.[107] Specifically, each EU nonbank SD is required to maintain tier 1 capital (*i.e.,* an aggregate of common equity tier 1 capital and additional tier 1 capital) equal to or in excess of 3 percent of the firm's total on-balance sheet and off-balance sheet exposures, including exposures on uncleared swaps, without regard to any risk-weighting.[108] The leverage ratio is a non-risk based minimum capital requirement that is intended to prevent an EU nonbank SD from engaging in excessive leverage, and complements the risk-based minimum capital requirement that is based on the EU nonbank SD's risk-weighted assets.

As noted above, the amount of regulatory capital that an EU nonbank SD is required to hold is determined by calculating the firm's total risk exposure, which requires the EU nonbank SD to risk-weight its on-balance sheet and off-balance sheet assets and exposures using specified standardized weights or, if approved for use by competent authorities, internal model-based methodologies.[109] Risk-weighting assets and exposures involves adjusting the notional or carrying value of each asset and risk exposure based on the inherent risk of the asset or exposure. Less risky assets and exposures are adjusted to lower values (*i.e.,* have less weight) than more risky assets or exposures. As a result, EU nonbank SDs are required to hold lower levels of regulatory capital for less risky assets and exposures and higher levels of regulatory capital for riskier assets and exposures. The categories of risk charges that an EU nonbank SD must include in determining its total risk exposure include charges reflecting: (i) market risk; (ii) credit risk; (iii) settlement risk; (iv) CVA risk of OTC derivative instruments; and (v) operational risk.[110] The methods for calculating such risk charges are based on the BCBS framework.[111]

Standardized market risk charges are generally calculated by multiplying the notional or carrying amount of net positions or of adjusted net positions by risk-weighting factors, which are based on the underlying market risk of each asset or exposure. The sum of the calculated amounts comprises the portion of the risk exposure amount attributable to market risk.[112] Standardized credit risk charges are generally calculated by multiplying the notional or carrying value of the EU nonbank SD's on-balance sheet and off-balance sheet assets and exposures by clearly defined risk-weighting factors, which are based on the underlying credit risk of each asset or exposure. The sum of the calculated amounts comprises the portion of the risk exposure amount attributable to credit risk.[113]

Settlement risk charges are intended to account for the price difference to which an EU nonbank SD is exposed if its transactions remain unsettled after the respective transaction's due delivery date.[114] CVA risk charges reflect the current market value of the credit risk of the counterparty to the EU nonbank SD in an OTC derivatives transaction.[115] Operational risk charges reflect the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk.[116]

As noted above, EU nonbank SDs may use internal model-based methodologies to calculate certain categories of risk charges in lieu of standardized charges if they have obtained the requisite regulatory approval.[117] EU Capital Rules set out quantitative and qualitative requirements that internal models must meet in order to obtain and maintain approval.[118] Quantitative and qualitative requirements address, among other issues, governance, validation, monitoring, and review. Modeled risk charges generally require the estimation of potential losses, with a certain degree of likelihood, within a specified time period, of a portfolio of assets.[119] Internal models allow for consideration of potential co-movement of prices across assets in the portfolio, leading to offsets of gains and losses. Credit risk models can also further include estimation of the likelihood of default of counterparties.

Furthermore, the EU Capital Rules also impose separate requirements on an EU nonbank SD to address liquidity risk. The liquidity requirements are composed of three main obligations. First, an EU nonbank SD is required to hold an amount of sufficiently liquid assets to meet the firm's expected payment obligations under stressed conditions for 30 days.[120] Second, an EU nonbank SD is subject to a stable funding requirement whereby the firm must hold a diversity of stable funding instruments [121] sufficient to meet long-term obligations under both normal and stressed conditions.[122] Third, to ensure that an EU nonbank SD continues to meet its liquidity requirements, the firm is required to maintain robust strategies, policies, processes, and system for the

January 2023, none of the four EU nonbank SDs registered with the Commission has been designated as G–SII and only one entity, Citigroup Global Markets Europe AG has been designated as an O–SII and subject to a 0.25 percent additional capital requirement.

[107] CRR, Article 92(1).

[108] Total exposures are required to be computed in accordance with CRR, Article 429.

[109] With regulator permission, EU nonbank SDs may use internal models to calculate credit risk (CRR, Article 143), including certain counterparty credit risk exposures (CRR, Article 283), operational risk (CRR, Article 312(2)), market risk (CRR, Article 363), and credit valuation adjustment risk (''CVA risk'') of over-the-counter (''OTC'') derivatives instruments (CRR, Article 383). The permission to use, and continue using, internal models is subject to strict criteria and supervisory oversight by the competent authorities.

[110] CRR, Article 92(3).

[111] EU Application, pp. 10–11.

[112] CRR, Articles 326–350.

[113] *Id.,* Articles 111–134.

[114] *Id.,* Article 378.

[115] *Id.,* Article 381.

[116] *Id.,* Article 4(1)(52).

[117] *Id.,* Articles 143 (credit risk), 283 (counterparty credit risk); 312(2) (operational risk), 363 (market risk), and 383 (CVA risk).

[118] *See e.g.,* CRR, Articles 144, 283(2); 321–322 and 365–369.

[119] The EU Capital Rules require EU nonbank SDs with internal model approval for market risk to use a VaR model with a 99 percent, one-tailed confidence interval with: (i) price change equivalent to 10 business-day movement in rates and prices; (ii) effective historical observation periods of at least one year; and (iii) at least monthly data set updates. *See* CRR, Article 365(1). EU nonbank SDs approved to use internal ratings-based credit risk models must support the assessment of credit risk, the assignment of exposures to rating grades or pools, and the quantification of default and loss estimates that have been developed for a certain type of exposures, among other conditions. *See* CRR, Articles 142–144. In addition, when EU nonbank SDs are approved to use a model to calculate counterparty credit risk exposures for OTC derivatives transactions, the model must specify the forecasting distribution for changes in the market value of a netting set attributable to joint changes in relevant market variables and calculate the exposure value for the netting set at each of the future dates on the basis of the joint changes in the market variables. *See* CRR, Article 284. EU nonbank SDs allowed to follow the ''advanced method'' of calculating CVA risk charges for OTC derivatives transactions must also use an internal market risk model to simulate changes in the credit spreads of counterparties, applying a 99 percent confidence interval and a 10-day equivalent holding period. *See* CRR, Article 383. Finally, EU nonbank SDs using ''advanced measurement approaches'' based on their own measurement systems to compute operational risk exposures must calculate capital requirements as comprising both expected loss and unexpected loss and capture potentially severe tail events, achieving a sound standard comparable to a 99.9 confidence interval over a one-year period. *See* CRR, Article 322.

[120] CRR, Article 412(1). Liquid assets primarily include cash, exposures to central banks, government-backed assets and other highly liquid assets with high credit quality. *Id.* Article 416(1).

[121] Stable funding instruments include common equity tier 1 capital instruments, additional tier 1 capital instruments, tier 2 capital instruments, and other preferred shares and capital instruments in excess of the tier 2 allowable amount with an effective maturity of one year or greater. CRR, Article 427(1).

[122] CRR, Article 413(1).

identification of liquidity risk over an appropriate set of time horizons, including intra-day.[123] The EU Capital Rules' liquidity requirements are intended to help ensure that EU nonbank SDs can continue to fund their operations over various time horizons, including the timely making of payments to customers and counterparties.

In addition, resolution authorities [124] in EU Member States may require that EU nonbank SDs satisfy an institution-specific MREL pursuant to provisions transposing BRRD.[125] The MREL requirement is separate from the minimum capital requirements imposed on EU nonbank SDs under CRR and CRD and is designed to ensure that credit institutions and investment firms, including the EU nonbank SDs subject to the requirement,[126] maintain at all times sufficient eligible instruments to facilitate the implementation of the preferred resolution strategy.[127] Specifically, the MREL is intended to permit loss absorption, where appropriate, such that the EU nonbank SD's capital and leverage ratios could be restored to the level necessary for compliance with its capital requirements.[128] The MREL is set by the relevant resolution authority and is expressed as two ratios that have to be met in parallel: (i) a percentage of the entity's total risk exposure amount, and (ii) a percentage of the entity's total leverage ratio exposure measure.[129] The MREL amount varies depending on the entity's size, funding model, and risk profile, among other considerations.[130]

Furthermore, CRR imposes an additional supplemental standard of total loss absorbing capacity (''TLAC'') for G–SII entities [131] identified as resolution entities [132] and requires such entities to maintain a risk-based capital and eligible liabilities ratio of 18 percent of the entity's total risk exposure amount and a non-risk-based capital and eligible liabilities ratio of 6.75 percent of the firm's total leverage ratio exposure measure.[133] In addition, CRR requires that ''material subsidiaries'' of non-EU G–SIIs, including subsidiaries of U.S. GSIBs, that are not resolution entities maintain MREL equal to 90 percent of the foregoing as applied to their parent entity at all times.[134]

III. Commission Analysis of the Comparability of the EU Capital Rules and EU Financial Reporting Rules With CFTC Capital Rules and CFTC Financial Reporting Rules

The following section provides a description and comparative analysis of the regulatory requirements of the EU Capital Rules and EU Financial Reporting Rules to the CFTC Capital Rules and CFTC Financial Reporting Rules. Immediately following a description of the requirement(s) of the CFTC Capital Rules or the CFTC Financial Reporting Rules for which a comparability determination was requested by the Applicants, the Commission provides a description of the EU's corresponding laws, regulations, or rules. The Commission then provides a comparative analysis of the EU Capital Rules or the EU Financial Reporting Rules with the corresponding CFTC Capital Rules or CFTC Financial Reporting Rules and identifies any material differences between the respective rules.

The Commission performed this proposed Capital Comparability Determination by assessing the comparability of the EU Capital Rules for EU nonbank SDs as set forth in the EU Application with the Commission's Bank-Based Approach. For clarity, the Commission did not assess the comparability of the EU Capital Rules to the Commission's TNW Approach or NLA Approach as the Commission understands that the EU nonbank SDs, as of the date of the EU Application, are subject to the current bank-based capital approach of the EU Capital Rules. In addition, as noted in Section I.C. above, the Applicants did not include the capital framework and requirements imposed on small investment firms under the IFR and IFD as part of the EU Application, and the Commission did not assess the comparability of the IFR and IFD capital requirements with the CFTC Capital Rules. Accordingly, when the Commission makes a preliminary determination herein regarding the comparability of the EU Capital Rules with the CFTC Capital Rules, the determination pertains to the comparability of the EU Capital Rules as imposed under CRR and CRD with the

[123] CRD, Article 86 provides that EU Member States' competent authorities must ensure that institutions, including EU nonbank SDs, have robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of liquidity risk over an appropriate set of time horizons, including intra-day, so as to ensure that entities maintain adequate levels of liquidity buffers. The strategies, policies, processes, and systems must be tailored to business lines, currencies, branches, and legal entities and must include adequate allocation mechanisms of liquidity costs, benefits and risks.

[124] In application of BRRD, Article 3, EU Member States designate resolution authorities that are empowered to apply the resolution tools and exercise the resolution powers described in BRRD. EU Member States may provide that the resolution authority is the competent authority for supervision for the purposes of CRR and CRD, provided an operational independence exists between the resolution functions and the supervisory or other functions of the relevant authority. BRRD, Article 3(3).

[125] BRRD, Articles 45, 45a to 45h; French MFC, Article L.613–44; and German SAG, Sections 49(1) and (2). Eligible liabilities include, among others items, instruments that are directly issued by the EU nonbank SD and fully paid up with remaining maturities of at least a year. CRR, Articles 72a and 72b. In addition, the liabilities cannot be owned, secured or guaranteed, by the EU nonbank SD itself, and the EU nonbank SD cannot have either directly or indirectly funded its purchase. CRR, Article 72b. The inclusion of derivatives is possible if certain requirements are met. BRRD, Article 45b(2); French MFC, Article R. 613–46–1; German SAG, Section 49b.

[126] Of the four EU nonbank SDs currently registered with the Commission, two—Citigroup Global Markets Europe AG and and Morgan Stanley Europe SE—are subject to MREL. *See* Responses to Staff Questions of May 15, 2023.

[127] BRRD, Article 45c. *See also* Single Resolution Board, *Minimum Requirement for Own Funds and Eligible Liabilities (MREL),* June 2022 (''SRB MREL Policy 2022''), at 5, available at: *https://www.srb.europa.eu/system/files/media/document/2022-06-08_MREL_clean.pdf.*

[128] BRRD, Article 45c.

[129] BRRD, Articles 45 and 45c. Pursuant to BRRD, Article 45, the total risk exposure amount is calculated in accordance with CRR, Article 92(3) and the total leverage ratio exposure measure is calculated in accordance with CRR, Articles 429 and 429a.

[130] BRRD, Article 45c(1)(d).

[131] ''G–SII entity'' is defined in CRR, Article 4(1)(136) as entity that is a G–SII or is part of a G–SII or of a non-EU G–SII. Although none of the EU nonbank SDs that are currently registered with the Commission has been designated as a G–SII in France or Germany as of January 2023, all four EU nonbank SDs are subsidiaries of a U.S. global systemically important bank (''GSIB'') and therefore considered a G–SII entity.

[132] ''Resolution entity'' is defined in general terms to mean a legal entity established in the EU, which has been identified by the resolution authority as an entity in respect of which the resolution plan provides for a resolution action. BRRD, Article 1(1)(83a). None of the four EU nonbank SDs is currently designated as a resolution entity as of March 30, 2023. *See* Responses to Staff Questions of May 15, 2023. As such, the EU nonbank SDs currently registered with the Commission are not subject to a TLAC requirement.

[133] CRR, Article 92a(1). As indicated in CRR, Article 92a(1), the total risk exposure amount is calculated in accordance with CRR, Articles 92(3) and 92(4) and the total leverage ratio exposure measure is calculated in accordance with CRR, Article 429(4).

[134] *Id.,* Article 92b(1). An EU nonbank SD may become subject to the requirement of CRR, Article 92b should it become a ''material subsidiary'' of non-EU G–SII. The term ''material subsidiary'' is defined as a subsidiary that on an individual or consolidated basis meets any of the following conditions: (i) the subsidiary holds more than 5 percent of the consolidated risk-weighted assets of the parent entity; (ii) the subsidiary generates more than 5 percent of the total operating income of the parent entity; or (iii) the total exposure measure (*i.e.,* the total on-balance sheet and off-balance sheet exposures) of the subsidiary is more than 5 percent of the consolidated total exposure measure of the parent entity. *See* CRR, Article 4(135) (defining the term ''material subsidiary'') and Article 429 (setting forth the method for calculating the total exposure measure). None of the EU nonbank SDs registered with the Commission is currently considered a ''material subsidiary'' of a non-EU G–SII and, therefore, subject to the 90 percent of MREL requirement.

Bank-Based Approach under the CFTC Capital Rules.

As described below, it is proposed that any material changes to the EU Capital Rules will require notification to the Commission. Therefore, if there are subsequent material changes to the EU Capital Rules to include, for example, another capital approach, the Commission will review and assess the impact of such changes on the Capital Comparability Determination Order as it is then in effect, and may amend or supplement the Order.[135]

In addition, although the BCBS bank capital standards establish minimum capital standards that are consistent with the requirements of the Commission's Bank-Based Approach, the Commission notes that consistency with the international standards is not determinative of a finding of comparability with the CFTC Capital Rules. In the Commission's view, a foreign jurisdiction's consistency with the BCBS international bank capital standards is an element in the Commission's comparability assessment, but, in and of itself, it may not be sufficient to demonstrate comparability with the CFTC Capital Rules without an assessment of the individual elements of the foreign jurisdiction's capital framework.

Capital and financial reporting regimes are complex structures comprised of a number of interrelated regulatory components. Differences in how jurisdictions approach and implement these regimes are expected, even among jurisdictions that base their requirements on the principles and standards set forth in the BCBS international bank capital framework. Therefore, the Commission's comparability determination involves a detailed assessment of the relevant requirements of the foreign jurisdiction and whether those requirements, viewed in the aggregate, lead to an outcome that is comparable to the outcome of the CFTC's corresponding requirements. Consistent with this approach, the Commission has grouped the CFTC Capital Rules and CFTC Financial Reporting Rules into the key categories that focus the analysis on whether the EU capital and financial reporting requirements are comparable to the Commission's SD requirements in purpose and effect, and not whether the EU requirements meet every aspect or contain identical elements as the Commission's requirements.

Specifically, as discussed in detail below, the Commission used the following key categories in its review: (i) the quality of the equity and debt instruments that qualify as regulatory capital, and the extent to which the regulatory capital represents committed and permanent capital that would be available to absorb unexpected losses or counterparty defaults; (ii) the process of establishing minimum capital requirements for an EU nonbank SD and how such process addresses market risk and credit risk of the firm's on-balance sheet and off-balance sheet exposures; (iii) the financial reports and other financial information submitted by an EU nonbank SD to its relevant regulatory authorities to effectively monitor the financial condition of the firm; and (iv) the regulatory notices and other communications between the EU nonbank SD and its relevant regulatory authorities that detail potential adverse financial or operational issues that may impact the firm. The Commission also reviewed the manner in which compliance by an EU nonbank SD with the EU Capital Rules and EU Financial Reporting rules is monitored and enforced. The Commission invites public comment on all aspects of the EU Application and on the Commission's proposed Capital Comparability Determination discussed below.

A. Regulatory Objectives of CFTC Capital Rules and CFTC Financial Reporting Rules and EU Capital Rules and EU Financial Reporting Rules

1. Regulatory Objectives of CFTC Capital Rules and CFTC Financial Reporting Rules

The regulatory objectives of the CFTC Capital Rules and the CFTC Financial Reporting Rules are to further the Congressional mandate to ensure the safety and soundness of nonbank SDs to mitigate the greater risk to nonbank SDs and the financial system arising from the use of swaps that are not cleared.[136] A primary function of the nonbank SD's capital is to protect the solvency of the firm from decreases in the value of firm assets, increases in the value of firm liabilities, and from losses, including losses resulting from counterparty defaults and margin collateral failures, by requiring the firm to maintain an appropriate level of quality capital, including qualifying subordinated debt, to absorb such losses without becoming insolvent. With respect to swap positions, capital and margin perform complementary risk mitigation functions by protecting nonbank SDs, containing the amount of risk in the financial system as a whole, and reducing the potential for contagion arising from uncleared swaps.

The objective of the CFTC Financial Reporting Rules is to provide the Commission with the means to monitor and assess a nonbank SD's financial condition, including the nonbank SD's compliance with minimum capital requirements. The CFTC Financial Reporting Rules are designed to provide the Commission and NFA, which, along with the Commission, oversees nonbank SDs' compliance with Commission regulations, with a comprehensive view of the financial health and activities of the nonbank SD. The Commission's rules require nonbank SDs to file financial information, including periodic unaudited and annual audited financial statements, specific financial position information, and notices of certain events that may indicate a potential financial or operational issue that may adversely impact the nonbank SD's ability to meet its obligations to counterparties and other creditors in the swaps market, or impact the firm's solvency.[137]

2. Regulatory Objective of EU Capital Rules and EU Financial Reporting Rules

The regulatory objective of the EU Capital Rules is to ensure the safety and soundness of EU financial institutions, including EU nonbank SDs.[138] The EU Capital Rules are designed to preserve the financial stability and solvency of an EU nonbank SD by requiring the firm to maintain a sufficient amount of qualifying equity capital and subordinated debt based on the EU nonbank SD's activities to absorb decreases in the value of firm assets, increases in the value of firm liabilities, and to cover losses from business activities, including possible counterparty defaults and margin collateral shortfalls associated with the firm's swap dealing activities.[139] The EU Capital Rules are also designed to ensure that the EU nonbank SDs have sufficient liquidity to meet their financial obligations to counterparties and other creditors in a distress scenario by requiring each firm to hold an amount of sufficiently liquid assets to meet expected payment obligations under stressed conditions for 30 days[140]

[135] The Commission also may amend or supplement the Capital Comparability Determination Order to address any material changes to the CFTC Capital Rules and CFTC Financial Reporting Rules that are adopted after a final Order is issued.

[136] *See* 7 U.S.C. 6s(e)(3)(A).

[137] *See* 17 CFR 23.105.

[138] EU Application, pp. 5–6.

[139] *Id.*

[140] CRR, Article 412(1). Liquid assets primarily include cash, exposures to central banks,

Continued

and to hold a diversity of stable funding instruments sufficient to meet long-term obligations under both normal and stressed conditions.[141]

With respect to financial reporting, the objective of the EU Financial Reporting Rules is to enable the applicable supervisory authorities to assess the financial condition and safety and soundness of EU nonbank SDs. The EU Financial Reporting Rules aim to achieve this objective by requiring an EU nonbank SD to provide financial reports and other financial position and capital information to the applicable supervisory authorities on a regular basis.[142] The financial reporting by an EU nonbank SD provides the supervisory authorities with information necessary to effectively monitor the EU nonbank SD's overall financial condition and its ability to meet its regulatory obligations as a nonbank SD.

3. Commission Analysis

The Commission has reviewed the EU Application and the relevant EU laws and regulations, and has preliminarily determined that the overall objectives of the EU Capital Rules and CFTC Capital Rules are comparable in that both sets of rules are intended to ensure the safety and soundness of nonbank SDs by establishing a regulatory regime that requires nonbank SDs to maintain a sufficient amount of qualifying regulatory capital to absorb losses, including losses from swaps and other trading activities, and to absorb decreases in the value of firm assets and increases in the value of firm liabilities without the nonbank SDs becoming insolvent. The EU Capital Rules and CFTC Capital Rules are also based on, and consistent with, the BCBS international bank capital framework, which is designed to ensure that banking entities hold sufficient levels of capital to absorb losses and decreases in the value of assets without the banks becoming insolvent.

The Commission further preliminarily believes that the EU Financial Reporting Rules have comparable objectives with the CFTC Financial Reporting Rules as both sets of rules require nonbank SDs to file and/or publish, as applicable, periodic financial reports, including unaudited financial reports and an annual audited financial report, detailing their financial operations and demonstrating their compliance with minimum capital requirements, with the goal of providing the EU supervisory authorities and the CFTC staff with information necessary to comprehensively assess the financial condition of a nonbank SD on an ongoing basis. In addition, to achieve this objective, the financial reports further provide the CFTC and EU authorities with information regarding potential changes in a nonbank SD's risk profile by disclosing changes in account balances reported over a period of time. Such changes in account balances may indicate that the nonbank SD has entered into new lines of business, has increased its activity in an existing line of business relative to other activities, or has terminated a previous line of business.

The prompt and effective monitoring of the financial condition of nonbank SDs through the receipt and review of periodic financial reports supports the Commission and EU supervisory authorities in meeting their respective objectives of ensuring the safety and soundness of nonbank SDs. In connection with these objectives, the early identification of potential financial issues provides the Commission and EU supervisory authorities with an opportunity to address such issues with the nonbank SD before the issues develop to a state where the financial condition of the firm is impaired such that it may no longer hold a sufficient amount of qualifying regulatory capital to absorb decreases in the value of firm assets or increases in the value of firm liabilities, or to cover losses from the firm's business activities, including the firm's swap dealing activities and obligations to swap counterparties.

The Commission invites public comment on its analysis above, including comment on the EU Application and relevant EU laws and regulations.

B. Nonbank Swap Dealer Qualifying Capital

1. CFTC Capital Rules: Qualifying Capital Under Bank-Based Approach

The CFTC Capital Rules require a nonbank SD electing the Bank-Based Approach to maintain regulatory capital in the form of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital in amounts that meet certain stated minimum requirements set forth in Commission Regulation 23.101.[143] Common equity tier 1 capital, additional tier 1 capital, and tier 2 capital are composed of certain defined forms of equity of the nonbank SD, including common stock, retained earnings, and qualifying subordinated debt.[144] The Commission's requirement for a nonbank SD to maintain a minimum amount of defined qualifying capital and subordinated debt is intended to ensure that the firm maintains a sufficient amount of regulatory capital to absorb decreases in the value of the firm's assets and increases in the value of the firm's liabilities, and to cover losses resulting from the firm's swap dealing and other activities, including possible counterparty defaults and margin collateral shortfalls, without the firm becoming insolvent.

Common equity tier 1 capital is generally composed of an entity's common stock instruments and any related surpluses, retained earnings, and accumulated other comprehensive income, and is a more conservative or permanent form of capital than additional tier 1 and tier 2 capital.[145] Additional tier 1 capital is generally composed of equity instruments such as preferred stock and certain hybrid securities that may be converted to common stock if triggering events occur.[146] Total tier 1 capital is composed of common equity tier 1 capital and further includes additional tier 1 capital.[147] Tier 2 capital includes certain types of instruments that include both debt and equity characteristics such as qualifying subordinated debt.[148]

Subordinated debt must meet certain conditions to qualify as tier 2 capital under the CFTC Capital Rules. Specifically, subordinated debt instruments must have a term of at least one year (with the exception of approved revolving subordinated debt agreements which may have a maturity term that is less than one year), and contain terms that effectively subordinate the rights of lenders to receive any payments, including accrued interest, to other creditors of the firm.[149]

government-backed assets and other highly liquid assets with high credit quality. CRR, Article 416(1).

[141] Stable funding instruments include common equity tier 1 capital instruments, additional tier 1 capital instruments, tier 2 capital instruments, and other preferred shares and capital instruments in excess of the tier 2 allowable amount with an effective maturity of one year or greater. CRR, Article 427(1).

[142] CRR, Article 430.

[143] *See* 17 CFR 23.101(a)(1)(i).

[144] The terms ''common equity tier 1 capital,'' ''additional tier 1 capital,'' and ''tier 2 capital'' are defined in the bank holding company regulations of the Federal Reserve Board. *See* 12 CFR 217.20.

[145] 12 CFR 217.20.

[146] *Id.*

[147] *Id.*

[148] *Id.*

[149] The subordinated debt must meet the requirements set forth in SEC Rule 18a–1d (17 CFR 240.18a–1d). *See* 17 CFR 23.101(a)(1)(i)(B) (providing that the subordinated debt used by a nonbank SD to meet its minimum capital requirement under the Bank-Based Approach must satisfy the conditions for subordinated debt under SEC Rule 18a–1d).

Common equity tier 1 capital, additional tier 1 capital, and tier 2 capital are permitted to be included in a nonbank SD's regulatory capital and used to meet the firm's minimum capital requirement due to their characteristics of being permanent forms of capital that are subordinate to the claims of other creditors, which ensures that a nonbank SD will have this regulatory capital to absorb decreases in the value of the firm's assets and increases in the value of the firm's liabilities, and to cover losses from business activities, including swap dealing activities, without the firm becoming insolvent.

2. EU Capital Rules: Qualifying Capital

The EU Capital Rules require an EU nonbank SD to maintain an amount of regulatory capital (*i.e.,* equity capital and qualifying subordinated debt) equal to or greater than 8 percent of the EU nonbank SD's total risk exposure, which is calculated as the sum of the firm's: (i) capital charges for market risk; (ii) risk-weighted exposure amounts for credit risk; (iii) capital charges for settlement risk; (iv) CVA risk of OTC derivatives instruments; and (v) capital charges for operational risk.[150] The EU Capital Rules limit the composition of regulatory capital to common equity tier 1 capital, additional tier 1 capital, and tier 2 capital in a manner consistent with the BCBS bank capital framework.[151] In this regard, the EU Capital Rules provide that an EU nonbank SD's regulatory capital may be composed of: (i) common equity tier 1 capital instruments, which generally include the EU nonbank SD's common equity, retained earnings, and accumulated other comprehensive income; [152] (ii) additional tier 1 capital instruments, which include other forms of capital instruments and certain long-term convertible debt instruments; [153] and (iii) tier 2 capital instruments, which includes other reserves, hybrid capital instruments, and certain qualifying subordinated term debt.[154]

Furthermore, subordinated debt instruments must meet certain conditions to qualify as tier 2 regulatory capital under the EU Capital Rules, including that the: (i) loans are not granted by the EU nonbank SD or its subsidiaries; (ii) claims on the principal amount of the subordinated loans under the provisions governing the subordinated loan agreement rank below any claim from eligible liabilities instruments (*i.e.,* certain non-capital instruments), meaning that they are effectively subordinated to claims of all non-subordinated creditors of the EU nonbank SD; (iii) subordinated loans are not secured, or subject to a guarantee that enhances the seniority of the claim, by the EU nonbank SD, its subsidiaries, or affiliates; (iv) loans have an original maturity of at least five years; and (v) provisions governing the loans do not include any incentive for the principal amount to be repaid by the EU nonbank SD prior to the loans' maturity.[155]

An EU nonbank SD must also maintain a capital conservation buffer equal to 2.5 percent of the firm's total risk exposure in addition to the requirement to maintain qualifying regulatory capital in excess of 8 percent of its total risk exposure.[156] The 2.5 percent capital conservation buffer must be met with common equity tier 1 capital.[157] Common equity tier 1 capital, as noted above, is limited to the EU nonbank SD's common equity, retained earnings, and accumulated other comprehensive income, and represents a more permanent form of capital than equity instruments that qualify as additional tier 1 capital and tier 2 capital.

The EU Capital Rules also impose different ratios for the various components of regulatory capital that are consistent with the BCBS bank capital framework.[158] In this regard, the EU Capital Rules provide that an EU nonbank SD's minimum regulatory capital must satisfy the following requirements: (i) common equity tier 1 capital ratio of 4.5 percent of the firm's total risk exposure amount; (ii) total tier 1 capital (*i.e.,* common equity tier 1 capital plus additional tier 1 capital) ratio of 6 percent of the firm's total risk exposure amount; and (iii) total capital (*i.e.,* an aggregate amount of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital) ratio of 8 percent of the firm's total risk exposure amount. As noted above, an EU nonbank SD must also maintain a capital conservation buffer of 2.5 percent of its total risk exposure amount that must be met with common equity tier 1 capital.[159] With the addition of the capital conservation buffer, each EU nonbank SD is required to maintain minimum regulatory capital that equals or exceeds 10.5 percent of the firm's total risk exposure amount, with common equity tier 1 capital comprising at least 7 percent of the 10.5 percent minimum regulatory capital requirement.[160]

Common equity tier 1 capital, additional tier 1 capital, and tier 2 capital are permitted to be included in an EU nonbank SD's regulatory capital and used to meet the firm's minimum capital requirement due to their characteristics of being permanent forms of capital that are subordinate to the claims of other creditors, which ensures

[150] CRR, Article 92.

[151] *Id.*

[152] CRR, Articles 26 and 28. Capital instruments that qualify as common equity tier 1 capital under the EU Capital Rules include instruments that: (i) are issued directly by the EU nonbank SD; (ii) are paid in full and not funded directly or indirectly by the EU nonbank SD; and (iii) are perpetual. In addition, the principal amount of the instruments may not be reduced or repaid, except in the liquidation of the EU nonbank SD or the repurchase of shares pursuant to the permission of the appropriate regulatory authority.

[153] *Id.,* Articles 50–52. To qualify as additional tier 1 capital, the instruments must meet certain conditions including: (i) the instruments are issued directly by the EU nonbank SD and paid in full; (ii) the instruments are not owned by the EU nonbank SD or its subsidiaries; (iii) the purchase of the instruments is not funded directly or indirectly by the EU nonbank SD; (iv) the instruments rank below tier 2 instruments in the event of the insolvency of the EU nonbank SD; (v) the instruments are not secured or guaranteed by the EU nonbank SD or an affiliate; (vi) the instruments are perpetual and do not include an incentive for the EU nonbank SD to redeem them; and (vii) distributions under the instruments are pursuant to defined terms and may be cancelled under the full discretion of the EU nonbank SD.

[154] *Id.,* Articles 62–63.

[155] *Id.,* Article 63.

[156] CRD, Article 129(1). In addition, an EU nonbank SD may also be subject to a capital countercyclical buffer which requires the EU nonbank SD to hold an additional amount of common equity tier 1 capital equal to its total risk-weighted assets multiplied by the weighted average of the countercyclical buffer rates that apply in all EU countries where the relevant exposures of the EU nonbank SD are located. CRD, Articles 130 and 140. EU nonbank SDs may also be subject to a G–SII or an O–SII buffer if they are of systemic importance. CRD, Article 131. In practice, however, only one of the EU nonbank SD registered with the Commission, Citigroup Global Markets Europe AG, is subject to an O–SII buffer (of 0.25 percent) as of January 2023 and none of the entities is subject to a G–SII buffer. Finally, EU nonbank SDs may be subject to a systemic risk buffer if the EU Member State in which they are domiciled or at least one EU Member State in which they have exposures has implemented a systemic risk buffer. CRD, Article 133. To meet the additional buffer requirements, if applicable, an EU nonbank SD must maintain a level of common equity tier 1 capital that is in addition to the common equity tier 1 capital required to meet its core capital requirement of 4.5 percent of its risk-weighted assets and the common equity tier 1 capital required to meet its capital conservation buffer. *See* CRD, Articles 130(1), 131(4), 131(5a) and 133(1). For EU Member States that have implemented capital countercyclical buffer rates, the rate varies between 0.5 percent and 2.5 percent of total risk exposure. *See* information about EU Member States' countercyclical capital buffer rate available here: *https://www.esrb.europa.eu/national_policy/ccb/html/index.en.html.*

[157] CRD, Article 129(1).

[158] CRR, Article 92(1).

[159] CRD, Article 129(1).

[160] The countercyclical capital buffer, the G–SII or O–SII buffer, and the systemic risk buffer are not included in the analysis given their varying implementation by EU Member States and limited applicability to the EU nonbank SDs that are currently registered with the Commission.

that an EU nonbank SD will have this regulatory capital to absorb decreases in the value of the firm's assets and increases in the value of the firm's liabilities, and to cover losses from business activities, including swap dealing activities, without the firm becoming insolvent.

3. Commission Analysis

The Commission has reviewed the EU Application and the relevant EU laws and regulations, and has preliminarily determined that the EU Capital Rules are comparable in purpose and effect to the CFTC Capital Rules with regard to the types and characteristics of a nonbank SD's equity that qualifies as regulatory capital in meeting its minimum requirements. The EU Capital Rules and the CFTC Capital Rules for nonbank SDs both require a nonbank SD to maintain a quantity of high-quality capital and permanent capital, all defined in a manner that is consistent with the BCBS international bank capital framework, that based on the firm's activities and on-balance sheet and off-balance sheet exposures, is sufficient to absorb losses and decreases in the value of the firm's assets and increases in the value of the firm's liabilities without resulting in the firm becoming insolvent. Specifically, equity instruments that qualify as common equity tier 1 capital and additional tier 1 capital under the EU Capital Rules and the CFTC Capital Rules have similar characteristics (*e.g.,* the equity must be in the form of high-quality, committed and permanent capital) and the equity instruments generally have no priority in distribution of firm assets or income with respect to other shareholders or creditors of the firm, which makes the equity available to a nonbank SD to absorb unexpected losses, including counterparty defaults.[161]

In addition, the Commission has preliminarily determined that the conditions imposed on subordinated debt instruments under the EU Capital Rules and the CFTC Capital Rules are comparable and are designed to ensure that the subordinated debt has qualities that support its recognition by a nonbank SD as equity for regulatory capital purposes. Specifically, in both sets of rules, the conditions include a requirement that the debt holders have effectively subordinated their claims for repayment of the debt to the claims of other creditors of the nonbank SD.[162]

Having reviewed the EU Application and the relevant EU laws and regulations, the Commission has made a preliminary determination that the EU Capital Rules and CFTC Capital Rules impose comparable requirements on EU nonbank SDs with respect to the types and characteristics of equity capital that must be used to meet minimum regulatory capital requirements. The Commission invites public comment on its analysis above, including comment on the EU Application and relevant EU laws and regulations.

C. Nonbank Swap Dealer Minimum Capital Requirement

1. CFTC Capital Rules: Nonbank SD Minimum Capital Requirement

The CFTC Capital Rules require a nonbank SD electing the Bank-Based Approach to maintain regulatory capital that satisfies each of the following criteria: (i) an amount of common equity tier 1 capital of at least $20 million; (ii) an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital in an amount equal to or in excess of 8 percent of the nonbank SD's uncleared swap margin amount; (iii) an aggregate amount of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital equal to or greater than 8 percent of the nonbank SD's total risk-weighted assets, provided that common equity tier 1 capital comprises at least 6.5 percent of the 8 percent; and (iv) the amount of capital required by the NFA.[163]

Prong (i) above requires each nonbank SD electing the Bank-Based Approach to maintain a minimum of $20 million of common equity tier 1 capital to operate as a nonbank SD. The requirement that each nonbank SD electing the CFTC Bank-Based Approach maintain a minimum of $20 million of common equity tier 1 capital is also consistent with the minimum capital requirement for nonbank SDs electing the NLA Approach and the TNW Approach.[164] The Commission adopted this minimum requirement as it believed that the role a nonbank SD performs in the financial markets by engaging in swap dealing activities warranted a minimum level of capital, stated as a fixed dollar amount that does not fluctuate with the level of the firm's dealing activities to help ensure the safety and soundness of the nonbank SD.[165]

Prong (ii) above is a minimum capital requirement that is based on the amount of uncleared margin for swap transactions entered into by the nonbank SD and is computed on a counterparty by counterparty basis. The requirement for a nonbank SD to maintain minimum capital equal to or greater than 8 percent of the firm's uncleared swap margin provides a capital floor based on a measure of the risk and volume of the swap positions, and the number of counterparties and the complexity of operations, of the nonbank SD. The intent of the minimum capital requirement based on a percentage of the nonbank SD's uncleared swap margin was to establish a minimum capital requirement that would help ensure that the nonbank SD meets all of its obligations as a SD to market participants, and to cover potential operational risk, legal risk, and liquidity risk in addition to the risks associated with its trading portfolio.[166]

Prong (iii) above is a minimum capital requirement that is based on the Federal Reserve Board's capital requirements for bank holding companies and is consistent with the BCBS international capital framework for banking institutions. As noted above, a nonbank SD under prong (iii) must maintain an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital in an amount equal to or greater than 8 percent of the nonbank SD's total risk-weighted assets, with common equity tier 1 capital comprising at least 6.5 percent of the 8 percent. Risk-weighted assets are a nonbank SD's on-balance sheet and off-balance sheet exposures, including proprietary swap, security-based swap, equity, and futures positions, weighted according to risk. The Bank-Based Approach requires each nonbank SD to maintain regulatory capital in an amount that equals or exceeds 8 percent of the firm's total risk-weighted assets to help ensure that the nonbank SD's level of capital is sufficient to absorb decreases in the value of the firm's assets and increases

[161] *Compare* 12 CFR 217.20(b) (defining capital instruments that qualify as common equity tier 1 capital under the rules of the Federal Reserve Board) and 12 CFR 217.20(c) (defining capital instruments that qualify as additional tier 1 capital under the rules of the Federal Reserve Board) *with* CRR, Articles 26 and 28 (defining items and capital instruments that qualify as common equity tier 1 capital under the EU Capital Rules) and CRR, Article 52 (defining capital instruments that qualify as additional tier 1 capital under the EU Capital Rules).

[162] *Compare* 17 CFR 240.18a–1d *with* CRR, Article 63(d).

[163] *See* 17 CFR 23.101(a)(1)(i). NFA has adopted the CFTC minimum capital requirements for nonbank SDs, but has not adopted additional capital requirements at this time.

[164] Nonbank SDs electing the NLA Approach are subject to a minimum capital requirement that includes a fixed minimum dollar amount of net capital of $20 million. *See* 17 CFR 23.101(a)(1)(ii)(A)(*1*). Nonbank SDs electing the TNW Approach are required to maintain levels of tangible net worth that equals or exceeds $20 million plus the amount of the nonbank SDs' market risk and credit risk associated with the firms' dealing activities. *See* 17 CFR 23.101(a)(2)(ii)(A).

[165] *See, e.g.,* 85 FR 57492.

[166] *See* 85 FR 57462.

in the value of the firm's liabilities, and to cover unexpected losses resulting from business activities, including uncollateralized defaults from swap counterparties, without the nonbank SD becoming insolvent.

A nonbank SD must compute its risk-weighted assets using standardized market risk and/or credit risk charges, unless the nonbank SD has been approved by the Commission or NFA to use internal models.[167] For standardized market risk charges, the Commission incorporates by reference the standardized market risk charges set forth in Commission Regulation 1.17 for FCMs and SEC Rule 18a–1 for nonbank SBSDs.[168] The standardized market risk charges under Commission Regulation 1.17 and SEC Rule 18a–1 are calculated as a percentage of the market value or notional value of the nonbank SD's marketable securities and derivatives positions, with the percentages applied to the market value or notional value increasing as the expected or anticipated risk of the positions increases.[169] The resulting total market risk exposure amount is multiplied by a factor of 12.5 to cancel the effect of the 8 percent multiplication factor applied to all of the nonbank SD's risk-weighted assets, which effectively requires a nonbank SD to hold qualifying regulatory capital equal to or greater than 100 percent of the amount of its market risk exposure.[170]

With respect to standardized credit risk charges for exposures from non-derivatives positions, a nonbank SD computes its on-balance sheet and off-balance sheet exposures in accordance with the standardized credit risk charges adopted by the Federal Reserve Board and set forth in Subpart D of 12 CFR 217 as if the SD itself were a bank holding company subject to Subpart D.[171] Standardized credit risk charges are computed by multiplying the amount of the exposure by defined counterparty credit risk factors that range from 0 percent to 150 percent.[172] A nonbank SD with off-balance sheet exposures is required to calculate a credit risk charge by multiplying each exposure by a credit conversion factor that ranges from 0 percent to 100 percent, depending on the type of exposure.[173] In addition to the risk-weighted assets for general credit risk, a nonbank SD calculating risk charges under Subpart D of 12 CFR 217 must also calculate risk-weighted assets for unsettled transactions involving securities, foreign exchange instruments, and commodities that have a risk of delayed settlement or delivery.

A nonbank SD may compute standardized credit risk charges for derivatives positions, including uncleared swaps and non-cleared security-based swaps, using either the current exposure method (''CEM'') or the standardized approach for measuring counterparty credit risk (''SA–CCR'').[174] Both CEM and SA–CCR are non-model, rules-based, approaches to calculating counterparty credit risk exposures for derivatives positions. Credit risk exposure under CEM is the sum of: (i) the current exposure (*i.e.,* the positive mark-to-market) of the derivatives contract; and (ii) the potential future exposure, which is calculated as the product of the notional principal amount of the derivatives contract multiplied by a standard credit risk conversion factor set forth in the rules of the Federal Reserve Board.[175] Credit risk exposure under SA–CCR is defined as the exposure at default amount of a derivatives contract, which is computed by multiplying a factor of 1.4 by the sum of: (i) the replacement costs of the contract (*i.e.,* the positive mark-to market); and (ii) the potential future exposure of the contract.[176]

A nonbank SD may also obtain approval from the Commission or NFA to use internal models to compute market risk and/or credit risk charges in lieu of the standardized charges. A nonbank SD seeking approval to use an internal model is required to submit an application to the Commission or NFA.[177] The application is required to include, among other things, a list of categories of positions that the nonbank SD holds in its proprietary accounts and a brief description of the methods that the nonbank SD will use to calculate market risk and/or credit risk charges for such positions, as well as a description of the mathematical models used to compute market risk and credit risk charges.

A nonbank SD approved by the Commission or NFA to use internal models to compute market risk is required to comply with Subpart F of the Federal Reserve Board's Part 217 regulations (''Subpart F'').[178] Subpart F is based on models that are consistent with the BCBS Basel 2.5 capital framework.[179] The Commission's qualitative and quantitative requirements for internal capital models are also comparable to the SEC's existing internal capital model requirements for broker-dealers in securities and SBSDs,[180] which are broadly based on the BCBS Basel 2.5 capital framework.

A nonbank SD approved to use internal models to compute credit risk charges is required to perform such computation in accordance with Subpart E of the Federal Reserve Board's Part 217 regulations [181] as if the SD itself were a bank holding company subject to Subpart E.[182] The internal credit risk modeling requirements are also based on the Basel 2.5 capital framework and the Basel 3 capital framework. A nonbank SD that computes its credit risk charges using internal models must multiply the resulting capital requirement by a factor of 12.5.[183]

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[167] *See* 17 CFR 23.101(a)(1)(i)(B) and the definition of the term *BHC equivalent risk-weighted assets* in 17 CFR 23.100.

[168] *See* paragraph (3) of the definition of the term *BHC equivalent risk-weighted assets* in 17 CFR 23.100.

[169] *See* 17 CFR 240.18a–1(c)(1).

[170] *See* 17 CFR 23.100 (Definition of *BHC equivalent risk-weighted assets*). As noted, a nonbank SD is required to maintain qualifying capital (*i.e.,* an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital) in an amount that exceeds 8 percent of its market risk-weighted assets and credit-risk-weighted assets. The regulations, however, require the nonbank SD to effectively maintain qualifying capital in excess of 100 percent of its market risk-weighted assets by requiring the nonbank SD to multiply its market-risk-weighted assets by 12.5.

[171] *See* 17 CFR 23.101(a)(1)(i)(B) and paragraph (1) of the definition of the term *BHC equivalent risk-weighted assets* in 17 CFR 23.100.

[172] *See* 17 CFR 217.32. Lower credit risk factors are assigned to entities with lower credit risk and higher credit risk factors are assigned to entities with higher credit risk. For example, a credit risk factor of 0% is applied to exposures to the U.S. government, the Federal Reserve Bank, and U.S. government agencies (*see* 12 CFR 217.32 (a)(1)), and a credit risk factor of 100% is assigned to an exposure to foreign sovereigns that are not members of the Organization of Economic Co-operation and Development (*see* 12 CFR 217.32(a)(2)).

[173] *See* 17 CFR 217.33.

[174] *See* 17 CFR 217.34. *See also,* Commission Regulation 23.100 (17 CFR 23.100) defining the term *BHC risk-weighted assets,* which provides that a nonbank SD that does not have model approval may use either CEM or SA–CCR to compute its exposures for over-the-counter derivative contracts without regard to the status of its affiliate entities with respect to the use of a calculation approach under the Federal Reserve Board's capital rules.

[175] *See* 12 CFR 217.34.

[176] *See* 12 CFR 217.132(c).

[177] *See* 17 CFR 23.102(c).

[178] *See* paragraph (4) of the definition of *BHC equivalent risk-weighted assets* in 17 CFR 23.100.

[179] *Compare* 17 CFR 23.100 (providing for a nonbank SD that is approved to use internal models to calculate market and credit risk to calculate its risk-weighted assets using Subparts E and F of 12 CFR part 217), Subpart F of 12 CFR, 17 CFR 23.101(a)(1)(ii) (providing for an SD that elects the Net Liquid Assets Approach to calculate its net capital in accordance with Rule 18a–1), and 17 CFR 23.102(a), *with* Basel Committee on Banking Supervision, Revisions to the Basel II Market Risk Framework (2011), *https://www.bis.org/publ/bcbs193.pdf* (describing the revised internal model approach under Basel 2.5).

[180] The SEC internal model requirements for SBSDs are listed in 17 CFR 240.18a–1(d).

[181] 12 CFR 217 Subpart E.

[182] *See* 85 FR 57462 at 57496.

[183] 12 CFR 217.131(e)(1)(iii), 217.131(e)(2)(iv), and 217.132(d)(9)(iii).

In adopting the final Bank-Based Approach rules, the Commission also noted that in choosing an alternative calculation, the nonbank SD must adopt the entirety of the alternative. As such, if the nonbank SD is calculating its risk-weighted assets using the regulations in Subpart E of 12 CFR 217, the nonbank SD must include charges reflecting all categories of risk-weighted assets applicable under these regulations, which include among other things, charges for operational risk, CVA of OTC derivatives contracts, and unsettled transactions involving securities, foreign exchange instruments, and commodities that have a risk of delayed settlement or delivery.[184] The capital charge for operational risk and CVA of OTC derivatives contracts calculated in accordance with Subpart E of 12 CFR 217 must also be multiplied by a factor of 12.5.[185]

Under the Basel 2.5 capital framework, nonbank SDs have flexibility in developing their internal models, but must follow certain minimum standards. Internal market risk and credit risk models must follow a Value-at-Risk (''VaR'') structure to compute, on a daily basis, a 99th percentile, one-tailed confidence interval for the potential losses resulting from an instantaneous price shock equivalent to a 10-day movement in prices (unless a different time-frame is specifically indicated). The simulation of this price shock must be based on a historical observation period of minimum length of one year, but there is flexibility on the method used to render simulations, such as variance-covariance matrices, historical simulations, or Monte Carlo.

The Commission and the Basel standards for internal models also have requirements on the selection of appropriate risk factors as well as on data quality and update frequency.[186] One specific concern is that internal models must capture the non-linear price characteristics of options positions, including but not limited to, relevant volatilities at different maturities.[187]

In addition, BCBS standards for market risk models include a series of additive components for risks for which the broad VaR is ill-suited or that may need targeted calculation. These include the calculation of a Stressed VaR measure (with the same specifications as the VaR, but calibrated to historical data from a continuous 12-month period of significant financial stress relevant to the firm's portfolio); a Specific Risk measure (which includes the effect of a specific instrument); an Incremental Risk measure (which addresses changes in the credit rating of a specific obligor which may appear as a reference in an asset); and a Comprehensive Risk measure (which addresses risk of correlation trading positions).

2. EU Capital Rules: EU Nonbank Swap Dealer Minimum Capital Requirements

The EU Capital Rules impose bank-like capital requirements on an EU nonbank SD that, consistent with the BCBS international bank capital framework, require the EU nonbank SD to hold a sufficient amount of qualifying equity capital and subordinated debt based on the EU nonbank SD's activities to absorb decreases in the value of firm assets and increases in the value of the firm's liabilities, and to cover losses from its business activities, including possible counterparty defaults and margin collateral shortfalls associated with the firm's swap dealing activities, without the firm becoming insolvent. Specifically, the EU Capital Rules require each EU nonbank SD to maintain sufficient levels of capital to satisfy the following capital ratios, expressed as a percentage of the EU nonbank SD's total risk exposure amount (*i.e.,* the sum of the EU nonbank SD's risk-weighted assets and exposures): (i) a common equity tier 1 capital ratio of 4.5 percent; [188] (ii) a tier 1 capital ratio of 6 percent; [189] and (iii) a total capital ratio of 8 percent.[190] The EU Capital Rules further require an EU nonbank SD to maintain a capital conservation buffer composed of common equity capital tier 1 capital in amount equal to 2.5 percent of the firm's total risk exposure.[191] The common equity tier 1 capital used to meet the capital conservation buffer must be separate and in addition to the 4.5 percent of common equity tier 1 capital that the EU nonbank is required to maintain in meeting its core 8 percent capital requirement.[192] Thus, an EU nonbank SD is required to maintain regulatory capital equal to at least 10.5 percent of its total risk exposure amount, with common equity tier 1 capital comprising at least 7 percent of the regulatory capital (4.5 percent of the core capital plus the 2.5 percent capital conservation buffer).

An EU nonbank SD's total risk exposure amount is calculated as the sum of the firm's: (i) capital requirements for market risk; (ii) risk-weighted exposure amounts for credit risk; (iii) capital requirements for settlement risk; (iv) capital requirements for CVA risk of OTC derivatives instruments; and (v) capital requirements for operational risk.[193] Capital charges for market risk and risk-weighted exposures for credit risk are computed based on the EU nonbank SD's on-balance sheet and off-balance sheet exposures, including proprietary swap, security-based swap, equity, and futures positions, weighted according to risk.[194] Settlement risk capital charges reflect the price difference to which an

[184] Settlement risk for OTC derivatives contracts is addressed as part of the counterparty-credit risk calculation methodology described in 12 CFR 217.132.

[185] 12 CFR 217.162(c) (operational risk) and 217.132(e)(4) (CVA of OTC derivative contracts).

[186] *See* 17 CFR Appendix A to Subpart E of Part 23(i)(2)(iii), and Basel Committee on Banking Supervision, Revisions to the Basel II Market Risk Framework (2011), paragraph 718(Lxxvi)(e), available at: *https://www.bis.org/publ/bcbs193.pdf.*

[187] The Commission's requirement is set forth in paragraph (i)(2)(iv)(A) of Appendix A to Subpart E of 17 CFR part 23. *See also,* Basel Committee on Banking Supervision, Revisions to the Basel II Market Risk Framework (2011), paragraph 718(Lxxvi)(h), available at: *https://www.bis.org/publ/bcbs193.pdf.*

[188] CRR, Article 92(1)(a).

[189] *Id.,* Article 92(1)(b). Tier 1 capital is the sum of the EU nonbank SD's common equity tier 1 capital and additional tier 1 capital.

[190] *Id.,* Article 92(1)(c). The total capital is the sum of the EU nonbank SD's tier 1 capital and tier 2 capital.

[191] CRD, Article 129(1).

[192] *Id.* An EU nonbank SD may also be required to maintain a countercyclical capital buffer composed of common equity tier 1 capital equal to the firm's total risk exposure multiplied by an entity-specific countercyclical buffer rate. The entity-specific countercyclical capital buffer rate is determined by calculating the weighted average of the countercyclical buffer rates that apply in the jurisdictions in which the EU nonbank SD has relevant credit exposures. *See* CRD, Article 140. In each EU Member State, the countercyclical buffer rate is set by a designated authority on a quarterly basis. *See* CRD, Article 136. In addition, an EU nonbank SD may be subject to a G–SII or O–SII buffer, if the entity is of systemic importance, and a systemic risk buffer if the EU Member State in which the EU nonbank SD is domiciled or at least one EU Member State in which the EU nonbank SD has exposures has implemented one. *See* CRD, Articles 131 and 133. In practice, however, currently only one of the EU nonbank SD registered with the Commission, Citigroup Global Markets Europe AG, is subject to O–SII buffer (of 0.25 percent) as of January 2023 and none of the registered EU nonbank SDs is subject to a G–SII buffer.

[193] CRR, Article 92(3).

[194] To compute capital requirements for market risk, EU nonbank SDs are required to calculate capital charges for all trading book positions and non-trading book positions that are subject to foreign exchange or commodity risk. *See* CRR, Article 325. The risk-weighted exposure amounts for credit risk include: (i) risk-weighted exposure amounts for credit risk and dilution risk in respect of all the business activities of the EU nonbank SD, excluding risk-weighted exposure amounts from the trading book business of the firm; and (ii) risk-weighted exposure amounts for counterparty risk arising from the trading book business for certain derivatives transactions, repurchase agreements, securities or commodities lending or borrowing transactions, margin lending or long settlement transactions. *See* CRR, Article 92(3)(a) and (f).

EU nonbank SD is exposed if its transactions in debt instruments, equity, foreign currency, and commodities remain unsettled after the respective product's due delivery date.[195] CVA is an adjustment to the mid-market value of the portfolio of OTC derivative transactions with a counterparty and reflects the current market value of the credit risk of the counterparty to the EU nonbank SD.[196] Operational risk capital charges reflect the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk.[197] To compute its total risk exposure amount, an EU nonbank SDs is also required to multiply the capital requirements for market risk, settlement risk, CVA risk, and operational risk, calculated in accordance with the EU Capital Rules, by a factor of 12.5, which effectively requires an EU nonbank SD to hold qualifying regulatory capital equal to or greater than the full amount of the relevant risk exposures.[198] The formulae for calculating risk-weighted exposure amounts for credit risk also include a 12.5 multiplication factor.[199]

Consistent with the Commission's Bank-Based Approach and the BCBS capital framework, the EU Capital Rules require EU nonbank SDs to compute market risk exposures and credit risk exposures using a standardized approach or, if approved by the relevant competent authorities, internal risk models.[200] In addition, EU Capital Rules, consistent with the BCBS capital framework, require EU nonbank SDs to compute capital charges for CVA risk and operational risk using standardized approaches, unless approved to use internal models by relevant competent authorities.[201]

EU nonbank SDs calculate standardized market risk charges generally by multiplying the notional or carrying amount of net positions by risk-weighting factors, which are based on the underlying market risk of each asset or exposure and increase as the expected risk of the positions increase. Market risk requirements for debt instruments and equity instruments are calculated separately under the standardized approach, and are each calculated as the sum of specific risk and general risk of the positions. Securitizations are treated as debt instruments for market risk requirements,[202] whereas derivative positions are generally treated as exposures on their underlying assets,[203] with options being delta-adjusted.[204]

The EU Capital Rules also require EU nonbank SDs to include in their risk-weighted assets market risk exposures to certain foreign currency and gold positions. Specifically, an EU nonbank SD with net positions in foreign exchange and gold that exceed 2 percent of the firm's total capital must calculate capital requirements for foreign exchange risk.[205] The capital requirement for foreign exchange risk under the standardized approach is 8 percent of the EU nonbank SD's net positions in foreign exchange and gold.[206]

The EU Capital Rules further require EU nonbank SDs to include exposures to commodity positions in calculating the firm's risk-weighted assets. The standardized calculation of commodity risk exposures may follow one of three approaches depending on type of position or exposure. The first is the sum of a flat percentage rate for net positions, with netting allowed among tightly defined sets, plus another flat percentage rate for the gross position.[207] The other two standardized approaches are based on maturity-ladders, where unmatched portions of each maturity band (*i.e.,* portions that do not net out to zero) are charged at a step-up rate in comparison to the base charges for matched portions.[208]

With respect to credit risk, the EU Capital Rules require an EU nonbank SD to calculate its standardized credit risk exposure in a manner aligned with the Commission's Bank-Based Approach and the BCBS framework by taking the carrying value or notional value of each of the EU nonbank SD's on-balance sheet and off-balance sheet exposures, making certain additional credit risk adjustments, and then applying specific risk-weights based on the type of counterparty and the asset's credit quality.[209] For instance, high quality credit exposures, such as exposures to EU Member States' central banks, carry a zero percent risk-weight. Exposures to EU banks, other investment firms, or other businesses, however, may carry risk-weights between 20 percent and 150 percent depending on the credit ratings available for the entity or, for exposures to banks and investment firms, for its central government.[210] If no credit rating is available, the EU nonbank SD must generally apply a 100 percent risk-weight, meaning the total accounting value of the exposure is used.[211]

With respect to counterparty credit risk for derivatives transactions and certain other agreements that give rise to bilateral credit risk, the EU Capital Rules require an EU nonbank SD that is not approved to use credit risk models to calculate its exposure using the standardized approach for counterparty credit risk (*i.e.,* SA–CCR),[212] which is one of the methods that a nonbank SD may use to calculate its credit risk exposure under a derivatives transaction pursuant to the Commission's Bank-Based Approach.[213] The exposure amount under the SA–CCR is computed, under both the EU Capital Rules and the Commission's Bank-Based Approach, as the sum of the replacement cost of the contract and the potential future exposure of the contract, multiplied by a factor of 1.4.[214]

EU Capital Rules also require an EU nonbank SD to calculate capital requirements for settlement risk.[215] Consistent with the BCBS framework, the capital charge for settlement risk for transactions settled on a delivery-versus-payment basis is computed by multiplying the price difference to which an EU nonbank SD is exposed as a result of an unsettled transaction by a

[195] CRR, Article 378. Settlement risk is calculated as 8 percent, 50 percent, 75 percent, or 100 percent of the price difference for transactions that are not settled within 5 to 15 business days, 16 to 30 business days, 31 to 45 business days, or 46 or more business days, respectively, from the due settlement date.

[196] *Id.,* Article 381.

[197] *Id.,* Article 4(1)(52).

[198] *Id.,* Article 92(4).

[199] *Id.,* Article 153 *et seq.*

[200] With the permission of the relevant competent authority, an EU nonbank SD may use internal models to calculate market risk (*see* CRR, Article 363) and credit risk (*see* CRR, Articles 143 and 283).

[201] *See,* CRR, Articles 382–384 for CVA risk calculations; and Article 312(2) for operational risk.

[202] *Id.,* Article 326. *See also* CRR, Articles 334–340 (provisions related to debt instruments) and 341–343 (provisions related to equities).

[203] *Id.,* Articles 328–330, 358.

[204] *Id.,* Article 329.

[205] *Id.,* Article 351.

[206] *Id.*

[207] *Id.,* Article 360.

[208] *Id.,* Articles 359–361.

[209] *Id.,* Articles 111 and 113(1).

[210] *Id.,* Articles 114–122.

[211] *Id.,* Articles 121(2) and 122(2).

[212] CRR, Articles 92(3)(f) and 274–280e. EU nonbank SDs with smaller-sized derivatives business may also use a ''simplified standardized approach to counterparty credit risk'' (CRR, Article 281) or an ''original exposure method'' (CRR, Article 282) as simpler methods for calculating exposure values. To use either of these alternative methods, an entity's on-and off-balance sheet derivatives business must be equal or less than 10 percent of the entity's total assets and EUR 300 million or 5 percent of the entity's total assets and EUR 100 million, respectively. CRR, Article 273a.

[213] 12 CFR 217.34.

[214] CRR, Article 274(2) and 12 CFR 217.132(c).

[215] CRR, Article 378 (indicating that if transactions in which debt instruments, equities, foreign currencies and commodities excluding repurchase transactions and securities or commodities lending and securities or commodities borrowing are unsettled after their due delivery dates, an EU nonbank SD must calculate the price difference to which it is exposed).

percentage factor that varies from 8 percent to 100 percent based on the number of working days after the due settlement date during which the transaction remains unsettled.[216] The CFTC's Bank-Based Approach provides for a similar calculation methodology for risk-weighted asset amounts for unsettled transactions involving securities, foreign exchange instruments, and commodities.[217]

Consistent with the BCBS framework, an EU nonbank SD is also required to calculate capital charges for CVA risk for OTC derivative instruments [218] to reflect the current market value of the credit risk of the counterparty to the EU nonbank SD.[219] CVA can be calculated following similar methodologies as those described in Subpart E of the Federal Reserve Board's Part 217 regulations.[220]

EU nonbank SD's total risk exposure amount also includes operational risk charges. Consistent with the BCBS framework, EU nonbank SDs may calculate standardized operational risk charges using either one of two approaches—the Basic Indicator Approach or the Standardized Approach.[221] Both the Basic Indicator Approach and the Standardized Approach use as a calculation basis the three-year average of the ''relevant indicator,'' which is the sum of certain items on the statement of income/loss (*i.e.,* the firm's net interest income and net non-interest income). Under the Basic Indicator Approach, EU nonbank SDs are required to multiply the relevant indicator by a factor of 15 percent. When using the Standardized Approach, firms need to allocate the relevant indicator into eight business lines specified by regulation (*e.g.,* trading and sales; retail brokerage; corporate finance) and multiply the corresponding portion by a percentage factor ranging from 12 to 18 percent depending on the business line. The capital requirements for operational risk are calculated as the sum of the individual business lines' charges.

As noted above, if approved by its relevant supervisory authority, an EU nonbank SD may use internal models to calculate its market risk charges, credit risk charges, including counterparty credit risk charges, CVA risk charges, and operational risk charges in lieu of using a standardized approach.[222] To obtain permission, an EU nonbank SD must demonstrate to the satisfaction of the relevant authority that it meets certain conditions for the use of models.[223]

With respect to market risk, the relevant supervisory authority may grant an EU nonbank SD permission to use internal models to calculate one or more of the following risk categories: (i) general risk of equity instruments, (ii) specific risk of equity instruments, (iii) general risk of debt instruments, (iv) specific risk of debt instruments, (v) foreign exchange risk, or (vi) commodities risk,[224] along with interest rate risk on derivatives.[225] To obtain approval to use a market risk model, an EU nonbank SD must meet conditions related to specified model elements and controls including risk and stressed risk calculations,[226] back-testing and multiplication factors,[227] risk measurement requirements,[228] governance and qualitative requirements,[229] internal validation,[230] and specific requirements by risk categories.[231] An EU nonbank SD approved to use models must also obtain approval from the relevant authority to implement a material change to the model or make a material extension to the use of the model.[232] The EU Capital Rules' market risk model-based methodology is based on the Basel 2.5 standard [233] and incorporates relevant aspects of the BCBS framework in terms of requiring EU nonbank SDs with model approval to use a VaR model with a 99 percent, one-tailed confidence level with (i) price changes equivalent to a 10-business day movement in rates and prices, (ii) effective historical observation periods of at least one year, and (iii) at least monthly data set updates.[234] EU Capital Rules also include a framework for governance that includes requirements related to the implementation of independent risk management,[235] senior management's involvement in the risk-control process,[236] establishment of procedures for monitoring and ensuring compliance with a documented set of internal policies and controls,[237] and the conducting of independent review of the models as part of the internal audit process.[238]

With regulatory permission, EU nonbank SDs may also use models to calculate credit risk exposures.[239] Credit risk models may include internal ratings based on the estimation of default probabilities and loss given default, consistent with the BCBS framework and subject to similar model risk management guidelines.[240] To obtain approval for the use of internal ratings-based models, an EU nonbank SD must meet requirements related to, among other things, the structure of its rating systems and its criteria for assigning exposures to grades and pools within a rating system, the parameters of risk quantification, the validation of internal estimates, and the internal governance and oversight of the rating systems and estimation processes.[241]

In addition, subject to regulatory approval, EU nonbank SDs may use internal models to calculate counterparty credit risk exposures for derivatives, securities financing, and long settlement transactions.[242] The prerequisites for approval for such models include requirements related to the establishment and maintenance of a counterparty credit risk management framework, stress testing, the integrity of the modelling process, the risk

[216] *Id.* The price difference to which an EU nonbank SD is exposed is the difference between the agreed settlement price for an instrument (*i.e.,* a debt instrument, equity, foreign currency or commodity) and the instrument's current market value, where the difference could involve a loss for the firm. CRR, Article 378.

[217] 17 CFR 23.100 (definition of *BHC equivalent risk-weighted assets*), 12 CFR 217.38 and 12 CFR 217.136.

[218] CRR, Article 382 (1). CVA risk charges need not be calculated for credit derivatives recognized to reduce risk-weighted exposure amounts for credit risk. *Id.*

[219] *Id.,* Article 381. CVA is defined to exclude debit valuation adjustment.

[220] *See* CRR, Articles 383–384 and 12 CFR 217.132(e)(5) and (6). Under the CFTC's Bank-Based Approach, nonbank SDs calculating their credit risk-weighted assets using the regulations in Subpart D of the Federal Reserve Board's Part 217 regulations, do not calculate CVA of OTC derivatives instruments.

[221] CRR, Article 312.

[222] *Id.,* Articles 143 (credit risk), 283 (counterparty credit risk), 312 (operational risk), 363 (market risk) and 383 (CVA risk). EU nonbank SDs are not permitted, however, to calculated counterparty credit risk charges using internal models when calculating large exposures. CRR, Article 390(4).

[223] *Id.,* Articles 143, 283, 312(2) and 363(1).

[224] *Id.,* Article 363(1).

[225] *Id.,* Article 331(1), using sensitivity models.

[226] *Id.,* Articles 364–365.

[227] *Id.,* Article 366.

[228] *Id.,* Article 367.

[229] *Id.,* Article 368.

[230] *Id.,* Article 369.

[231] *Id.,* Articles 364–377.

[232] *Id.,* Article 363(3).

[233] *Compare* CRR, Articles 362–377 *with* Revisions to the Basel II Market Risk Framework.

[234] *Id.,* Article 365(1).

[235] *Id.,* Articles 368 (1)(b).

[236] *Id.,* Articles 368 (1)(c).

[237] *Id.,* Articles 368 (1)(e).

[238] *Id.,* Articles 368 (1)(h).

[239] *Id.,* Article 143.

[240] *Id.*

[241] *Id.,* Articles 170–177 (rating systems), 178–184 (risk quantification), 185 (validation of internal estimates), and 189–191 (internal governance and oversight).

[242] *Id.,* Article 283. As noted above, however, EU nonbank SDs are not permitted to calculate counterparty credit risk charges using internal models when calculating large exposures. CRR, Article 390(4).

management system, and validation.[243] The EU Capital Rules' internal counterparty credit risk model-based methodology is also based on the Basel 2.5 standard.[244] The EU Capital Rules allow for the estimation of expected exposure as a measure of the average of the distribution of exposures at a particular future date,[245] with adjustments to the period of risk, as appropriate to the asset and counterparty.

EU nonbank SDs may also obtain regulatory permission to use ''advanced measurement approaches'' based on their own operational risk measurement systems, to calculate capital charges for operational risk. To obtain such permission, EU nonbank SDs must meet qualitative and quantitative standards, as well as general risk management standards set forth in the EU Capital Rules.[246] Specifically, among other qualitative standards, EU nonbank SDs must meet requirements related to the governance and documentation of their operational risk management processes and measurement systems.[247] In addition, EU nonbank SDs must meet quantitative standards related to process, data, scenario analysis, business environment and internal control factors laid down in the EU Capital Rules.[248]

As an additional element to the capital requirements, the EU Capital Rules further impose a 3 percent leverage ratio floor on EU nonbank SDs.[249] Specifically, each EU nonbank SD is required to maintain an aggregate amount of common equity tier 1 capital and additional tier 1 capital equal to or in excess of 3 percent of the firm's total on-balance sheet and off-balance sheet exposures, including exposures on uncleared swaps, without regard to any risk-weighting.[250] The leverage ratio is a non-risk based minimum capital requirement that is intended to prevent an EU nonbank SD from engaging in excessive leverage, and complements the risk-based minimum capital requirement that is based on the EU nonbank SD's risk-weighted assets.

Furthermore, the EU Capital Rules also impose separate liquidity requirements on an EU nonbank SD to address liquidity risk. The liquidity requirements are composed of three main obligations. First, an EU nonbank SD is required to hold an amount of sufficiently liquid assets to meet the firm's expected payment obligations under stressed conditions for 30 days.[251] Second, an EU nonbank SD is subject to a stable funding requirement whereby the firm must hold a diversity of stable funding instruments [252] sufficient to meet long-term obligations under both normal and stressed conditions.[253] Third, to ensure that an EU nonbank SD continues to meet its liquidity requirements, the firm is required to maintain robust strategies, policies, processes, and systems for the identification of liquidity risk over an appropriate set of time horizons, including intra-day.[254] The EU Capital Rules' liquidity requirements are intended to help ensure that EU nonbank SDs can continue to fund their operations over various time horizons, including the timely making of payments to customers and counterparties.

The EU Capital Rules also require EU nonbank SDs to comply with a minimum initial capital requirement of EUR 5 million in order to become and remain licensed as a credit institution.[255] The initial capital requirement must be met with common equity tier 1 capital.[256]

3. Commission Analysis

The Commission has reviewed the EU Application and the relevant EU laws and regulations, and has preliminarily determined that the EU Capital Rules are comparable in purpose and effect to the CFTC Capital Rules with regard to the establishment of the nonbank SD's minimum capital requirement and the calculation of the nonbank SD's amount of regulatory capital to meet that requirement.[257] Although there are differences between the EU Capital Rules and the CFTC Capital Rules, as discussed below, the Commission preliminarily believes that the EU Capital Rules and the CFTC Capital Rules are designed to ensure the safety and soundness of a nonbank SD and, subject to the proposed conditions discussed below, will achieve comparable outcomes by requiring the firm to maintain a minimum level of qualifying regulatory capital, including subordinated debt, to absorb losses from the firm's business activities, including swap dealing activities, and decreases in the value of the firm's assets and increases in the value of the firm's liabilities, without the nonbank SD becoming insolvent. The Commission's preliminary finding of comparability is based on a comparative analysis of the three minimum capital requirements thresholds of the CFTC Capital Rules' Bank-Based Approach (*i.e.,* the three prongs recited in Section III.C.1 above) and the respective elements of the EU Capital Rules' requirements, as discussed below.

a. Fixed Amount Minimum Capital Requirement

CFTC Capital Rules and the EU Capital Rules both require nonbank SDs to hold a minimum amount of regulatory capital that is not based on the risk-weighted assets of the firms. Prong (i) of the CFTC Capital Rules requires each nonbank SD electing the Bank-Based Approach to maintain a minimum of $20 million of common

[243] *Id.,* Articles 283–294.

[244] Compare CRR, Article 362–377 with Revisions to the Basel II Market Risk Framework.

[245] CRR, Article 272(19), 283–285.

[246] CRR, Article 312(1), cross-referencing CRR, Articles 321 and 322 and CRD, Articles 74 and 85.

[247] CRR, Article 321.

[248] *Id.,* Article 322.

[249] *Id.,* Article 92(1)(d).

[250] Total exposures are required to be computed in accordance with CRR, Article 429.

[251] CRR, Article 412(1) provides that an EU nonbank SD shall hold liquid assets in amount sufficient to cover the liquidity outflows less the liquidity inflows under stressed conditions so as to ensure the firm maintains levels of liquidity buffers that are adequate to address any possible imbalance between liquidity inflows and outflows under stressed conditions over a period of 30 days. Liquid assets primarily include cash, deposits with central banks (to the extent that the deposits can be withdrawn at any times in periods of stress), government-backed assets and other highly liquid assets with high credit quality. *Id.,* Article 416(1).

[252] Stable funding instruments include common equity tier 1 capital instruments, additional tier 1 capital instruments, tier 2 capital instruments, and other preferred shares and capital instruments in excess of the tier 2 allowable amount with an effective maturity of one year or greater. CRR, Article 427(1).

[253] CRR, Article 413(1).

[254] CRD, Article 86 provides that EU Member States' competent authorities must ensure that institutions, including EU nonbank SDs, have robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of liquidity risk over an appropriate set of time horizons, including intra-day, so as to ensure that entities maintain adequate levels of liquidity buffers. The strategies, policies, processes, and systems must be tailored to business lines, currencies, branches, and legal entities and must include adequate allocation mechanisms of liquidity costs, benefits, and risks. CRD, Article 86 was implemented into French law by MFC, Articles L.511–41–1–B and L.511–41–1–C for credit institutions and L.533–2–1 for investment firms subject to the CRR/CRD framework, as well as the Articles 148 to 186 of the Ministerial Order on Internal Control. Article 86 was implemented into German law by Bundesanstalt für Finanzdienstleistungsaufsicht's (''BaFin'') Minimum Requirements for Risk Management (''MaRisk'') Circular.

[255] CRD, Article 12(1).

[256] *Id.,* Article 12(2).

[257] The Commission notes that pursuant to Article 7 of CRR, the competent authority may exempt an entity subject to CRR from the applicable capital requirements, provided certain conditions are met. In such case, the relevant requirements would apply to the entity's parent entity, on a consolidated basis. The Commission's assessment does not cover the application of Article 7 of CRR and therefore an entity that benefits from an exemption under Article 7 of CRR would not qualify for substituted compliance under the Capital Comparability Determination Order.

equity tier 1 capital. The CFTC's $20 million fixed-dollar minimum capital requirement is intended to ensure that each nonbank SD maintains a level of regulatory capital, without regard to the level of the firm's dealing and other activities, sufficient to meet its obligations to swap market participants given the firm's status as a CFTC-registered nonbank SD and to help ensure the safety and soundness of the nonbank SD.[258] The EU Capital Rules also contain a requirement that an EU nonbank SD maintain a fixed amount of minimum initial capital of EUR 5 million of common equity tier 1 capital in order to become and remain authorized as a credit institution.[259]

The Commission recognizes that the $20 million fixed-dollar minimum capital required under the CFTC Capital Rules is substantially higher than the EUR 5 million minimum initial capital required under the EU Capital Rules and the Commission preliminarily believes that the $20 million represents a more appropriate level of minimum capital to help ensure the safety and soundness of the nonbank SD that is engaging in uncleared swap transactions. Accordingly, the Commission is proposing to condition the Capital Comparability Determination Order to require each EU nonbank SD to maintain, at all times, a minimum level of $20 million regulatory capital in the form of common equity tier 1 items as defined in Article 26 of CRR.[260] The proposed condition would require each EU nonbank SD to maintain an amount of common equity tier 1 capital denominated in euro that is equivalent to the $20 million in U.S. dollars.[261] The Commission is also proposing that an EU nonbank SD may convert the euro-denominated common equity tier 1 capital amount to the U.S. dollar equivalent based on a commercially reasonable and observable exchange rate.

b. Minimum Capital Requirement Based on Risk-Weighted Assets

Prong (iii) of the CFTC Capital Rules requires each nonbank SD to maintain an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital in an amount equal to or greater than 8 percent of the nonbank SD's total risk-weighted assets, with common equity tier 1 capital comprising at least 6.5 percent of the 8 percent.[262] Risk-weighted assets are a nonbank SD's on-balance sheet and off-balance sheet market risk and credit risk exposures, including exposures associated with proprietary swap, security-based swap, equity, and futures positions, weighted according to risk. The requirements and capital ratios set forth in prong (iii) are based on the Federal Reserve Board's capital requirements for bank holding companies and are consistent with the BCBS international bank capital adequacy framework. The requirement for each nonbank SD to maintain regulatory capital in an amount that equals or exceeds 8 percent of the firm's total risk-weighted assets is intended to help ensure that the nonbank SD's level of capital is sufficient to absorb decreases in the value of the firm's assets and increases in the value of the firm's liabilities, and to cover unexpected losses resulting from the firm's business activities, including losses resulting from uncollateralized defaults from swap counterparties, without the nonbank SD becoming insolvent.

The EU Capital Rules contain capital requirements for EU nonbank SDs that the Commission preliminarily believes are comparable to the requirements contained in prong (iii) of the CFTC Capital Rules. Specifically, the EU Capital Rules require an EU nonbank SD to maintain: (i) common equity tier 1 capital equal to at least 4.5 percent of the EU nonbank SD's total risk exposure amount; (ii) total tier 1 capital (*i.e.,* common equity tier 1 capital plus additional tier 1 capital) equal to at least 6 percent of the EU nonbank SD's total risk exposure amount; and (iii) total capital (*i.e.,* an aggregate amount of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital) equal to at least 8 percent of the EU nonbanks SD's total risk exposure amount.[263] In addition, the EU Capital Rules further require each EU nonbank SD to maintain an additional capital conservation buffer equal to 2.5 percent of the EU nonbank SD's total risk exposure amount, which must be met with common equity tier 1 capital.[264] Thus, an EU nonbank SD is effectively required to maintain total qualifying regulatory capital in an amount equal to or in excess of 10.5 percent of the market risk, credit risk, CVA risk, settlement risk and operational risk of the firm (*i.e.,* total capital requirement of 8 percent of risk-weighted assets and an additional 2.5 percent of risk-weighted assets as a capital conservation buffer), which is higher than the 8 percent required of nonbank SDs under prong (iii) of the CFTC Capital Rules.[265]

The Commission also preliminarily believes that the EU Capital Rules and the CFTC Capital Rules are comparable with respect to the calculation of capital charges for market risk and credit risk (including as it relates to aspects of settlement risk and CVA risk), in determining the nonbank SD's risk-weighted assets. More specifically, with respect to the calculation of market risk charges and general credit risk charges, both regimes require a nonbank SD to use standardized approaches to compute market and credit risk, unless the firms are approved to use internal models. The standardized approaches follow the same structure that is now the common global standard: (i) allocating assets to categories according to risk and assigning each a risk-weight; (ii) allocating counterparties according to risk assessments and assigning each a risk factor; (iii) calculating gross exposures based on valuation of assets; (iv) calculating a net exposure allowing offsets following well defined procedures and subject to clear limitations; (v) adjusting the net exposure by the market risk-weights; and (vi) finally, for credit risk exposures, multiplying the sum of net exposures to each counterparty by their corresponding risk factor.

Internal market risk and credit risk models under the EU Capital Rules and the CFTC Capital Rules are based on the BCBS framework and contain comparable quantitative and qualitative requirements, covering the same risks, though with slightly different categorization, and including comparable model risk management requirements. As both rule sets address the same types of risk, with similar allowed methodologies and under similar controls, the Commission

[258] 85 FR 57492.

[259] CRD, Article 12.

[260] The Commission notes that the proposed requirement that EU nonbank SDs maintain a minimum level of $20 million of common equity tier 1 capital is consistent with conditions set forth in the proposed Capital Comparability Determination Orders for Japan and Mexico, respectively. *See, Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination from the Financial Services Agency of Japan,* 87 FR 48092 (Aug. 8, 2022) (''Proposed Japan Order''); *Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on behalf of Nonbank Swap Dealers subject to Regulation by the Mexican Comision Nacional Bancaria y de Valores,* 87 FR 76374 (Dec. 13, 2022) (''Proposed Mexico Order'').

[261] Each of the four current EU nonbank SDs currently maintains common equity tier 1 capital in excess of $20 million based on financial filings made with the Commission. Therefore, the Commission does not anticipate that the proposed condition would have any material impact on the EU nonbank SDs currently registered with the Commission. Nonetheless, the Commission requests comment on the proposed condition.

[262] 17 CFR 23.101(a)(1)(B).

[263] CRR, Article 92(1).

[264] CRD, Article 129(1).

[265] CRR, Article 92(1) and CRD, Article 129(1).

preliminarily believes that these requirements are comparable.

The Commission also preliminarily believes that the EU Capital Rules and CFTC Capital Rules are comparable in that nonbank SDs are required to account for operational risk in computing their minimum capital requirements. In this connection, the EU Capital Rules require an EU nonbank SD to calculate an operational risk exposure as a component of the firm's total risk exposure amount.[266] EU nonbank SDs may use either a standardized approach or, if the EU nonbank SD has obtained regulatory permission, an internal approach based on the firm's own measurement systems, to calculate their capital charges for operational risk. The CFTC Capital Rules address operational risk both as a stand-alone, separate minimum capital requirement that a nonbank SD is required to meet under prong (ii) of the Bank-Based Approach[267] and as a component of the calculation of risk-weighted assets for nonbank SDs that use Subpart E of the Federal Reserve Board's Part 217 regulations to calculate their credit risk-weighted assets via internal models.[268]

c. Minimum Capital Requirement Based on the Uncleared Swap Margin Amount

As noted above, prong (ii) of the CFTC Capital Rules' Bank-Based Approach requires a nonbank SD to maintain regulatory capital in an amount equal to or greater than 8 percent of the firm's total uncleared swaps margin amount associated with its uncleared swap transactions to address potential operational, legal, and liquidity risks.

The EU Capital Rules differ from the CFTC Capital Rules in that they do not impose a capital requirement on EU nonbank SDs based on a percentage of the margin for uncleared swap transactions. The Commission notes, however, that the EU Capital Rules impose capital and liquidity requirements that may compensate for the lack of direct analogue to the 8 percent uncleared swap margin requirement. Specifically, as discussed above, under the EU Capital Rules, the total risk exposure amount is computed as the sum of the EU nonbank SD's capital charges for market risk, credit risk, settlement risk, CVA risk of OTC derivatives instruments, and operational risk.[269] Notably, the EU Capital Rules require that EU nonbank SDs, including firms that do not use internal models, calculate capital charges for operational risk as a separate component of the total risk exposure amount. The EU Capital Rules also impose separate liquidity requirements designed to ensure that the EU nonbank SDs can meet both short- and long-term obligations, in addition to the general requirement to maintain processes and systems for the identification of liquidity risk.[270] In comparison, the Commission requires nonbank SDs to maintain a risk management program covering liquidity risk, among other risk categories, but does not have a distinct liquidity requirement.[271]

As such, the Commission preliminarily believes the inclusion of an operational risk charge in the EU nonbank SD's total risk exposure amount in all circumstances, and the existence of separate liquidity requirements, will achieve a comparable outcome to the Commission's requirement for nonbank SDs to hold regulatory capital in excess of 8 percent of its uncleared swap margin amount. In that regard, the Commission, in establishing the requirement that a nonbank SD must maintain a level of regulatory capital in excess of 8 percent of the uncleared swap margin amount associated with the firm's swap transactions, stated that the intent of the requirement was to establish a method of developing a minimum amount of required capital for a nonbank SD to meet its obligations as an SD to market participants, and to cover potential operational, legal, and liquidity risks.[272]

d. Preliminary Finding of Comparability

Based on a principles-based, holistic assessment, the Commission has preliminarily determined, subject to the proposed condition below, and further subject to its consideration of public comments to the proposed Capital Comparability Determination and Order, that the purpose and effect of the EU Capital Rules and the CFTC Capital Rules are comparable. In this regard, the EU Capital Rules and the CFTC Capital Rules are both designed to require a nonbank SD to maintain a sufficient amount of qualifying regulatory capital and subordinated debt to absorb losses resulting from the firm's business activities, and decreases in the value of firm assets, without the nonbank SD becoming insolvent.

The Commission invites comment on the EU Application, the EU laws and regulations, and the Commission's analysis above regarding its preliminary determination that, subject to the $20 million minimum capital requirement, the EU Capital Rules and the CFTC Capital Rules are comparable in purpose and effect and achieve comparable outcomes with respect to the minimum regulatory capital requirements and the calculation of regulatory capital for nonbank SDs. The Commission also specifically seeks public comment on the question of whether the requirements under the EU Capital Rules that EU nonbank SDs calculate an operational risk exposure as part of the firm's total risk exposure amount and meet separate liquidity requirements are sufficiently comparable in purpose and effect to the Commission's requirement for a nonbank SD to hold regulatory capital equal to or greater than 8 percent of its uncleared swap margin amount.

[266] CRR, Article 92(3).

[267] Specifically, as further discussed below, prong (ii) of the CFTC Capital Rules' Bank-Based Approach requires a nonbank SD to maintain regulatory capital in an amount equal to or greater than 8 percent of the firm's total uncleared swaps margin amount associated with its uncleared swap transactions to address potential operational, legal, and liquidity risks. 17 CFR 101(a)(i)(C). The term ''uncleared swap margin'' is defined by Commission Regulation 23.100 as the amount of initial margin, computed in accordance with the Commission's margin rules for uncleared swaps, that a nonbank SD would be required to collect from each counterparty for each outstanding swap position of the nonbank SD. 17 CFR 23.100 and 23.154. A nonbank SD must include all swap positions in the calculation of the uncleared swap margin amount, including swaps that are exempt or excluded from the scope of the Commission's margin regulations for uncleared swaps pursuant to Commission Regulation 23.150, exempt foreign exchange swaps or foreign exchange forwards, or netting set of swaps or foreign exchange swaps, for each counterparty, as if that counterparty was an unaffiliated swap dealer. 17 CFR 23.100 and 23.150. Furthermore, in computing the uncleared swap margin amount, a nonbank SD may not exclude any de minis thresholds contained in Commission Regulation 23.151. 17 CFR 23.100 and 23.151.

[268] 17 CFR 23.101(a)(1)(i) and 17 CFR 23.100 (definition of *BHC equivalent risk-weighted assets*).

[269] CRR, Article 92(3).

[270] More specifically, the EU Capital Rules impose separate liquidity buffers and ''stable funding'' requirements designed to ensure that EU nonbank SDs can cover both long-term obligations and short-term payment obligations under stressed conditions for 30 days. CRR, Article 412–413. In addition, EU nonbank SDs are required to maintain robust strategies, policies, processes, and systems for the identification of liquidity risk over an appropriate set of time horizons, including intra-day. CRD, Article 86.

[271] Specifically, CFTC Regulation 23.600(b) requires each SD to establish, document, maintain, and enforce a system of risk management policies and procedures designed to monitor and manage the risks related to swaps, and any products used to hedge swaps, including futures, options, swaps, security-based swaps, debt or equity securities, foreign currency, physical commodities, and other derivatives. The elements of the SD's risk management program are required to include the identification of risks and risk tolerance limits with respect to applicable risks, including operational, liquidity, and legal risk, together with a description of the risk tolerance limits set by the SD and the underlying methodology in written policies and procedures. 17 CFR 23.600.

[272] *See* 85 FR 57462 at 57485.

D. Nonbank Swap Dealer Financial Reporting Requirements

1. CFTC Financial Recordkeeping and Reporting Rules for Nonbank Swap Dealers

The CFTC Financial Reporting Rules impose financial recordkeeping and reporting requirements on nonbank SDs. The CFTC Financial Reporting Rules require each nonbank SD to prepare and keep current ledgers or similar records summarizing each transaction affecting the nonbank SD's asset, liability, income, expense, and capital accounts.[273] The nonbank SD's ledgers and similar records must be prepared in accordance with generally accepted accounting principles as adopted in the United States (''U.S. GAAP''), except that if the nonbank SD is not otherwise required to prepare financial statements in accordance with U.S. GAAP, the nonbank SD may prepare and maintain its accounting records in accordance with International Financial Reporting Standards (''IFRS'') issued by the International Accounting Standards Board.[274]

The CFTC Financial Reporting Rules also require each nonbank SD to prepare and file with the Commission and with NFA periodic unaudited and annual audited financial statements.[275] A nonbank SD that elects the TNW Approach is required to file unaudited financial statements within 17 business days of the close of each quarter, and its annual audited financial statements within 90 days of its fiscal year-end.[276] A nonbank SD that elects the NLA Approach or the Bank-Based Approach is required to file unaudited financial statements within 17 business days of the end of each month, and to file its annual audited financial statements within 60 days of its fiscal year-end.[277]

The CFTC Financial Reporting Rules provide that a nonbank SD's unaudited financial statements must include: (i) a statement of financial condition; (ii) a statement of income/loss; (iii) a statement of changes in liabilities subordinated to claims of general creditors; (iv) a statement of changes in ownership equity; (v) a statement demonstrating compliance with and calculation of the applicable regulatory requirement; and (vi) such further material information necessary to make the required statements not misleading.[278] The annual audited financial statements must include: (i) a statement of financial condition; (ii) a statement of income/loss; (iii) a statement of cash flows; (iv) a statement of changes in liabilities subordinated to claims of general creditors; (v) a statement of changes in ownership equity; (vi) a statement demonstrating compliance with and calculation of the applicable regulatory capital requirement; (vii) appropriate footnote disclosures; and (viii) a reconciliation of any material differences from the unaudited financial report prepared as of the nonbank SD's year-end date.[279]

A nonbank SD that has obtained approval from the Commission or NFA to use internal capital models also must submit certain model metrics, such as aggregate VaR and counterparty credit risk information, each month to the Commission and NFA.[280] A nonbank SD also is required to provide the Commission and NFA with a detailed list of financial positions reported at fair market value as part of its monthly unaudited financial statements.[281] Each nonbank SD is also required to provide information to the Commission and NFA regarding its counterparty credit concentration for the 15 largest exposures in derivatives, a summary of its derivatives exposures by internal credit ratings, and the geographical distribution of derivatives exposures for the 10 largest countries.[282]

CFTC Financial Reporting Rules also require a nonbank SD to attach to each unaudited and audited financial report an oath or affirmation that to the best knowledge and belief of the individual making the affirmation the information contained in the financial report is true and correct.[283] The individual making the oath or affirmation must be a duly authorized officer if the nonbank SD is a corporation, or one of the persons specified in the regulation for business organizations that are not corporations.[284]

The CFTC Financial Reporting Rules further require a nonbank SD to make certain financial information publicly available by posting the information on its public website.[285] Specifically, a nonbank SD must post on its website a statement of financial condition and a statement detailing the amount of the nonbank SD's regulatory capital and the minimum regulatory capital requirement based on its audited financial statements and based on its unaudited financial statements that are as of a date that is six months after the nonbank SD's audited financial statements.[286] Such public disclosure is required to be made within 10 business days of the filing of the audited financial statements with the Commission, and within 30 calendar days of the filing of the unaudited financial statements required with the Commission.[287] A nonbank SD also must obtain written approval from NFA to change the date of its fiscal year-end for financial reporting.[288]

The CFTC Financial Reporting Rules also require a nonbank SD to provide the Commission and NFA with information regarding the custodianship of margin for uncleared swap transactions (''Margin Report'').[289] The Margin Report must contain: (i) the name and address of each custodian holding initial margin or variation margin that is required for uncleared swaps subject to the CFTC margin rules (''uncleared margin rules''), on behalf of the nonbank SD or its swap counterparties; (ii) the amount of initial and variation margin required by the uncleared margin rules held by each custodian on behalf of the nonbank SD and on behalf its swap counterparties; and (iii) the aggregate amount of initial margin that the nonbank SD is required to collect from, or post with, swap counterparties for uncleared swap transactions subject to the uncleared margin rules.[290] The Commission requires this information in order to monitor the use of custodians by nonbank SDs and their swap counterparties. Such information assists the Commission in monitoring the safety and soundness of a nonbank SD by verifying whether the firm is current with its swap counterparties with respect to the posting and collecting of margin required by the uncleared margin rules. By requiring the nonbank SD to report the required amount of margin to be posted and collected, and the amount of margin that is actually posted and collected, the Commission could identify potential issues with the margin practices and compliance by nonbank SDs that may hinder the ability of the firm to meet its obligations to market participants. The Margin Report also allows the Commission to identify custodians used by nonbank SDs and

[273] 17 CFR 23.105(b).

[274] *Id.*

[275] 17 CFR 23.105(d) and (e).

[276] 17 CFR 23.105(d)(1) and (e)(1).

[277] *Id.*

[278] 17 CFR 23.105(d)(2).

[279] 17 CFR 23.105(e)(4).

[280] 17 CFR 23.105(k) and (l) and Appendix B to Subpart E of Part 23.

[281] 17 CFR 23.105(l) and Appendix B to Subpart E of Part 23.

[282] 17 CFR 23.105(l) and Appendix B to Subpart E of Part 23, Schedules 2, 3, and 4.

[283] 17 CFR 23.105(f).

[284] *Id.*

[285] 17 CFR 23.105(i).

[286] *Id.*

[287] *Id.*

[288] 17 CFR 23.105(g).

[289] 17 CFR 23.105(m).

[290] *Id.*

their counterparties, which may permit the Commission to assess potential market issues, including a concentration of custodial services by a limited number of banks.

2. EU Nonbank Swap Dealer Financial Reporting Requirements

The EU Financial Reporting Rules impose financial reporting requirements on an EU nonbank SD that are designed to provide relevant EU competent authorities with a comprehensive view of the financial information and capital position of the firm. Specifically, Article 430 of CRR requires an EU nonbank SD to report information to the relevant competent authorities concerning its capital and financial condition sufficient to provide a comprehensive view of the firm's risk profile, including information on the firm's capital requirements, leverage ratio, large exposures, and liquidity requirements.[291]

Article 430 of CRR does not mandate the specific individual financial statements that an EU nonbank SD is required to provide to its applicable competent authorities in view of differing local conventions in EU Member States. Instead, the relevant competent authorities specify the financial statements to be submitted. To ensure a level of consistency, the European Banking Authority (''EBA'') developed implementing technical standards to specify uniform reporting templates and to determine the frequency of reporting by EU nonbank SDs.[292]

The implementing technical standards under Article 430 of CRR (''CRR Reporting ITS'') [293] require an EU nonbank SD subject to the standards, including the EU nonbank SDs currently registered with the Commission, to prepare and deliver to its competent authorities common reporting (''COREP'') on a quarterly basis. COREP requires, among other things, calculations in relation to the EU nonbank SD's capital and capital requirements,[294] capital ratios and capital levels,[295] and market risk (the listed items are collectively referred to hereinafter as ''COREP Reports'').[296]

The CRR Reporting ITS also specify the contents of the required financial reports (''FINREP'') for certain EU nonbank SDs that report financial information on a consolidated basis.[297] To further ensure comparability of the financial information reported by EU nonbank SDs, the ECB has adopted a regulation setting forth a common minimum set of financial information that must be reported by credit institutions subject to CRR to their relevant competent authorities on the basis of the CRR Reporting ITS (''ECB FINREP Regulation'').[298] More specifically, the ECB FINREP Regulation complements the CRR Reporting ITS by imposing financial reporting requirements applying on an individual basis to entities subject to CRR, including EU nonbank SDs, whereas CRR, Article 430 and the CRR Reporting ITS impose financial reporting requirements on a consolidated basis.[299] In addition to those requirements, each national competent authority has discretion to require institutions subject to CRR to report additional supervisory information on the basis of CRR and the CRR Reporting ITS or of national law.[300]

Pursuant to the CRR Reporting ITS, as complemented by the ECB FINREP Regulation, an EU nonbank SD is required to provide, among other items, the following statements or reports to its relevant competent authorities: (i) on a quarterly basis, a balance sheet statement (or statement of financial position) that reflects the EU nonbank SD's financial condition; [301] (ii) on a quarterly basis, a statement of profit or loss; [302] (iii) on a quarterly basis, a breakdown of financial liabilities by product and by counterparty sector; [303] (iv) on a quarterly basis, a listing of subordinated financial liabilities; [304] and (v) on an annual basis, a statement of changes in equity.[305] Under the FINREP requirements, an EU nonbank SD subject to the CRR Reporting ITS is also required to provide its competent authorities with additional financial information, including a breakdown of its loans and advances by product and type of counterparty,[306] as well as detailed information regarding its

[291] CRR, Article 430(1). CRR also establishes reporting requirements for reporting on stable funding (Articles 427–428) and TLAC (Articles 92a and 430).

[292] The EBA is a regulatory agency of the EU that is tasked with establishing a single regulatory and supervisory framework for the banking sector in EU Member States. CRR, Article 430(7) provides that the EBA shall develop draft implementing technical standards to specify the uniform reporting formats and templates, the instructions and methodology on how to use the templates, the frequency and dates of reporting, and the definitions.

[293] *See Commission Implementing Regulation (EU) 2021/451 of 17 December 2020 laying down implementing technical standards for the application of Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to supervisory reporting of institutions and repealing Implementing Regulation (EU) No 680/2014.*

[294] CRR, Article 430; Annex I, Template Numbers 1 and 2 CRR Reporting ITS.

[295] CRR, Article 430; Annex I, Template Number 3 CRR Reporting ITS.

[296] CRR, Article 430; Annex I, Template Numbers 18–25 (as applicable) CRR Reporting ITS.

[297] *See* CRR, Article 430(3), (4), and (9); CRR Reporting ITS, Articles 11 and 12 (requiring EU nonbank SDs subject to CRR to submit FINREP reports on a consolidated basis if they are any of the following: (i) an entity that prepares its consolidated accounts in accordance with IFRS; (ii) an entity that determines its capital requirements on a consolidated basis in accordance with IFRS and has been required by the competent authority to submit FINREP reports on a consolidated basis; and (iii) an entity subject to a national accounting framework that is not already reporting on a consolidated basis, to which the competent authority has decided to extend the requirement to submit FINREP reports on a consolidated basis).

[298] *See Regulation (EU) 2015/534 of the European Central Bank of March 17, 2015 on reporting of supervisory financial information.*

[299] ECB FINREP Regulation, Articles 6, 7, 13, and 14.

[300] In France, the Autorité de Contrôle Prudentiel et de Résolution (''ACPR''), the French regulatory authority with prudential supervision authority over French financial firms, including EU nonbank SDs domiciled in France, requires the submission of several statistical financial reports and may request additional information during examinations pursuant to French MFC, Articles L.612–1 and L.612–24. In Germany, BaFin, the German financial sector regulatory authority, may request information on all business matters pursuant to German KWG, Section 44. *See* Responses to Staff Questions of May 15, 2023.

[301] CRR, Article 430; Annex III, Template Numbers 1.1, 1.2, and 1.3 (for reporting according to IFRS) and Annex IV, Template Numbers 1.1., 1.2, and 1.3 (for reporting according to national accounting frameworks), CRR Reporting ITS; and ECB FINREP Regulation, Articles 6, 7 and 13 (referring to Annex III and Annex IV of the CRR Reporting ITS, as applicable).

[302] CRR, Article 430; Annex III, Template Number 2 (for reporting according to IFRS) and Annex IV, Template Number 2 (for reporting according to national accounting frameworks), CRR Reporting ITS; and ECB FINREP Regulation, Articles 6, 7 and 13 (referring to Annex III and Annex IV of the CRR Reporting ITS, as applicable).

[303] CRR, Article 430; Annex III, Template Number 8.1 (for reporting according to IFRS) and Annex IV, Template Number 8.1(for reporting according to national accounting frameworks), CRR Reporting ITS; and ECB FINREP Regulation, Articles 6, 7 and 13 (referring to Annex III and Annex IV of the CRR Reporting ITS, as applicable).

[304] CRR, Article 430, Annex III, Template Number 8.2 (for reporting according to IFRS) and Annex IV, Template Number 8.3 (for reporting according to national accounting frameworks), CRR Reporting ITS; and ECB FINREP Regulation, Articles 6, 7 and 13 (referring to Annex III and Annex IV of the CRR Reporting ITS, as applicable).

[305] CRR, Article 430; Annex III, Template Number 46 (for reporting according to IFRS) and Annex IV, Template Number 46 (for reporting according to national accounting frameworks), CRR Reporting ITS; and ECB FINREP Regulation, Articles 6, 7 and 13 (referring to Annex III and Annex IV of the CRR Reporting ITS, as applicable).

[306] CRR, Article 430; Annex III, Template Numbers 5.1 and 6.1 (for reporting according to IFRS) and Annex IV, Template Numbers 5.1 and 6.1, CRR Reporting ITS; and ECB FINREP Regulation, Articles 6, 7 and 13 (referring to Annex III and Annex IV of the CRR Reporting ITS, as applicable).

derivatives trading activities,[307] collateral and guarantees.[308]

Furthermore, with the exception of certain ''small'' entities, EU nonbank SDs are required to prepare annual audited financial statements and a management report (together, ''annual audited financial report'') pursuant to Article 430 of CRR and the Accounting Directive.[309] The audit of the financial statements and management report is required to be performed by one or more statutory auditors or auditors approved by EU Member States to conduct audits of EU nonbank SDs.[310] The annual audited financial report, together with the opinion and statements of the auditor, must be published.[311]

The annual audited financial statements must comprise, at a minimum, a balance sheet, a profit and loss statement, and notes to the financial statements.[312] The auditor's audit report must include: (i) a specification of the financial statements subject to the audit and the financial reporting framework that was applied in their preparation; (ii) a description of the scope of the audit, which must specify the auditing standards used to conduct the audit; (iii) an audit opinion stating whether the financial statements give a true and fair view in accordance with the relevant financial reporting framework; and (iv) a reference to any matters emphasized by the auditor that did not qualify the audit opinion.[313]

The management report is required to include a review of the development and performance of the EU nonbank SD's business and of its position, with a description of the principal risks and uncertainties that the firm faces.[314] The auditors are required to express an opinion on whether the management report is consistent with the financial statements for the same financial year, and whether the management report has been prepared in accordance with applicable legal requirements.[315] The opinion also must state whether the auditor has identified material misstatements in the management report and, if so, describe the misstatement.[316]

In addition, the SEC's French and German Orders granting substituted compliance for financial reporting to EU nonbank SBSDs, as supplemented by the SEC Order on Manner and Format of Filing Unaudited Financial and Operational Information, require an EU nonbank SBSD to file an unaudited SEC Form X–17A–5 Part II (''FOCUS Report'') with the SEC on a monthly basis.[317] The FOCUS Report is required to include, among other statements and schedules: (i) a statement of financial condition; (ii) a statement of the EU nonbank SBSD's capital computation in accordance with home country Basel-Based requirements; (iii) a statement of income/loss; and (iv) a statement of capital withdrawals.[318] An EU nonbank SBDS is required to file its FOCUS Report with the SEC within 35 calendar days of the month end.[319]

3. Commission Analysis

The Commission has reviewed the EU Application and the relevant EU laws and regulations, and has preliminarily determined that, subject to the proposed conditions described below, the financial reporting requirements of the EU Financial Reporting Rules are comparable to CFTC Financial Reporting Rules in purpose and effect as they are intended to provide the relevant EU competent authorities and the Commission, respectively, with financial information to monitor and assess the financial condition of nonbank SDs and their ability to absorb decreases in firm assets and increases in firm liabilities, and to cover losses from business activities, including swap dealing activities, without the firm becoming insolvent.

The EU Financial Reporting Rules require EU nonbank SDs to prepare and submit to the competent authorities on a quarterly basis unaudited financial information that includes: (i) a statement of financial condition; (ii) a statement of profit or loss; and (iii) a schedule of the breakdown of financial liabilities by product and by counterparty sector. The EU Financial Reporting Rules also require EU nonbank SDs to prepare and submit to the competent authorities on an annual basis an unaudited statement of changes in equity. Under the FINREP reporting requirements, an EU nonbank SD is also required to provide its competent authorities with additional financial information, including a breakdown of its loans and advances by product and type of counterparty, as well as detailed information regarding its derivatives trading activities, collateral, and guarantees. In addition, under the COREP reporting requirement, an EU nonbank SD is required to provide its competent authorities on a quarterly basis with calculations in relation to the EU nonbank SD's capital requirements and capital ratios, among other items.

The EU Financial Reporting Rules further require an EU nonbank SD to prepare and publish an annual audited financial report. The annual audited financial report is required to include a statement of financial condition and a statement of profit or loss, and must also include relevant notes to the financial statements.[320]

The Commission preliminarily finds that the EU Financial Reporting Rules impose reporting requirements that are comparable with respect to overall form and content to the CFTC Financial Reporting Rules, which require each nonbank SD to file, among other items, periodic unaudited financial reports with the Commission and NFA that contain: (i) a statement of financial condition; (ii) a statement of profit or loss; (iii) a statement of changes in liabilities subordinated to the claims of general creditors; (iv) a statement of changes in ownership equity; and (v) a statement demonstrating compliance with the capital requirements. Accordingly, the Commission has preliminarily determined that an EU nonbank SD may comply with the financial reporting requirements contained in Commission Regulation 23.105 by complying with the corresponding EU Financial Reporting

[307] CRR, Article 430; Annex III, Template Number 10 (for reporting according to IFRS) and Annex IV, Template Number 10 (for reporting according to national accounting frameworks), CRR Reporting ITS; and ECB FINREP Regulation, Articles 6, 7 and 13 (referring to Annex III and Annex IV of the CRR Reporting ITS, as applicable).

[308] CRR, Article 430; Annex III, Template Number 13 (for reporting according to IFRS) and Annex IV, Template Number 13 (for reporting according to national accounting frameworks), CRR Reporting ITS; and ECB FINREP Regulation, Articles 6, 7 and 13 (referring to Annex III and Annex IV of the CRR Reporting ITS, as applicable).

[309] Accounting Directive, Articles 4, 19 and 34; French MFC, Articles L.511–35 to L.511–38; German Commercial Code (*Handelsgesetzbuch,* ''HGB''), Section 316 *et seq.* The Accounting Directive provides that the audit requirement is not applicable to ''small'' entities defined as firms meeting the following requirements: (1) the firm's balance sheet is not more than EUR 4 million; (2) the firm's net turnover does not exceed more than EUR 8 million; or (3) the firm did not employ more than 50 employees during the financial year. *See* Article 3(2) and Article 34 of the Accounting Directive. The Applicants represent that the four EU nonbank SDs currently registered with the Commission do not meet the criteria to be classified as ''small'' entities and, therefore, are required to prepare audited annual financial reports. *See* EU Application, p. 5.

[310] Accounting Directive, Article 34(1).

[311] *Id.,* Article 30.

[312] *Id.,* Article 4(1).

[313] *Id.,* Article 35.

[314] *Id.,* Article 19.

[315] *Id.*

[316] *Id.*

[317] *See,* French Order and German Order. *See also,* SEC Order on Manner and Format of Filing Unaudited Financial and Operational Information.

[318] *See,* SEC Order on Manner and Format of Filing Unaudited Financial and Operational Information.

[319] *Id.*

[320] Accounting Directive, Articles 4(1), 30, and 34.

Rules, subject to the conditions set forth below.[321]

The Commission is proposing to condition the Capital Comparability Determination Order on an EU nonbank SD providing the Commission and NFA with copies of the relevant templates of the FINREP reports and COREP reports that correspond to the EU nonbank SD's statement of financial condition, statement of income/loss, and statement of regulatory capital, total risk exposure, and capital ratios. These templates consist of FINREP templates 1.1 (Balance Sheet Statement: assets), 1.2 (Balance Sheet Statement: liabilities), 1.3 (Balance Sheet Statement: equity), 2 (Statement of profit or loss), and 10 (Derivatives—Trading and economic hedges), and COREP templates 1 (Own Funds), 2 (Own Funds Requirements) and 3 (Capital Ratios). The Commission also notes that EU nonbank SDs submit FINREP and COREP templates in addition to the ones listed above to their competent authorities. These templates generally provide supporting detail to the core financial templates that the Commission is proposing to require from each EU nonbank SD. The Commission is not proposing to require an EU nonbank SD to file these additional FINREP and COREP templates as a condition to the Capital Comparability Order, and alternatively would exercise its authority under Commission Regulation 23.105(h) to direct EU nonbank SDs to provide such additional information to the Commission and NFA on an ad hoc basis as necessary to oversee the financial condition of the firms.[322]

As noted in Section D.2. of this Determination, EU Financial Reporting Rules require EU nonbank SDs to submit the unaudited FINREP and COREP templates to their competent authorities on a quarterly basis. The CFTC Financial Reporting Rules contain a more frequent reporting requirement by requiring nonbank SDs that elect the Bank-Based Approach to file unaudited financial information with the Commission and NFA, on a monthly basis.[323] The financial statement reporting requirements are an integral part of the Commission's and NFA's oversight programs to effectively and timely monitor nonbank SDs' compliance with capital and other financial requirements, and for Commission and NFA staff to assess the overall financial condition and business operations of nonbank SDs. The Commission has extensive experience with monitoring the financial condition of registrants through the receipt of financial statements, including FCMs and, more recently, nonbank SDs. Both FCMs and nonbank SDs that elect the Bank-Based Approach or NLA Approach file financial statements with the Commission and NFA on a monthly basis. The Commission preliminarily believes that receiving financial information from EU nonbank SDs on a quarterly basis is not comparable with the CFTC Financial Reporting Rules and would impede the Commission's and NFA's ability to effectively and timely monitor the financial condition of EU nonbank SDs for the purposes of assessing their safety and soundness, as well as their ability to meet obligations to creditors and counterparties without becoming insolvent. Therefore, the Commission is preliminarily proposing to include a condition in the Capital Comparability Determination Order to require EU nonbank SDs to file the applicable templates of the FINREP reports and COREP reports with the Commission and NFA on a monthly basis. The Commission also is proposing to condition the Capital Comparability Determination Order on the EU nonbank SD filing the above-listed templates of the FINREP reports and COREP reports with the Commission and NFA within 35 calendar days of the end of each month.[324]

The Commission is further proposing that in lieu of filing such FINREP and COREP reports, EU nonbank SDs that are registered with the SEC as EU nonbank SBSDs could satisfy this condition by filing with the CFTC and NFA, on a monthly basis, copies of the unaudited FOCUS Reports that the EU nonbank SDs are required to file with the SEC pursuant to the SEC French Order or SEC German Order, as supplemented by the SEC Order on Manner and Format of Filing Unaudited Financial and Operational Information. The FOCUS Report is required to include, among other statements and schedules: (i) a statement of financial condition; (ii) a statement of the EU nonbank SBSD's capital computation in accordance with home country Basel-Based requirements; (iii) a statement of income/loss; and (iv) a statement of capital withdrawals.[325]

The filing of a FOCUS Report would be at the election of the EU nonbank SD as an alternative to the filing of unaudited FINREP and COREP templates that such firms would otherwise be required to file with the Commission and NFA pursuant to the proposed Order. Three of the EU nonbank SDs currently registered with the SEC as EU nonbank SBSDs would be eligible to file copies of their monthly FOCUS Report with the Commission and NFA in lieu of the FINREP and COREP templates and Schedule 1. An EU nonbank SD electing to file copies of its monthly FOCUS Reports would be required to submit the reports to the Commission and NFA within 35 calendar days of the end of each month.

In addition, the Commission is proposing to condition the Capital Comparability Determination Order on an EU nonbank SD submitting to the Commission and NFA copies of the EU nonbank SD's annual audited financial report that is required to be prepared pursuant to provisions implementing the Accounting Directive.[326] EU nonbank SDs would be required to file the annual audited financial report with the Commission and NFA on the earliest of the date the report is filed with the competent authority, the date the report is published, or the date the report is required to be filed with the competent authority or the date the report is required to be published pursuant to the EU Financial Reporting Rules.

The Commission is also proposing to condition the Capital Comparability Determination Order on the EU nonbank SD translating the reports and statements into the English language with balances converted to U.S. dollars.[327] The Commission, however, recognizes that the requirement to translate accounts denominated in euro to U.S. dollars on the annual audited financial report may impact the opinion provided by the independent auditor. The Commission is therefore proposing

[321] An EU nonbank SD that qualifies and elects to seek substituted compliance with the EU Capital Rules must also seek substituted compliance with the EU Financial Reporting Rules.

[322] Commission Regulation 23.105(h) provides that the Commission or NFA may, by written notice, require any nonbank SD to file financial or operational information as may be specified by the Commission or NFA. 17 CFR 23.105(h).

[323] Commission Regulation 23.105(d) (17 CFR 23.105(d)).

[324] The proposed condition for EU nonbank SDs to file monthly unaudited financial information with the Commission and NFA is consistent with proposed conditions contained in the Commission's proposed Capital Comparability Determinations for Japanese nonbank SDs and Mexican nonbank SDs. *See* Proposed Japan Order and Proposed Mexico Order.

[325] *See,* SEC Order on Manner and Format of Filing Unaudited Financial and Operational Information.

[326] Accounting Directive, Articles 4, 19, and 34; French MFC, Articles L.511–35 to L.511–38; German HGB, Section 316 *et seq.*

[327] The translation of audited financial statements into the English language and the conversion of account balances from euro to U.S. dollars is not required to be subject to the audit of the independent auditor. An EU nonbank SD must report the exchange rate that it used to convert balances from euro to U.S. dollars to the Commission and NFA as part of the financial reporting.

to accept the annual audited financial report denominated in euro, provided that the report is translated into the English language.

The Commission is proposing to impose these conditions as they are necessary to ensuring that the CFTC Financial Reporting Rules and EU Financial Reporting Rules, supplemented by the proposed conditions, are comparable and provide the Commission and NFA with appropriate financial information to effectively monitor the financial condition of EU nonbank SDs. Frequent financial reporting is a central component of the Commission's and NFA's programs for monitoring and assessing the safety and soundness of nonbank SDs as required under Section 4s(e) of the CEA. Although, as further discussed in Section D.2. below, the Commission preliminarily believes that the competent authorities have the necessary powers to supervise and enforce compliance by EU nonbank SDs with applicable capital and financial reporting requirements, the Commission is proposing the conditions to facilitate the timely access to information allowing the Commission and NFA to effectively monitor and assess the ongoing financial condition of all nonbank SDs, including EU nonbank SDs, to help ensure their safety and soundness and their ability to meet their financial obligations to customers, counterparties, and creditors.

The Commission preliminarily considers that its approach of requiring EU nonbank SDs to provide the Commission and NFA with the selected FINREP and COREP templates and the annual audited financial report that the firms currently file with the relevant competent authorities strikes an appropriate balance of ensuring that the Commission receives the financial reporting necessary for the effective monitoring of the financial condition of the nonbank SDs, while also recognizing the existing regulatory structure of the EU Financial Reporting Rules. Under the proposed conditions, the EU nonbank SD would not be required to prepare different financial reports and statements for filing with the Commission, but would be required to prepare selected reports and statements in the content and format used for submissions to the relevant competent authority and translate the reports and financial statements into the English language with balances converted to U.S. dollars so that Commission staff may properly understand and efficiently analyze the financial information. Although the Commission is proposing to require submission of certain reports (*i.e.,* selected FINREP and COREP templates) on a more frequent basis (monthly instead of quarterly as required by the EU Financial Reporting Rules), the proposed conditions provide the EU nonbank SDs with 35 calendar days from the end of each month to translate the documents into English and to convert balances to U.S. dollars. In addition, EU nonbank SDs that are registered as SBSDs with the SEC would have the option of filing a copy of the FOCUS Report they submit to the SEC in lieu of the FINREP and COREP templates. The Commission preliminarily believes that by requiring that EU nonbank SDs file unaudited financial reports on a monthly basis instead of quarterly, the Commission would help ensure that the CFTC Financial Reporting Rules and the EU Financial Reporting Rules achieve a comparable outcome.

The Commission is also proposing to condition the Capital Comparability Determination Order on EU nonbank SDs filing with the Commission and NFA, on a monthly basis, the aggregate securities, commodities, and swap positions information set forth in Schedule 1 of Appendix B to Subpart E of Part 23.[328] The Commission is proposing to require that Schedule 1 be filed with the Commission and NFA as part of the EU nonbank SD's monthly submission of selected FINREP and COREP templates or FOCUS Report, as applicable. Schedule 1 provides the Commission and NFA with detailed information regarding the financial positions that a nonbank SD holds as of the end of each month, including the firm's swap positions, which will allow the Commission and NFA to monitor the types of investments and other activities that the firm engages in and will enhance the Commission's and NFA's ability to monitor the safety and soundness of the firm.

The Commission is also proposing to condition the Capital Comparability Determination Order on an EU nonbank SD submitting with each set of selected FINREP and COREP templates, annual audited financial report, and the applicable Schedule 1 a statement by an authorized representative or representatives of the EU nonbank SD that to the best knowledge and belief of the person(s) the information contained in the respective reports and statements is true and correct, including the translation of the reports and statements into the English language and conversion of balances in the statements to U.S. dollars, as applicable. The statement by the authorized representative or representatives of the EU nonbank SD is in lieu of the oath or affirmation required of nonbank SDs under Commission Regulation 23.105(f), and is intended to ensure that reports and statements filed with the Commission and NFA are prepared and submitted by firm personnel with knowledge of the financial reporting of the firm who can attest to the accuracy of the reporting and translation.

The Commission is further proposing to condition the Capital Comparability Determination Order on an EU nonbank SD filing the Margin Report specified in Commission Regulation 23.105(m) with the Commission and NFA. The Margin Report contains: (i) the name and address of each custodian holding initial margin or variation margin on behalf of the nonbank SD or its swap counterparties; (ii) the amount of initial and variation margin held by each custodian on behalf of the nonbank SD and on behalf its swap counterparties; and (iii) the aggregate amount of initial margin that the nonbank SD is required to collect from, or post with, swap counterparties for uncleared swap transactions.[329]

The Commission preliminarily believes that receiving this margin information from EU nonbank SDs will assist in the Commission's assessment of the safety and soundness of the EU nonbank SDs. Specifically, the Margin Report would provide the Commission with information regarding an EU nonbank SD's swap book, the extent to which it has uncollateralized exposures to counterparties or has not met its financial obligations to counterparties. This information, along with the list of custodians holding both the firms' and counterparties' collateral for swap transactions, is expected to assist the Commission in assessing and monitoring potential financial impacts to the nonbank SD resulting from defaults on its swap transactions. The Commission is further proposing to require an EU nonbank SD to file the Margin Report with the Commission and NFA within 35 calendar days of the end of each month, which corresponds with the proposed timeframe for the EU nonbank SD to file the selected FINREP and COREP templates or FOCUS Report, as applicable, and proposing to require the Margin Report to be prepared in the

[328] Schedule 1 of Appendix B to Subpart E of Part 23 includes a nonbank SD's holding of U.S Treasury securities, U.S. government agency debt securities, foreign debt and equity securities, money market instruments, corporate obligations, spot commodities, cleared and uncleared swaps, cleared and non-cleared security-based swaps, and cleared and uncleared mixed swaps in addition to other position information.

[329] 17 CFR 23.105(m).

English language with balances reported in U.S. dollars.

The Commission notes that the proposed conditions in the EU Capital Comparability Determination Order are consistent with the proposed conditions set forth in the proposed Capital Comparability Determination Orders for Japan and Mexico,[330] and reflects the Commission's approach of preliminarily determining that non-U.S. nonbank SDs could meet their financial statement reporting obligations to the Commission by filing financial reports currently prepared for home country regulators, albeit in the case of certain financial reports under a more frequent submission schedule, provided such reports are translated into English language and, in certain circumstances, balances expressed in U.S. dollars. The Commission's proposed conditions also include certain financial information and notices that the Commission believes are necessary for effective monitoring of EU nonbank SDs that are not currently part of the relevant EU authorities' supervision regimes.

The Commission is not proposing to require that an EU nonbank SD that has been approved by the relevant competent authority to use capital models files with the Commission or NFA the monthly model metric information contained in Commission Regulation 23.105(k) [331] or that an EU nonbank SD files with the Commission or NFA the monthly counterparty credit exposure information specified in Commission Regulation 23.105(l) and Schedules 2, 3, and 4 of Appendix B to Subpart E of Part 23.[332]

The Commission, in making the preliminary determination to not require an EU nonbank SD to file the model metrics and counterparty exposures required by Commission Regulations 23.105(k) and (l), respectively, recognizes that NFA's current risk monitoring program requires each bank SD and each nonbank SD, including each EU nonbank SD, to file risk metrics addressing market risk and credit risk with NFA on a monthly basis. NFA's monthly risk metric information includes: (i) VaR for interest rates, credit, foreign exchange, equities, commodities, and total VaR; (ii) total stressed VaR; (iii) interest rate, credit spread, foreign exchange market, and commodity sensitivities; (iv) total swaps current exposure both before and after offsetting against collateral held by the firm; and (v) a list of the 15 largest swaps counterparty current exposures before collateral and net of collateral.[333]

Although there are differences in the information required under Commission Regulations 23.105(k) and (l), the NFA risk metrics provide a level of information that allows NFA to identify SDs that may pose heightened risk and to allocate appropriate NFA regulatory oversight resources. The Commission preliminarily believes that the proposed financial statement reporting set forth in the proposed Capital Comparability Determination Order, and the risk metric and counterparty exposure information currently reported by nonbank SDs (including EU nonbank SDs) under NFA rules, provide the appropriate balance of recognizing the comparability of the EU Financial Reporting Rules to the CFTC Financial Reporting Rules while also ensuring that the Commission and NFA receive sufficient data to monitor and assess the overall financial condition of EU nonbank SDs. The Commission has access to the monthly risk metric filings collected by NFA. In addition, the Commission retains authority to request EU nonbank SDs to provide information regarding their model metrics and counterparty exposures on an ad hoc basis.

Furthermore, the Commission notes that although the EU Financial Reporting Rules do not contain an analogue to the CFTC's requirements for nonbank SDs to file monthly model metric information and counterparty exposures information, the competent authorities have access to comparable information. More specifically, under the EU Financial Reporting Rules, the competent authorities have broad powers to request any information necessary for the exercise of their functions.[334] As such, the competent authorities have access to information allowing them to assess the ongoing performance of risk models and to monitor the EU nonbank SD's credit exposures, which may be comprised of credit exposures to primarily other EU counterparties. In addition, the COREP reports, which EU nonbank SDs are required to file with the competent authority on a quarterly basis, include information regarding the EU nonbank SD's risk exposure amounts, including risk-weighted exposure amounts for credit risk.[335]

The Commission invites public comment on its analysis above, including comment on the EU Application and relevant EU Financial Reporting Rules. The Commission also invites comment on the proposed conditions listed above and on the Commission's proposal to exclude EU nonbank SDs from certain reporting requirements outlined above. Specifically, the Commission requests comment on its preliminary determination to not require EU nonbank SDs to submit the information set forth in Commission Regulations 23.105(k) and (l). Are there specific elements of the data required under Commission Regulations 23.105(k) and (l) that the Commission should require of EU nonbank SDs for purposes of monitoring model performance?

The Commission requests comment on the proposed filing dates for the reports and information specified above. Specifically, do the proposed filing dates provide sufficient time for EU nonbank SDs to prepare the reports, translate the reports into English, and, where required, convert balances into U.S. dollars? If not, what period of time should the Commission consider imposing on one or more of the reports?

The Commission also requests specific comment regarding the setting of compliance dates for any new reporting obligations that the proposed Capital Comparability Determination Order would impose on EU nonbank SDs. In this connection, if the Commission were to require EU nonbank SDs to file the Margin Report discussed above and included in the proposed Order below, how much time would EU nonbank SDs need to develop new systems or processes to capture information that is required? Would EU nonbank SDs need a period of time to develop any systems or processes to

[330] *See* Proposed Japan Order and Proposed Mexico Order.

[331] Commission Regulation 23.105(k) requires a nonbank SD that has obtained approval from the Commission or NFA to use internal capital models to submit to the Commission and NFA each month information regarding its risk exposures, including VaR and credit risk exposure information when applicable. The model metrics are intended to provide the Commission and NFA with information that would assist with the ongoing oversight and assessment of internal market risk and credit risk models that have been approved for use by a nonbank SD. 17 CFR 23.105(k).

[332] Commission Regulation 23.105(l) requires each nonbank SD to provide information to the Commission and NFA regarding its counterparty credit concentration for the 15 largest exposures in derivatives, a summary of its derivatives exposures by internal credit ratings, and the geographic distribution of derivatives exposures for the 10 largest countries in Schedules 2, 3, and 4, respectively. 17 CFR 23.105(l).

[333] *See* NFA Financial Requirements, Section 17—*Swap Dealer and Major Swap Participant Reporting Requirements,* and Notice to Members—*Monthly Risk Data Reporting for Swap Dealers* (May 30, 2017).

[334] *See* CRD, Article 65(3)(a), French MFC, Article L.612–24, and SSM Regulation, Article 10 (indicating that competent authorities have broad information gathering powers).

[335] *See* CRR Reporting ITS, Annex I.

meet any other reporting obligations in the proposed Capital Comparability Determination Order? If so, what would be an appropriate amount of time for an EU nonbank SD to develop and implement such systems or processes?

E. Notice Requirements

1. CFTC Nonbank SD Notice Reporting Requirements

The CFTC Financial Reporting Rules require nonbank SDs to provide the Commission and NFA with written notice of certain defined events.[336] The notice provisions are intended to provide the Commission and NFA with an opportunity to assess whether the information contained in the notices indicates the existence of actual or potential financial and/or operational issues at a nonbank SD, and, when necessary, allows the Commission and NFA to engage the nonbank SD in an effort to minimize potential adverse impacts on swap counterparties and the larger swaps market. The notice provisions are part of the Commission's overall program for helping to ensure the safety and soundness of nonbank SDs and the swaps markets in general.

The CFTC Financial Reporting Rules require a nonbank SD to provide written notice within specified timeframes if the firm is: (i) undercapitalized; (ii) fails to maintain capital at a level that is in excess of 120 percent of its minimum capital requirement; or (iii) fails to maintain current books and records.[337] A nonbank SD is also required to provide written notice if the firm experiences a 30 percent or more decrease in excess regulatory capital from its most recent financial report filed with the Commission.[338] A nonbank SD also is required to provide notice if the firm fails to post or collect initial margin for uncleared swap and non-cleared security-based swap transactions or exchange variation margin for uncleared swap and non-cleared security-based swap transactions as required by the Commission's uncleared swaps margin rules or the SEC's non-cleared security-based swaps margin rules, respectively, if the aggregate is equal to or greater than: (i) 25 percent of the nonbank SD's required capital under Commission Regulation 23.101 calculated for a single counterparty or group of counterparties that are under common ownership or control; or (ii) 50 percent of the nonbank SD's required capital under Commission Regulation 23.101 calculated for all of the firm's counterparties.[339]

The CFTC Financial Reporting Rules further require a nonbank SD to provide notice two business days prior to a withdrawal of capital by an equity holder that would exceed 30 percent of the firm's excess regulatory capital.[340] Finally, a nonbank SD that is dually-registered with the SEC as an SBSD or major security based swap participant (''MSBSP'') must file a copy of any notice with the Commission and NFA that the SBSD or MSBSP is required to file with the SEC under SEC Rule 18a–8 (17 CFR 240.18a–8).[341] SEC Rule 18a–8 requires SBSDs and MSBSPs to provide written notice to the SEC for comparable reporting events as in the CFTC Capital Rule in Commission Regulation 23.105(c), including if a SBSD or MSBSP is undercapitalized or fails to maintain current books and records.

2. EU Nonbank Swap Dealer Notice Requirements

The EU capital and resolution frameworks require EU nonbank SDs to provide certain notices to competent authorities concerning the firm's compliance with relevant laws and regulations. The EU Financial Reporting Rules require an EU nonbank SD to provide notice within five business days to the competent authority [342] if the firm fails to meet its combined buffer requirement, which at a minimum consists of a capital conservation buffer of 2.5 percent of the EU nonbank SD's total risk exposure amount.[343] As noted earlier, to meet its capital buffer requirements, an EU nonbank SDs must hold common equity tier 1 capital in addition to the minimum common equity tier 1 ratio requirement of 4.5 percent of the firm's core capital requirement of 8 percent of the firm's total risk exposure amount. The notice to the competent authority must be accompanied by a capital conservation plan that sets out how the EU nonbank SD will restore its capital levels.[344] The capital conservation plan is required to include: (i) estimates of income and expenditures and a forecast balance sheet; (ii) measures to increase the capital ratios of the EU nonbank SD; (iii) a plan and timeframe for the increase in the capital of the EU nonbank SD with the objective of meeting fully the combined buffer requirement; and (iv) any other information that the competent authority considers to be necessary to assess the capital conservation plan.[345]

The relevant competent authority is required to assess the capital conservation plan, and may approve the plan only if it considers that the plan would be reasonably likely to conserve or raise sufficient capital to enable the EU nonbank SD to meet its combined capital buffer requirement within a timeframe that the competent authority considers to be appropriate.[346] If the relevant competent authority does not approve the capital conservation plan, the competent authority may impose requirements for the EU nonbank SD to increase its capital to specified levels within a specified time or the competent authority may impose more restrictions on distributions.[347]

In addition, an EU nonbank SD must immediately notify its relevant resolution authority in situations where the firm meets the combined buffer requirement, but fails to meet the combined buffer requirement when considered in addition to the applicable MREL requirements.[348] The EU nonbank SD must also notify the relevant resolution authority if it

[336] 17 CFR 23.105(c).

[337] 17 CFR 23.105(c)(1), (2), and (3).

[338] 17 CFR 23.105(c)(4).

[339] 17 CFR 23.105(c)(7).

[340] 17 CFR 23.105(c)(5).

[341] 17 CFR 23.105(c)(6).

[342] As further discussed in Section F.2. below, the relevant prudential competent authority may either be the national competent authority with jurisdiction to oversee compliance with the EU Capital Rules and the EU Financial Reporting Rules or, for EU nonbank SDs that are authorized as credit institutions and qualify as ''significant supervised entities,'' the ECB. *See generally* SSM Regulation and SSM Framework Regulation.

[343] CRD, Article 142; French MFC, Article L.511–41–1–A; French Ministerial Order on Capital Buffers, Articles 61 to 64; German KWG, Sections 10i(2) to (9). The combined capital buffer requirement is the total common equity tier 1 capital required to meet the requirement for the capital conservation buffer required by Article 129 of CRD, extended to include, as applicable, an institution-specific countercyclical buffer required by Article 130 of CRD, a G–SII buffer required by Article 131(4) of CRD, an O–SII buffer required by Article 131(5) of CRD, and a systemic risk buffer required by Article 133 of CRD. CRD, Article 128.

[344] *Id.,* Article 142(1); French Ministerial Order on Capital Buffers, Article 61; German KWG, Section 10i(6). The competent authority may extend the filing deadline, and require the EU nonbank SD to file the capital conservation plan within 10 days of the firm identifying that it failed to meet the applicable buffer requirements.

[345] *Id.,* Article 142(2); French Ministerial Order on Capital Buffers, Article 62; German KWG, Section 10i(6).

[346] *Id.,* Article 142(3); French MFC, Article L.511–41–1–1; French Ministerial Order on Capital Buffers, Article 63; German KWG, Section 10i(7).

[347] *Id.,* Article 142(4); French MFC, Article L.511–41–1–A; French Ministerial Order on Capital Buffers, Article 64 and French Ministerial Order on Distribution Restrictions, Articles 2 to 9; German KWG, Section 10i(8).

[348] BRRD, Article 16a; French MFC, Article L.613–56 III and French Ministerial Order on Distribution Restrictions, Articles 7 and 8; German SAG, Article 58a.

considers the firm to be failing or likely to fail.[349]

Furthermore, if an EU nonbank SD breaches its liquidity or MREL requirements, the EU authorities possess wide-ranging tools to deal with the firm's financial deterioration. Specifically, the competent authority may impose administrative penalties or other administrative measures, including prudential capital charges, if an EU nonbank SD's liquidity position repeatedly or persistently falls below the liquidity and stable funding requirements established at the national or EU level.[350]

In addition, if MREL is breached, the EU nonbank SD's resolution authority may take early measures to intervene, such as requiring management to take certain actions, order members of management to be removed or replaced, or require changes to the firm's business strategy or legal or operational structure, among other measures.[351] If additional requirements are met, it is also possible that resolution authorities may assess the EU nonbank SD as ''failing or likely to fail,'' triggering a resolution action, which could occur even before the firm actually breached its minimum capital requirements.[352] A breach of the EU nonbank SD's MREL requirements may also trigger restrictions on the firm's ability to make certain distributions (*e.g.,* paying certain dividends or employee bonuses).[353]

3. Commission Analysis

The Commission has reviewed the EU Application and the relevant EU laws and regulations, and has preliminarily determined that the EU Financial Reporting Rules related to notice provisions, subject to the conditions specified below, are comparable to the notice provisions of the CFTC Financial Reporting Rules. The Commission is therefore proposing to issue a Capital Comparability Determination Order providing that an EU nonbank SD may comply with the notice provisions required under EU laws and regulations in lieu of certain notice provisions required of nonbank SDs under Commission Regulation 23.105(c),[354] subject to the conditions set forth below.

The notice provisions contained in Commission Regulation 23.105(c) are intended to provide the Commission and NFA with information in a prompt manner regarding actual or potential financial or operational issues that may adversely impact the safety and soundness of a nonbank SD by impairing the firm's ability to meet its obligations to counterparties, creditors, and the general swaps market. Upon the receipt of a notice from a nonbank SD under Commission Regulation 23.105(c), the Commission and NFA initiate reviews of the facts and circumstances that resulted in the notice being filed including, as appropriate, communicating with personnel of the nonbank SD. The review of the facts and the interaction with the personnel of the nonbank SD provide the Commission and NFA with information to develop an assessment of whether it is necessary for the nonbank SD to take remedial action to address potential financial or operational issues, and whether the remedial actions instituted by the nonbank SD properly address the issues that are the root cause of the operational or financial issues. Such actions may include the infusion of additional capital into the firm, or the development and implementation of additional internal controls to address operational issues. The notice filings further allow the Commission and NFA to monitor the firm's performance after the implementation of remedial actions to assess the effectiveness of such actions.

The EU Financial Reporting Rules require an EU nonbank SD to provide notice to competent authorities if the firm fails to maintain a minimum capital ratio of common equity tier 1 capital to risk-weighted assets equal or greater than 7 percent (4.5 percent of the core capital requirement plus the 2.5 percent capital conservation buffer requirement, assuming no other capital buffer requirements apply). The EU nonbank SD is also required to file a capital conservation plan with its notice to the competent authority. The capital conservation plan is required to contain information regarding actions that the EU nonbank SD will take to ensure proper capital adequacy.

The Commission has preliminarily determined that the requirement for an EU nonbank SD to provide notice of a breach of its capital buffer requirements to its competent authority is not sufficiently comparable in purpose and effect to the CFTC notice provisions contained in Commission Regulation 23.105(c)(1) and (2),[355] which require a nonbank SD to provide notice to the Commission and to NFA if the firm fails to meet its minimum capital requirement or if the firm's regulatory capital falls below 120 percent of its minimum capital requirement (''Early Warning Level''). The requirement for an EU nonbank SD to provide notice of a breach of its capital buffer requirements does not achieve a comparable outcome to the CFTC's Early Warning Level requirement due to the difference in the thresholds triggering a notice requirement in the respective rule sets.

The requirement for a nonbank SD to file notice with the Commission and NFA if the firm becomes undercapitalized or if the firm experiences a decrease of excess regulatory capital below defined levels is a central component of the Commission's and NFA's oversight program for nonbank SDs.[356] Therefore, the Commission preliminarily believes that it is necessary for the Commission and NFA to receive copies of notices filed under Article 142 of CRD by EU nonbank SDs alerting competent authorities of a breach of the EU nonbank SD's combined capital buffer. The notice must be filed by the EU nonbank SD within 24 hours of the filing of the notice with the relevant competent authority, and the Commission expects that, upon the receipt of a notice, Commission staff and NFA staff will engage with staff of the EU nonbank SD to obtain an understanding of the facts that led to the filing of the notice and will discuss with the EU nonbank SD the firm's capital conservation plan. The proposed condition would not require the EU nonbank SD to file copies of its capital conservation plan with the Commission or NFA. To the extent Commission staff needs further information from the EU nonbank SD, the Commission expects to request such information as part of its assessment of the notice and its communications with the EU nonbank SD.

In addition, due to the lack of a sufficiently comparable analogue to the CFTC Financial Reporting Rules' Early Warning Level requirement, the Commission is proposing to condition the Capital Comparability Determination Order to require an EU nonbank SD to file a notice with the

[349] BRRD, Article 81(1); French MFC, Article L.613–49; German SAG, Section 138(1).

[350] CRD, Articles 67(1)(j) and 105; French MFC, Articles L.511–41–3 and L.612–40; German KWG, Section 45(1), (2) and (3), 36(1) and (3).

[351] BRRD, Article 27(1); French MFC, Article L.511–41–5; German SAG, Section 36(1).

[352] BRRD, Article 32(1)(a); French MFC, Article L.613–49; German SAG, Section 62(2).

[353] BRRD, Article 16a; French MFC, Article L.613–56 III and French Ministerial Order on Distribution Restrictions, Articles 7 and 8; German SAG, Article 58a.

[354] 17 CFR 23.105(c).

[355] 17 CFR 23.105(c)(1) and (2).

[356] *See* Commission Regulation 23.105(c)(4), which requires a nonbank SD to file notice with the Commission and NFA if it experiences decrease in excess capital of 30 percent or more from the excess capital reported in its last financial filing with the Commission. 17 CFR 23.105(c)(4).

Commission and NFA if the firm's capital ratio does not equal or exceed 12.6 percent.[357] The proposed condition would further require the EU nonbank SD to file the notice with the Commission and NFA within 24 hours of when the firm knows or should have known that its regulatory capital was below 120 percent of its minimum capital requirement. The timing requirement for the filing of the proposed notice with the Commission and NFA is consistent with the Commission's requirements for an FCM or a nonbank SD, which are both required to file an Early Warning Level notice with the Commission and NFA when the firm knows or should have known that its regulatory capital is below specified reporting levels.[358] The requirement for a firm to file a notice with the Commission when it knows or should have known that its capital is below the reporting level is designed to prevent a situation where a firm's deficient recordkeeping leads to an inadequate monitoring of the Early Warning Level threshold. More generally, the ''should have known'' part of the timing standard for the filing of the proposed notice is intended to cover facts and circumstances that should reasonably lead the firm to believe that its regulatory capital is below 120 percent of the minimum requirement.[359] In practice, even if the EU nonbank SD's books and records do not reflect a decrease of regulatory capital below 120 percent of the minimum requirement or if the computations that may reveal a decrease of regulatory capital below 120 percent have not been made yet, the firm would be expected to provide notice if it became aware of deficiencies in its recordkeeping processes that could result in inaccurate recording of the firm's capital levels or if it had other reasons to believe its regulatory capital is below the Early Warning Level threshold.[360]

As noted above, a purpose of the proposed Early Warning Level notice provision is to allow the Commission and NFA to initiate conversations and fact finding with a registrant that may be experiencing operational or financial issues that may adversely impact the firm's ability to meet its obligations to market participants, including customers or swap counterparties. The notice filing is a central component of the Commission's and NFA's oversight program, and the Commission believes that a firm that is experiencing operational challenges that prevent the firm from definitively computing its capital level during a period when it recognizes from the facts and circumstances that the firm's capital level may be below the reporting threshold should file the notice with the Commission and NFA. Therefore, the Commission preliminarily deems it appropriate to include a similar early warning notice condition in the Capital Comparability Determination Order.

The EU Financial Reporting Rules also do not contain an explicit requirement for an EU nonbank SD to notify its competent authority if the firm fails to maintain current books and records, experiences a decrease in regulatory capital over levels previously reported, or fails to collect or post initial margin with uncleared swap counterparties that exceed certain threshold levels.[361] The EU Financial Reporting Rules also do not require an EU nonbank SD to provide the relevant competent authority with advance notice of equity withdrawals initiated by equity holders that exceed defined amounts or percentages of the firm's excess regulatory capital.[362]

To ensure that the Commission and NFA receive prompt information concerning potential operational or financial issues that may adversely impact the safety and soundness of an EU nonbank SD, the Commission is proposing to condition the Capital Comparability Determination Order to require EU nonbank SDs to file certain notices required under the CFTC Financial Reporting Rules with the Commission and NFA. In this connection, the Commission is proposing to condition the Capital Comparability Determination Order on an EU nonbank SD providing the Commission and NFA with notice if the firm fails to maintain current books and records with respect to its financial condition and financial reporting requirements. For avoidance of doubt, in this context the Commission believes that books and records would include current ledgers or other similar records which show or summarize, with appropriate references to supporting documents, each transaction affecting the EU nonbank SD's asset, liability, income, expense and capital accounts in accordance with the accounting principles accepted by the relevant competent authorities.[363] The Commission preliminarily believes that the maintenance of current books and records is a fundamental and essential component of operating as a registered nonbank SD and that the failure to comply with such a requirement may indicate an inability of the firm to promptly and accurately record transactions and to ensure compliance with regulatory requirements, including regulatory capital requirements. Therefore, the proposed Order would require an EU nonbank SD to provide the Commission and NFA with a written notice within 24 hours if the firm fails to maintain books and records on a current basis.

The proposed Capital Comparability Determination Order would also require an EU nonbank SD to file notice with the Commission and NFA if: (i) a single counterparty, or group of counterparties under common ownership or control, fails to post required initial margin or pay required variation margin on uncleared swap and security-based swap positions that, in the aggregate, exceeds 25 percent of the EU nonbank SD's minimum capital requirement; (ii) counterparties fail to post required initial margin or pay required variation margin to the EU nonbank SD for uncleared swap and security-based swap positions that, in the aggregate, exceeds 50 percent of the EU nonbank

[357] The Commission's proposed reporting level of 12.6 percent reflects the aggregate of the EU nonbank SD's core capital requirement of 8 percent and capital conservation buffer requirement of 2.5 percent, multiplied by a factor of 1.20. For purposes of the calculation, the Commission proposes that the 20 percent capital increase must be comprised of common equity tier 1 capital (*i.e.,* common equity tier 1 capital must comprise a minimum of 8.4 percent, which reflects the aggregate of the 4.5 percent core common equity tier 1 capital requirement and the 2.5 percent capital conservation buffer requirement, multiplied by a factor of 1.20).

[358] 17 CFR 1.12 and 17 CFR 23.105(c)(ii)(2).

[359] This interpretation is consistent with the Commission's discussion of the timing standard in the preamble to the 1998 final rule adopting amendments to Commission Regulation 1.12, where the Commission noted that the part of the standard requiring an FCM to report when it ''should know'' of a problem may be defined as the point at which a party, in the exercise of reasonable diligence, should become aware of an event. *See* 63 FR 45711 at 45713.

[360] To that point, in discussing the standard applicable to the timing requirement for the filing of a notice by an FCM to report an undersegregated or undersecured condition (*i.e.,* situation where the FCM has insufficient funds in accounts segregated for the benefit of customers trading on U.S. contract markets or has insufficient funds set aside for customers trading on non-U.S. markets to meet the FCM's obligations to its customers), the Commission noted that an obligation to file a notice could arise even before the required computations that would reveal deficiencies must be made. *See id.*

[361] 17 CFR 23.105(c)(3), (4), and (7).

[362] Commission Regulation 23.105(c)(5) requires a nonbank SD to provide written notice to the Commission and NFA two business days prior to the withdrawal of capital by action of the equity holders if the amount of the withdrawal exceeds 30 percent of the nonbank SD's excess regulatory capital. 17 CFR 23.105(c)(5).

[363] For comparison, see Commission Regulation 23.105(b), which similarly defines the term ''current books and records'' as used in the context of the Commission's requirements. 17 CFR 23.105(b).

SD's minimum capital requirement; (iii) an EU nonbank SD fails to post required initial margin or pay required variation margin for uncleared swap and security-based swap positions to a single counterparty or group of counterparties under common ownership and control that, in the aggregate, exceeds 25 percent of the EU nonbank SD's minimum capital requirement; and (iv) an EU nonbank SD fails to post required initial margin or pay required variation margin to counterparties for uncleared swap and security-based swap positions that, in the aggregate, exceeds 50 percent of the EU nonbank SD's minimum capital requirement. The Commission is proposing to require this notice so that it and the NFA may commence communication with the EU nonbank SD and the relevant competent authority in order to obtain an understanding of the facts that have led to the failure to exchange material amounts of initial margin and variation margin in accordance with the applicable margin rules, and to assess whether there is a concern regarding the financial condition of the firm that may impair its ability to meet its financial obligations to customers, counterparties, creditors, and general market participants, or otherwise adversely impact the firm's safety and soundness.

The proposed Capital Determination Order would not require an EU nonbank SD to file notices with the Commission and NFA concerning withdrawals of capital or changes in capital levels as such information will be reflected in the financial statement reporting filed with the Commission and NFA as conditions of the Order, and because the EU nonbank SD's capital levels are monitored by the relevant competent authority, which the Commission preliminarily believes renders the separate reporting to the Commission superfluous.

The proposed Capital Comparability Determination Order would require an EU nonbank SD to file any notices required under the Order with the Commission and NFA in English and, where applicable, to reflect any balances in U.S. dollars. Each notice required by the proposed Capital Comparability Determination Order must be filed in accordance with instructions issued by the Commission or NFA.[364]

The Commission invites public comment on its analysis above, including comment on the EU Application and relevant EU Financial Reporting Rules. The Commission also invites comment on the proposed conditions to the Capital Comparability Determination Order that are listed above.

The Commission requests comment on the timeframes set forth in the proposed conditions for EU nonbank SDs to file notices with the Commission and NFA. In this regard, the proposed conditions would require EU nonbank SDs to file certain written notices with the Commission within 24 hours of the occurrence of a reportable event or of being alerted to a reportable event by the relevant competent authority. These notices would have to be translated into English prior to being filed with the Commission and NFA. The Commission requests comment on the issues EU nonbank SDs may face meeting the filing requirements given time-zone difference, translation, and governance issues, as applicable. The Commission also requests specific comment regarding the setting of compliance dates for the notice reporting conditions that the proposed Capital Comparability Determination Order would impose on EU nonbank SDs.

F. Supervision and Enforcement

1. Commission and NFA Supervision and Enforcement of Nonbank SDs

The Commission and NFA conduct ongoing supervision of nonbank SDs to assess their compliance with the CEA, Commission regulations, and NFA rules by reviewing financial reports, notices, risk exposure reports, and other filings that nonbank SDs are required to file with the Commission and NFA. The Commission and/or NFA also conduct periodic examinations as part of the supervision of nonbank SDs, including routine onsite examinations of nonbank SDs' books, records, and operations to ensure compliance with CFTC and NFA requirements.[365]

As noted in Section D.1. above, financial reports filed by a nonbank SD provide the Commission and NFA with information necessary to ensure the firm's compliance with minimum capital requirements and to assess the firm's overall safety and soundness and its ability to meet its financial obligations to customers, counterparties, and creditors. A nonbank SD is also required to provide written notice to the Commission and NFA if certain defined events occur, including that the firm is undercapitalized or maintains a level of capital that is less than 120 percent of the firm's minimum capital requirements.[366] The notice provisions, as stated in Section E.1. above, are intended to provide the Commission and NFA with information of potential issues at a nonbank SD that may impact the firm's ability to maintain compliance with the CEA and Commission regulations. The Commission and NFA also have the authority to require a nonbank SD to provide any additional financial and/or operational information on a daily basis or at such other times as the Commission or NFA may specify to monitor the safety and soundness of the firm.[367]

The Commission also has authority to take disciplinary actions against a nonbank SD for failing to comply with the CEA and Commission regulations. Section 4b–1(a) of the CEA [368] provides the Commission with exclusive authority to enforce the capital requirements imposed on nonbank SDs adopted under Section 4s(e) of the CEA.[369]

2. EU Authorities' Supervision and Enforcement of EU Nonbank SDs

Supervision of EU nonbank SDs' compliance with the EU Capital Rules and the EU Financial Reporting Rules is conducted by the ECB and the relevant national competent authorities in the EU Member States. EU nonbank SDs that are registered as credit institutions and that qualify as ''significant supervised entities'' fall under the direct authority of the ECB and are supervised within the ''Single Supervisory Mechanism'' (''SSM'').[370] Within the SSM, the ECB supervises firms for compliance with the EU Capital Rules and the EU Financial Reporting Rules through joint supervisory teams (''JSTs''), comprised of ECB staff and staff of the national competent

[364] The proposed conditions for EU nonbank SDs to file a notice with the Commission and NFA if the firm fails to maintain current books and records or fails to collect or post margin with uncleared swap counterparties that exceed the above-referenced threshold levels are consistent with the proposed conditions in the proposed Capital Comparability Determination Orders for Japan and Mexico. *See* Proposed Japan Order and Proposed Mexico Order.

[365] Section 17(p)(2) of the CEA requires NFA as a registered futures association to establish minimum capital and financial requirements for non-bank SDs and to implement a program to audit and enforce compliance with such requirements. 7 U.S.C. 21(p)(2). Section 17(p)(2) further provides that NFA's capital and financial requirements may not be less stringent than the capital and financial requirements imposed by the Commission.

[366] *See* 17 CFR 23.105(c).

[367] *See* 17 CFR 23.105(h).

[368] 7 U.S.C. 6b–1(a).

[369] 7 U.S.C. 6s(e).

[370] *See generally* SSM Regulation and SSM Framework Regulation. The criteria for determining whether credit institutions are considered ''significant supervised entities'' include size, economic importance for the specific EU Member State or the EU economy, significance of cross-border activities, and request for or receipt of direct public financial assistance. *See* SSM Regulation, Article 6 and SSM Framework Regulation, Articles 39–44 and 50–62.

authorities.[371] EU nonbank SDs that are registered as credit institutions and that qualify as ''less significant supervised entities,'' [372] or EU nonbank SDs registered as investment firms that remain subject to the CRR/CRD framework regime, fall under the direct authority of the applicable national competent authorities.[373]

The ECB and the ACPR have supervision, audit, and investigation powers with respect to EU nonbank SDs, which include the power to require EU nonbank SDs to provide all necessary information in order for the authorities to carry out their supervisory tasks; [374] examine the books and records of EU nonbank SDs; obtain written and oral explanations from the EU nonbank SD's management, staff, and other persons; [375] and conduct all necessary inspections at the business premises of EU nonbank SDs and other group entities.[376]

The competent authorities also monitor the capital adequacy of EU nonbank SDs through supervisory measures on an ongoing basis. The monitoring includes assessing the notices and the capital conservation plan discussed in Section E.2. above. In addition to the tools described in Section E.2., the relevant competent authorities are empowered with a variety of measures to address an EU nonbank SD's financial deterioration. Specifically, if an EU nonbank SD fails to meet its capital or liquidity thresholds or if the competent authority has evidence that the EU nonbank SD is likely to breach its capital or liquidity thresholds in the next 12 months, the competent authority may order an EU nonbank SD to comply with additional requirements, including: (i) maintaining additional capital in excess of the minimum requirements, if certain conditions are met; (ii) requiring that the EU nonbank SD submit a plan to restore compliance with applicable capital or liquidity thresholds; (iii) imposing restrictions on the business or operations of the EU nonbank SD; (iv) imposing restrictions or prohibitions on distributions or interest payments to shareholders or holders of additional tier 1 capital instruments; (v) requiring additional or more frequent reporting requirements; and (vi) imposing additional specific liquidity requirements.[377] The competent authority may also withdraw an EU nonbank SD's authorization if the firm no longer meets its minimum capital requirements.[378]

Although the relevant competent authorities generally have broad discretion as to what powers they may exercise, the EU Capital Rules and the EU Financial Reporting Rules specifically mandate that the competent authorities require EU nonbank SDs to hold increased capital when: (i) risks or elements of risks are not covered by the capital requirements imposed by the EU Capital Rules; (ii) the EU nonbank SD lacks robust governance arrangements, appropriate resolution and recovery plans, processes to manage large exposures or effective processes to maintain on an ongoing basis the amounts, types and distribution of capital needed to cover the nature and level of risks to which they might be exposed and it is unlikely that other supervisory measures would be sufficient to ensure that those requirements can be met within an appropriate timeframe; (iii) the EU nonbank SD repeatedly fails to establish or maintain an adequate level of additional capital to cover the guidance communicated by the relevant competent authorities; or (iv) other entity-specific situations deemed by the relevant competent authority to raise material supervisory concerns.[379]

The national competent authorities can also issue administrative penalties and other administrative measures if an EU nonbank SD (or its management) does not fully comply with its reporting requirements.[380] These penalties and measures include: (i) public statements identifying a firm or one or more of its managers as responsible for the breach; (ii) cease-and-desist orders; (iii) temporary bans against a member of the firm's management body or other manager; (iv) administrative monetary penalties against the firm of up to 10 percent of the total annual net turnover of the preceding year; (v) administrative monetary penalties of up to twice the amount of the profits gained or losses avoided because of the breach; or (vi) withdrawal of the firm's authorization.[381]

The ECB has the same powers to impose administrative monetary penalties for breaches of directly applicable EU laws and regulations.[382] In addition, the ECB can instruct the national competent authorities to open proceedings that may lead to the imposition of non-monetary penalties for breaches of directly applicable EU law and regulations, monetary and non-monetary penalties for breaches of EU Member State laws implementing relevant directives, and monetary and non-monetary penalties against natural

[371] SSM Framework Regulation, Article 3.

[372] SSM Regulation, Article 6. Entities that qualify as ''less significant supervised entities'' are supervised by their national competent authorities in close cooperation with the ECB. With respect to the prudential supervision of these entities, the ECB has the power to issue regulations, guidelines or general instructions to the national competent authorities. SSM Regulation, Article 6(5)(a). At any time, the ECB can also decide to directly supervise any one of these less significant supervised entities to ensure that high supervisory standards are applied consistently. SSM Regulation, Article 6(5)(b).

[373] Three of the four EU nonbank SDs currently registered with the Commission (BofA Securities Europe S.A.; Citigroup Global Markets Europe AG; and Morgan Stanley Europe SE) are registered as credit institutions and qualify as ''significant supervised entities'' subject to the direct supervision of the ECB. One entity (Goldman Sachs Paris Inc. et Cie) is registered as an investment firm, but has a pending application for authorization as a credit institution. The Applicants represented that Goldman Sachs Paris Inc et Cie would likely be a categorized as a ''less significant supervised entity'' and subject to direct supervision by the French ACPR. According to the Applicants, however, the ECB is still considering whether it may exercise direct supervisory authority over the entity, pursuant to SSM Regulation, Article 6. *See* Responses to Staff Questions of May 15, 2023.

Accordingly, this Section describes the supervisory powers of the ECB and the French ACPR and refers to provisions establishing those powers. Therefore, if a future EU nonbank SD applicant that is subject to supervision by a national competent authority in an EU Member State other than France, seeks substituted compliance for some or all of the CFTC Capital Rules and CFTC Financial Reporting Rules, the EU nonbank SD applicant must submit an application to the Commission in accordance with Commission Regulation 23.106 (17 CFR 23.106) and provide, among other information, a description of the ability of the relevant EU Member State regulatory authority to supervise and enforce compliance with the relevant EU Member State's capital adequacy and financial reporting requirements.

[374] CRD, Article 65(3)(a); French MFC, Article L.612–24; and SSM Regulation, Article 10.

[375] CRD, Article 65(3)(b); French MFC, Article L.612–24; and SSM Regulation, Article 11.

[376] CRD, Article 65(3)(c); French MFC, Articles L.612–23 and L.612–26; and SSM Regulation, Article 12.

[377] CRD, Articles 102(1) and 104(1); French MFC, Articles L.511–41–3 and L.612–31 to L.612–33; SSM Regulation, Article 16.

[378] CRD Article 18; MiFID, Article 8c; French MFC, Articles L.532–6 and L.612–40; SSM Regulation, Article 14.

[379] CRD, Article 104 and 104a; French MFC, Article L.511–41–3; German KWG, Section 6c(1); and SSM Regulation, Articles 9 (indicating that the ECB shall have all the powers and obligations that national authorities have under EU law, unless otherwise provided in the SSM Regulation, and that the ECB may require, by way of instructions, that national competent authorities make use of their powers, where the SSM Regulation does not confer such powers to the ECB) and 16 (describing ECB's supervisory powers, including the power to require entities subject to its authority to hold capital in excess of the capital requirements imposed by relevant EU law).

[380] CRD, Articles 65, 67(1)(e) to (i) and 67(2); French MFC, Article L.612–39 and L.612–40; German KWG, Sections 56(6) and (7), 60b(1) and (3).

[381] *Id.*

[382] SSM Regulation, Article 18.

persons for breaches of relevant EU laws and regulations.[383]

3. Commission Analysis

Based on the above, the Commission preliminarily finds that the competent authorities have the necessary powers to supervise, investigate, and discipline EU nonbank SDs for compliance with the applicable capital and financial reporting requirements, and to detect and deter violations of, and ensure compliance with, the applicable capital and financial reporting requirements in the EU.[384]

The Commission would expect to communicate and consult, to the fullest extent permissible under applicable law, with the relevant competent authorities regarding the supervision of the financial and operational condition of the EU nonbank SDs. An appropriate MOU or similar arrangement with the relevant competent authorities would facilitate cooperation and information sharing in the context of supervising the EU nonbank SDs. Such an arrangement would enhance communication with respect to entities within the arrangement's scope (''Covered Firms''), as appropriate, regarding: (i) general supervisory issues, including regulatory, oversight, or other related developments; (ii) issues relevant to the operations, activities, and regulation of Covered Firms; and (iii) any other areas of mutual supervisory interest, and would anticipate periodic meetings to discuss relevant functions and regulatory oversight programs. The arrangement would provide for the Commission and the relevant competent authority to inform each other of certain events, including any material events that could adversely impact the financial or operational stability of a Covered Firm, and would provide a procedure for any on-site examinations of Covered Firms.

In the absence of an MOU or similar information sharing arrangement, the Commission is proposing to condition the Capital Comparability Determination Order on an EU nonbank SD providing notice to the Commission and NFA if its competent authority has required an EU nonbank SD to: (i) maintain additional capital in excess of the minimum requirements; (ii) require that the EU nonbank SD submit a plan to restore compliance with applicable capital or liquidity thresholds; (iii) impose restrictions on the business or operations of the EU nonbank SD; (iv) impose restrictions or prohibitions on distributions or interest payments to shareholders or holders of additional tier 1 capital instruments; (v) require additional or more frequent reporting requirements; or (vi) impose additional specific liquidity requirements.[385] Upon receipt of such notice, the Commission and NFA would communicate with the EU nonbank SD to obtain further information regarding the underlying issues that prompted the competent authority to direct the EU nonbank SD to take such actions and would obtain information regarding how the EU nonbank SD would address the underlying issues.

The Commission invites public comment on the EU Application, the EU laws and regulations, and the Commission's analysis above regarding its preliminary determination that the competent authorities in the EU and the CFTC have supervision programs and enforcement authority that are comparable in that the purpose of the relevant programs and authority is to ensure that nonbank SDs maintain compliance with applicable capital and financial reporting requirements.

IV. Proposed Capital Comparability Determination Order

A. Commission's Proposed Comparability Determination

The Commission's preliminary view, based on the EU Application and the Commission's review of applicable EU laws and regulations, is that the EU Capital Rules and the EU Financial Reporting Rules, subject to the conditions set forth in the proposed Capital Comparability Determination Order below, achieve comparable outcomes and are comparable in purpose and effect to the CFTC Capital Rules and CFTC Financial Reporting Rules. In reaching this preliminary conclusion, the Commission recognizes that there are certain differences between the EU Capital Rules and CFTC Capital Rules and certain differences between the EU Financial Reporting Rules and the CFTC Financial Reporting Rules. The proposed Capital Comparability Determination Order is subject to proposed conditions that are preliminarily deemed necessary to promote consistency in regulatory outcomes, or to reflect the scope of substituted compliance that would be available notwithstanding certain differences. In the Commission's preliminary view, the differences between the two rules sets would not be inconsistent with providing a substituted compliance framework for EU nonbank SDs subject to the conditions specified in the proposed Order below.

Furthermore, the proposed Capital Comparability Determination Order is limited to the comparison of the EU Capital Rules to the Bank-Based Approach contained within the CFTC Capital Rules. As noted previously, the Applicants have not requested, and the Commission has not performed, a comparison of the EU Capital Rules to the Commission's NAL Approach or TNW Approach. In addition, as discussed in Section I.C. above, the Applicants have not requested, and the Commission has not performed, a comparison of the capital rules for smaller EU investment firms under IFR to the Commission's Bank-Based Approach, NAL Approach, or TNW Approach.

B. Proposed Capital Comparability Determination Order

The Commission invites comments on all aspects of the EU Application, relevant EU laws and regulations, the Commission's preliminary views expressed above, the question of whether requirements under the EU Capital Rules are comparable in purpose and effect to the Commission's requirement for a nonbank SD to hold regulatory capital equal to or greater than 8 percent of its uncleared swap margin amount, and the Commission's proposed Capital Comparability Determination Order, including the proposed conditions included in the proposed Order, set forth below.

C. Proposed Order Providing Conditional Capital Comparability Determination for Certain EU Nonbank Swap Dealers

It is hereby determined and ordered, pursuant to Commodity Futures Trading Commission (''CFTC'' or ''Commission'') Regulation 23.106 (17 CFR 23.106) under the Commodity Exchange Act (''CEA'') (7 U.S.C. 1 *et seq.*) that a swap dealer (''SD'') organized and domiciled in the French Republic (''France'') or the Federal

[383] SSM Regulation, Article 9.

[384] The Commission, the French Autorité des Marchés Financiers (''AMF'') (the French market conduct regulatory authority with which the ACPR shares supervision authority over French financial firms, including EU nonbank SDs domiciled in France, as it regards business conduct matters), and the German BaFin (the German financial sector regulatory authority whose staff participates in the SSM's JSTs that conduct prudential supervision of the two EU nonbank SDs domiciled in Germany) are signatories to the *IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information* (revised May 2012), which covers primarily information sharing in the context of enforcement matters.

[385] The authority for the competent authorities to impose such conditions or requirements is set forth in CRD, Articles 102(1) and 104(1); French MFC, Articles L.511–41–3 and L.612–31 to L.612–33; SSM Regulation, Article 16.

Republic of Germany (''Germany'') and subject to the Commission's capital and financial reporting requirements under Sections 4s(e) and (f) of the CEA (7 U.S.C. 6s(e) and (f)) may satisfy the capital requirements under Section 4s(e) of the CEA and Commission Regulation 23.101(a)(1)(i) (17 CFR 23.101(a)(1)(i)) (''CFTC Capital Rules''), and the financial reporting rules under Section 4s(f) of the CEA and Commission Regulation 23.105 (17 CFR 23.105) (''CFTC Financial Reporting Rules''), by complying with certain specified requirements of the European Union (''EU'') laws and regulations cited below and otherwise complying with the following conditions, as amended or superseded from time to time:

(1) The SD is not subject to regulation by a prudential regulator defined in Section 1a(39) of the CEA (7 U.S.C. 1a(39));

(2) The SD is organized under the laws of France or Germany (''EU Member State'') and is domiciled in France or Germany, respectively (''EU nonbank SD'');

(3) The EU nonbank SD is licensed as a credit institution or an investment firm in an EU Member State and is treated for the purposes of the EU capital and financial reporting rules as an ''institution,'' as defined in *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012* (''Capital Requirements Regulation'' or ''CRR''), Article 4(1)(3), and *Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC* (''Capital Requirements Directive'' or ''CRD''), Article 3(1)(3);

(4) The EU nonbank SD is subject to and complies with: CRR and CRD as implemented in the national laws of France and Germany (collectively, ''EU Capital Rules'');

(5) The EU nonbank SD satisfies at all times applicable capital ratio and leverage ratio requirements set forth in Article 92 of CRR, the capital conservation buffer requirements set forth in Article 129 of CRD, and applicable liquidity requirements set forth in Articles 412 and 413 of CRR, and otherwise complies with the requirements to maintain a liquidity risk management program as required under Article 86 of CRD;

(6) The EU nonbank SD is subject to and complies with: *Commission Implementing Regulation (EU) 2021/451 of 17 December 2020 laying down implementing technical standards for the application of Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to supervisory reporting of institutions and repealing Implementing Regulation (EU) No 680/2014* (''CRR Reporting ITS''); *Regulation (EU) 2015/534 of the European Central Bank of 17 March 2015 on reporting of supervisory financial information* (''ECB FINREP Regulation''); and *Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC* (''Accounting Directive'') as implemented in the national laws of France and Germany (collectively and together with CRR and CRD as implemented in the national laws of France and Germany, ''EU Financial Reporting Rules'');

(7) The EU nonbank SD is subject to prudential supervision by an EU Member State supervisory authority with jurisdiction to enforce the requirements set forth by the EU Capital Rules and the EU Financial Reporting Rules or the European Central Bank (''ECB''), as applicable (''competent authority'');

(8) The EU nonbank SD maintains at all times an amount of regulatory capital in the form of common equity tier 1 capital as defined in Article 26 of CRR, equal to or in excess of the equivalent of $20 million in United States dollars (''U.S. dollars''). The EU nonbank SD shall use a commercially reasonable and observable euro/U.S. dollar exchange rate to convert the value of the euro-denominated common equity tier 1 capital to U.S. dollars;

(9) The EU nonbank SD has filed with the Commission a notice stating its intention to comply with the EU Capital Rules and the EU Financial Reporting Rules in lieu of the CFTC Capital Rules and the CFTC Financial Reporting Rules. The notice of intent must include the EU nonbank SD's representation that the firm is organized and domiciled in an EU Member State, is a licensed investment firm or a credit institution in an EU Member State, and is subject to, and complies with, the EU Capital Rules and EU Financial Reporting Rules. An EU nonbank SD may not rely on this Capital Comparability Determination Order until it receives confirmation from Commission staff, acting pursuant to authority delegated by the Commission, that the EU nonbank SD may comply with the applicable EU Capital Rules and EU Financial Reporting Rules in lieu of the CFTC Capital Rules and CFTC Reporting Rules. Each notice filed pursuant to this condition must be prepared in the English language and submitted to the Commission via email to the following address: *MPDFinancialRequirements@cftc.gov;*

(10) The EU nonbank SD prepares and keeps current ledgers and other similar records in accordance with accounting principles required by the relevant competent authority;

(11) The EU nonbank SD files with the Commission and with the National Futures Association (''NFA'') a copy of templates 1.1 (Balance Sheet Statement: assets), 1.2 (Balance Sheet Statement: liabilities), 1.3 (Balance Sheet Statement: equity), 2 (Statement of profit or loss), and 10 (Derivatives—Trading and economic hedges) of the financial reports (''FINREP'') that EU nonbank SDs are required to submit pursuant to CRR Reporting ITS, Annex III or IV, or the ECB FINREP Regulation, as applicable, and templates 1 (Own Funds), 2 (Own Funds Requirements) and 3 (Capital Ratios) of the common reports (''COREP'') that EU nonbank SDs are required to submit pursuant to CRR Reporting ITS, Annex I. The FINREP and COREP templates must be translated into the English language and balances must be converted to U.S. dollars. The FINREP and COREP templates must be filed with the Commission and NFA within 35 calendar days of the end of each month. EU nonbank SDs that are registered as security-based swap dealers (''SBSDs'') with the U.S. Securities and Exchange Commission (''SEC'') may comply with this condition by filing with the Commission and NFA a copy of Form X–17A–5 (''FOCUS Report'') that the EU nonbank SD is required to file with the SEC or its designee pursuant to an order granting conditional substituted compliance with respect to Securities Exchange Act of 1934 Rule 18a–7. The copy of the FOCUS Report must be filed with the Commission and NFA within 35 calendar days after the end of each month in the manner, format and conditions specified by the SEC in Order Specifying the Manner and Format of Filing Unaudited Financial and Operational Information by Security-Based Swap Dealers and Major Security-Based Swap Participants that are not U.S. Persons and are Relying on Substituted Compliance with Respect to Rule 18a–7, 86 FR 59208 (Oct. 26, 2021);

(12) The EU nonbank SD files with the Commission and with NFA a copy

of its annual audited financial statements and management report (together, ''annual audited financial report'') that are required to be prepared and published pursuant to Articles 4, 19, 30 and 34 of the Accounting Directive as implemented in the national laws of France and Germany. The annual audited financial report must be translated into the English language and balances may be reported in euro. The annual audited financial report must be filed with the Commission and NFA on the earliest of the date the report is filed with the competent authority, the date the report is published, or the date the report is required to be filed with the competent authority or the date the report is required to be published pursuant to the EU Financial Reporting Rules;

(13) The EU nonbank SD files Schedule 1 of Appendix B to Subpart E of Part 23 of the CFTC's regulations (17 CFR 23 Subpart E—Appendix B) with the Commission and NFA on a monthly basis. Schedule 1 must be prepared in the English language with balances reported in U.S. dollars and must be filed with the Commission and NFA within 35 calendar days of the end of each month;

(14) The EU nonbank SD submits with each set of FINREP and COREP templates, annual audited financial report, and Schedule 1 of Appendix B to Subpart E of Part 23 of the CFTC's regulations a statement by an authorized representative or representatives of the EU nonbank SD that to the best knowledge and belief of the representative or representatives the information contained in the reports, including the translation of the reports into English and conversion of balances in the reports to U.S. dollars, is true and correct. The statement must be prepared in the English language;

(15) The EU nonbank SD files a margin report containing the information specified in Commission Regulation 23.105(m) (17 CFR 23.105(m)) with the Commission and with NFA within 35 calendar days of the end of each month. The margin report must be in the English language and balances reported in U.S. dollars;

(16) The EU nonbank SD files a notice with the Commission and NFA within 24 hours of being informed by a competent authority that the firm is not in compliance with any component of the EU Capital Rules or EU Financial Reporting Rules. The notice must be prepared in the English language;

(17) The EU nonbank SD files a notice within 24 hours with the Commission and NFA if it fails to maintain regulatory capital in the form of common equity tier 1 capital as defined in Article 26 of CRR, equal to or in excess of the U.S. dollar equivalent of $20 million using a commercially reasonable and observable euro/U.S. dollar exchange rate. The notice must be prepared in the English language;

(18) The EU nonbank SD provides the Commission and NFA with notice within 24 hours of filing a capital conservation plan with the relevant competent authority pursuant to the relevant EU Member State's provisions implementing Article 143 of CRD, indicating that the firm has breached its combined capital buffer requirement. The notice filed with the Commission and NFA must be prepared in the English language;

(19) The EU nonbank SD provides the Commission and NFA with notice within 24 hours if it is required by its competent authority to maintain additional capital or additional liquidity requirements, or to restrict its business operations, or to comply with other requirements pursuant to Articles 102(1) and 104(1) of CRD as implemented in the national laws of France or to Article 16 of *Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.* The notice filed with the Commission and NFA must be prepared in the English language;

(20) The EU nonbank SD files a notice with the Commission and NFA within 24 hours if it fails to maintain its minimum requirement for own funds and eligible liabilities (''MREL''), if such requirement is applicable to the EU nonbank SD pursuant to *Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council* as implemented in the national laws of France and Germany. The notice filed with the Commission and NFA must be prepared in the English language;

(21) The EU nonbank SD files a notice with the Commission and NFA within 24 hours of when the firm knew or should have known that its regulatory capital fell below 120 percent of its minimum capital requirement, comprised of the firm's core capital requirements and any applicable capital buffer requirements. For purposes of the calculation, the 20 percent excess capital must be in the form of common equity tier 1 capital. The notice filed with Commission and NFA must be prepared in the English language;

(22) The EU nonbank SD files a notice with the Commission and NFA within 24 hours if it fails to make or keep current the financial books and records. The notice must be prepared in the English language;

(23) The EU nonbank SD files a notice with the Commission and NFA within 24 hours of the occurrence of any of the following: (i) a single counterparty, or group of counterparties under common ownership or control, fails to post required initial margin or pay required variation margin on uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 25 percent of the EU nonbank SD's minimum capital requirement; (ii) counterparties fail to post required initial margin or pay required variation margin to the EU nonbank SD for uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 50 percent of the EU nonbank SD's minimum capital requirement; (iii) the EU nonbank SD fails to post required initial margin or pay required variation margin for uncleared swap and non-cleared security-based swap positions to a single counterparty or group of counterparties under common ownership and control that, in the aggregate, exceeds 25 percent of the EU nonbank SD's minimum capital requirement; or (iv) the EU nonbank SD fails to post required initial margin or pay required variation margin to counterparties for uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 50 percent of the EU nonbank SD's minimum capital requirement. The notice must be prepared in the English language;

(24) The EU nonbank SD files a notice with the Commission and NFA of a change in its fiscal year-end approved or permitted to go into effect by the relevant competent authority. The notice required by this paragraph will satisfy the requirement for a nonbank SD to obtain the approval of NFA for a change in fiscal year-end under Commission Regulation 23.105(g) (17 CFR 23.105(g)). The notice of change in fiscal year-end must be prepared in the English language and filed with the Commission and NFA at least 15 business days prior to the effective date of the EU nonbank SD's change in fiscal year-end;

(25) The EU nonbank SD or an entity acting on its behalf notifies the

Commission of any material changes to the information submitted in the application for capital comparability determination, including, but not limited to, material changes to the EU Capital Rules or EU Financial Reporting Rules imposed on EU nonbank SDs, the ECB or relevant EU Member State authority's supervisory authority or supervisory regime over EU nonbank SDs, and proposed or final material changes to the EU Capital Rules or EU Financial Reporting Rules as they apply to EU nonbank SDs; and

(26) Unless otherwise noted in the conditions above, the reports, notices, and other statements required to be filed by the EU nonbank SD with the Commission and NFA pursuant to the conditions of this Capital Comparability Determination Order must be submitted electronically to the Commission and NFA in accordance with instructions provided by the Commission or NFA.

Issued in Washington, DC, on June 20, 2023, by the Commission.

Robert Sidman,

Deputy Secretary of the Commission.

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Domiciled in the French Republic and Federal Republic of Germany and Subject to Capital and Financial Reporting Requirements of the European Union—Voting Summary and Commissioners' Statements

Appendix 1—Voting Summary

On this matter, Chairman Behnam and Commissioners Johnson, Goldsmith Romero, Mersinger, and Pham voted in the affirmative. No Commissioner voted in the negative.

Appendix 2—Statement of Chairman Rostin Behnam in Support of the Notice of Proposed Order and Request for Comment on the Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Domiciled in the French Republic and Federal Republic of Germany and Subject to Capital and Financial Reporting Requirements of the European Union

I support the Commission's proposed order and request for comment on an application for a preliminary capital comparability determination on behalf of four nonbank swap dealers that are domiciled in France or Germany. All four of these EU nonbank SDs are subject to, and comply with, the EU capital and financial reporting rules as implemented by the national laws of France or Germany, which the Commission has preliminarily determined are comparable to certain capital and financial reporting requirements under the Commodity Exchange Act and the Commission's regulations, subject to certain conditions. This preliminary capital comparability determination for these EU nonbank SDs is the third proposed order and request for comment to come before the Commission since it adopted its substituted compliance framework for non-U.S. domiciled nonbank swap dealers in July 2020.

Appendix 3—Statement of Commissioner Kristin N. Johnson in Support of Notice and Order on EU Capital Comparability Determination

I support the Commission's issuance of the proposed capital comparability order for comment (Proposed Order).[1] The Proposed Order, if approved, will allow registered nonbank swap dealers (SDs) organized and domiciled in France and Germany to satisfy certain capital and financial reporting requirements under the Commodity Exchange Act (CEA) by being subject to and complying with comparable capital and financial reporting requirements under the European Union (EU) laws and regulations applicable in those countries. Since July 2020, this is the third proposed capital comparability determination approved for comment.[2]

As I previously noted in the context of another recent proposed capital comparability determination,[3] the Commission vigilantly monitors and surveils risk management activities by our market participants. Capital requirements play a critical role in fostering the safety and soundness of financial markets. Our efforts to coordinate and harmonize regulation with regulators around the world reinforce the adoption, implementation, and enforcement of sound prudential and capital requirements. These requirements aim to ensure the integrity of entities operating in these markets, to ensure rapid identification and remediation of liquidity crises, and to mitigate the threat of systemic risks that may threaten the stability of domestic and global financial markets.

Section 4s(e) of the CEA directs the Commission to impose capital requirements on all SDs registered with the Commission.[4] Section 4s(f) of the CEA directs the Commission to adopt rules imposing financial condition reporting obligations on all SDs.[5] The Commission's capital and financial reporting requirements adopted pursuant to these sections of the CEA are critical to ensuring the safety and soundness of our markets by addressing and managing risks that arise from a firm's operation as an SD.[6] Ensuring necessary levels of capital, as well as accurate and timely reporting about financial conditions, helps to protect swap dealers and the broader financial markets ecosystem from shocks, thereby ensuring solvency and resiliency. This, in turn, protects the financial system as a whole, reducing the risk of contagion that could arise from uncleared swaps. Financial reporting requirements work with the capital requirements by allowing the Commission to monitor and assess an SD's financial condition, including compliance with minimum capital requirements. The Commission uses the information it receives pursuant to these requirements to detect potential risks before they materialize.

I support acknowledging market participants' compliance with the regulations of foreign jurisdictions when the requirements lead to an outcome that is comparable to the outcome of complying with the CFTC's corresponding requirements. Moreover, notwithstanding our issuance of the Proposed Order, the covered swap dealers domiciled in France and Germany would remain subject to the Commission's examination and enforcement authority. Capital adequacy and financial reporting are pillars of risk management oversight for any business, and, for firms operating in our markets, it is of the utmost importance that rules governing these risk management tools

[1] The application here is by three trade associations (the Institute of International Bankers, the International Swaps and Derivatives Association, and the Securities Industry and Financial Markets Association), and there are currently four nonbank swap dealers who would be eligible to take advantage of a comparability determination if made (France: BofA Securities Europe SA and Goldman Sachs Paris Inc. et Cie; Germany: Citigroup Global Markets Europe AG and Morgan Stanley Europe SE). *See* Letter dated Sept. 24, 2021, from Stephanie Webster, General Counsel, Institute of International Bankers, Steven Kennedy, Global Head of Public Policy, International Swaps and Derivatives Association, and Kyle Brandon, Managing Director, Head of Derivatives Policy, Securities Industry and Financial Markets Association, *https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm.* There are no other nonbank SDs registered with the Commission and organized and domiciled within the EU.

[2] The Commission approved a Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination from the Financial Services Agency of Japan at its July 27, 2022 open meeting. *See* 87 FR 48,092 (Aug. 8, 2022); *see also* Statement of Commissioner Kristin N. Johnson in Support of Proposed Order on Japanese Capital Comparability Determination, July 27, 2022, *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement072722c.*

The Commission approved a Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Subject to Regulation by the Mexican Comisión Nacional Bancaria y de Valores at its November 10, 2022 open meeting. *See* 87 FR 76374 (Dec. 13, 2022); *see also* Statement of Commissioner Kristin N. Johnson in Support of Proposed Order and Request for Comment on Mexican Capital Comparability Determination, Nov. 10, 2022, *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement111022c.*

[3] *See* Statement of Commissioner Kristin N. Johnson in Support of Proposed Order and Request for Comment on Mexican Capital Comparability Determination, Nov. 10, 2022, *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement111022c; see also* Statement of Commissioner Kristin N. Johnson in Support of Proposed Order on Japanese Capital Comparability Determination, July 27, 2022, *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement072722c.*

[4] 7 U.S.C. 6s(e).

[5] 7 U.S.C. 6s(f).

[6] *See* 7 U.S.C. 6s(e); 17 CFR subpart E.

are effectively calibrated, continuously assessed, and fit for purpose. The Commission's efforts in considering the Proposed Order reflect careful and thoughtful evaluation of the comparability of relevant standards and an attempt to coordinate our efforts to bring transparency to the swaps market and reduce its risks to the public. I look forward to reviewing the comments that the Commission will receive in response to the Proposed Order.

I commend the work of staff in the Market Participants Division and their careful consideration of this application. I commend the staff of the Market Participants Division: Amanda Olear, Tom Smith, Rafael Martinez, Liliya Bozhanova, Joo Hong, and Justin McPhee, as well as the members of the Office of International Affairs for their careful review of the capital and financial reporting requirements for SDs organized and domiciled in France and Germany.

I also want to thank my fellow Commissioners for their support in advancing this matter before the Commission. Successfully implementing comparability determinations requires collaboration between the CFTC and its partner regulators in other countries. The EU is one of our closest partners internationally, and increased collaboration can only be beneficial in achieving our key goals of customer protection and market integrity.

Appendix 4—Statement of Commissioner Christy Goldsmith Romero on the CFTC's Proposed Comparability Determination for European Swap Dealer Capital Requirements

Today, the Commission considers efforts to safeguard the resilience of four swap dealers in the European Union (''EU'').[1] The proposal is part of the Commission's ''substituted compliance'' framework—a framework that promotes global harmonization with like-minded foreign regulators that have rules, supervision and enforcement that are comparable in purpose and effect to the CFTC. Our capital rules are a critical pillar of the Dodd-Frank Act reforms. We must ensure that our comparability assessments are sound and do not increase risk to U.S. markets.

The CFTC's capital framework for swap dealers heeds the lessons of the 2008 financial crisis.

The 2008 financial crisis precipitated the failure or near-failure of almost every major investment bank and a number of systemically important banks. It demonstrated all too clearly the financial stability risks presented by undercapitalized financial institutions, including a sprawling network of globally interconnected derivatives dealers. That is why Congress mandated that the Commission establish capital requirements for non-bank swap dealers. The Dodd-Frank Act provided that swap dealer capital requirements should ''offset the greater risk to the SD . . . and the financial system arising from the use of swaps that are not cleared'' [2] and ''help ensure the safety and soundness of the SD.'' [3] The Commission's capital requirements, adopted in 2020,[4] are intended to do exactly that.

Our capital requirements promote the resilience of swap dealers and protect the U.S. financial system. They ensure that swap dealers can weather economic downturns, and remain resilient during periods of stress to continue their critical market functions. Our capital requirements also help prevent contagion of losses spreading to other financial institutions.

The CFTC must ensure that capital requirements eligible for substituted compliance are comparable in outcomes, supervision, and enforcement.

Substituted compliance must leave U.S. markets at no greater risk than full compliance with our rules. The Commission has to proceed cautiously given the importance of capital to financial stability, the complexity of capital frameworks, the interconnected nature of global derivatives markets, and the speed of contagion in the global financial system.

First, we have to ensure that our substituted compliance framework recognizes only those frameworks that are comparable with respect to the most fundamental outcome—the amount of capital required to support a swap dealer's activities. The substituted compliance framework must result in the application of capital rules that are legitimately a *substitute* for the capital protections provided by U.S. law.

Second, the fact that a foreign regulator may have comparable capital rules will not be enough. We have to look beyond the four corners of rules. Substituted compliance requires a like-minded foreign regulator with comparable supervision and enforcement to the CFTC.

Our substituted compliance decisions should not allow for regulatory arbitrage for swap dealers to escape strong U.S. capital rules—a situation that could erode Dodd-Frank Act post-crisis reforms. I served as the Special Inspector General for the Troubled Asset Relief Program (''SIGTARP'') for more than a decade, providing oversight over the U.S. Government's unprecedented taxpayer-funded injections of hundreds of billions of dollars in capital into Wall Street as a response to the 2008 financial crisis. I have testified before Congress and reported to Congress about how inadequate capitalization at the largest banks contributed to the financial crisis, how the significant interconnections between financial institutions posed systemic risk, and the painful toll the crisis took on hardworking America families and small businesses.

All four swap dealers who would be able to avail themselves of our determination today are affiliated with the largest TARP recipients. That fact alone is a good reminder of what is at stake in terms of risk. It is not just danger to financial institutions, but also American families and businesses. Under this proposal in addition to the Commission's two prior capital comparability proposals,[5] 10 of 106 registered swap dealers would be eligible to rely on substituted compliance.[6]

Strong capital requirements and areas where the Commission would particularly benefit from public comment.

Three of the four EU swap dealers are dually-registered with the U.S. Securities and Exchange Commission (''SEC''). The SEC has issued final comparability determination orders permitting them to satisfy certain SEC capital requirements through substituted compliance with applicable French and German requirements.[7]

In conducting the CFTC's own analysis, it is important to remember that substituted compliance is not an all-or-nothing proposition. The Commission retains examinations and enforcement authority and it can, should, and will, impose any conditions and take all actions appropriate to protect the safety and soundness of swap dealers and the U.S. financial system. Today, the Commission proposes 24 conditions, including conditions requiring capital reporting and Commission notification that are essential to monitoring the financial condition and capital adequacy of swap dealers.

Just as with swap dealers in Japan and Mexico,[8] one of the most important

[1] The four swap dealers in the European Union are located in France and Germany—BofA Securities Europe SA (France), Citigroup Global Markets Europe AG (Germany), Morgan Stanley Europe SE (Germany), and Goldman Sachs Paris Inc. et Cie (France).

[2] 7 U.S.C. 6s(e)(3)(A).

[3] 7 U.S.C. 6s(e)(3)(A)(i). The capital requirements also must ''be appropriate to the risk associated with non-cleared swaps.'' 7 U.S.C. 6s(e)(3)(A)(ii).

[4] *See* Commodity Futures Trading Commission, *Capital Requirements of Swap Dealers and Major Swap Participants,* 85 FR 57462 (Sept. 15, 2020).

[5] *See* Commodity Futures Trading Commission, *Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination from the Financial Services Agency of Japan,* 87 FR 48092 (Aug. 8, 2022); *See also* Commodity Futures Trading Commission, *Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on behalf of Nonbank Swap dealers subject to Regulation by the Mexican Comision Nacional Bancaria y de Valores,* 87 FR 76374 (Dec. 13, 2022).

[6] 55 of the 107 swap dealers are subject to U.S. prudential regulatory capital requirements.

[7] *See Amended and Restated Order Granting Conditional Substituted Compliance in Connection with Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the Federal Republic of Germany; Amended Orders Addressing Non-U.S. Security-Based Swap Entities Subject to Regulation in the French Republic or the United Kingdom; and Order Extending the Time to Meet Certain Conditions Relating to Capital and Margin,* 86 FR 59797 (Oct. 28, 2021); *Order Granting Conditional Substituted Compliance in Connection with Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the French Republic,* 86 FR 41612 (Aug. 8, 2021); *and Order Specifying the Manner and Format of Filing Unaudited Financial and Operational Information by Security-Based Swap Dealers and Major Security-Based Swap Participants that are not U.S. Persons and are Relying on Substituted Compliance with Respect to Rule 18a–7,* 86 FR 59208 (Oct. 26, 2021).

[8] *See* CFTC Commissioner Christy Goldsmith Romero, *Proposal for Strong Capital Requirements and Financial Reporting for Swap Dealers in Japan,* (July 27, 2022) Statement of Commissioner Christy

Continued

conditions is that the Commission will continue to require compliance with the CFTC's minimum capital requirement of $20 million in common equity tier 1 capital.[9] This is one of the most critical components of the CFTC's capital requirements. It helps to ensure that each nonbank swap dealer, whether current or a future new entrant, maintains at all times, $20 million of the highest quality capital to meet its financial obligations without becoming insolvent.

Today, the Commission preliminarily finds that EU capital rules requiring 8 percent of risk-weighted assets and an additional 2.5 percent buffer, for a total of 10.5 percent, are higher than the CFTC's requirement of 8 percent of risk-weighted assets. This capital requirement helps ensure that the swap dealer has sufficient capital levels to cover for example, unexpected losses from business activities.

There are proposed deviations from the Commission's bank-based capital requirements that should be closely scrutinized. For example, the Commission proposes to permit compliance with EU capital rules that are not necessarily anchored by a threshold percentage of uncleared swap margin as the CFTC requires. I note that EU capital rules address liquidity, operational risks, as well as other risks arising from derivatives exposures, through other mechanisms. I look forward to public comment on the comparability of the approaches.

In these areas, and others, public comments will be tremendously beneficial. I approve.

Appendix 5—Statement of Commissioner Caroline D. Pham in Support of Proposed Order and Request for Comment on Comparability Determination for EU Nonbank Swap Dealer Capital and Financial Reporting Requirements

In order to implement Title VII of the Dodd-Frank Act and create a comprehensive regulatory framework for over-the-counter (OTC) derivatives markets, the Commodity Futures Trading Commission (Commission or CFTC) promulgated rules for the registration of swap dealers in 2012.[1] Since that time, the Commission has issued dozens of rules for the oversight of swap dealers and their activities.[2] Because swaps markets are global and involve cross-border transactions, and both U.S. and non-U.S. swap dealers must register with the CFTC, the Commission has also made 12 comparability determinations in order to provide for substituted compliance for non-U.S. swap dealers with home jurisdiction regulations that are comparable and comprehensive.[3]

I support the Commission's proposed order and request for comment on a comparability determination for European Union (EU) nonbank swap dealer capital and financial reporting requirements. I would like to first deeply thank the staff of the Market Participants Division (MPD) for their hard work on these incredibly technical and detailed requirements, involving many hours of engagement with the European Central Bank (ECB), Autorité de contrôle prudentiel et de resolution (ACPR), and CFTC registrants. This proposal is the staff's third proposed capital adequacy and financial reporting comparability determination in the past year, after Japan[4] and Mexico,[5] with the UK to be addressed next.

I want to remind you that this decidedly unglamorous work by CFTC staff creates the underpinnings of global markets that enable governments, central banks and commercial banks, asset managers and investors, and companies to manage the risks inherent in international flows of capital that fuel economic growth and prosperity in both developed and developing economies. I commend these MPD staff members for their dedication and work on this proposal: Amanda Olear, Tom Smith, Rafael Martinez, Liliya Bozhanova, Joo Hong, and Justin McPhee.

Conditions for Notice Requirements

I especially thank the staff for addressing my comments on the prior capital and financial reporting comparability determination proposals, by providing more clarity on the conditions for notice requirements for certain defined events such as undercapitalization or breaches of capital levels. Generally, the proposal states that written notice to the CFTC and the National Futures Association (NFA) is required within 24 hours of when the firm ''knows or should have known'' of the defined event.

I am pleased that this proposal solves the guessing game and now makes clear that the ''should have known'' part of the timing standard for the filing of the proposed notice is ''intended to cover facts and circumstances that should reasonably lead the firm to believe'' that the defined event has occurred. This additional clarity will allow EU nonbank swap dealers to implement reasonably designed notification processes to comply with the proposed conditions.

In addition, I thank the staff for providing more clarity in response to my feedback on conditions for written notice within 24 hours to the CFTC and NFA if an EU nonbank swap dealer fails to maintain current books and records. I am pleased that this proposal now makes clear that the proposed notice requirement applies to books and records with respect to the EU nonbank swap dealer's financial condition and financial reporting requirements, such as ''current ledgers or other similar records'' regarding asset, liability, income, expense, and capital accounts ''in accordance with the accounting principles accepted by the relevant competent authorities.''

Without this substantive clarification, the proposed notice requirement could have been so overbroad as to require 24 hours' written notice to the CFTC and NFA for *any* failure to maintain books and records. The Commission could have been inundated by a nonstop deluge of written notices for recordkeeping lapses, no matter how immaterial.

Market Fragmentation and Good Practices for Cross-Border Regulation

The importance of substituted compliance and these comparability determinations for global swaps markets cannot be overstated. As noted by the International Organization of Securities Commissions (IOSCO) in its 2019 report on *Market Fragmentation and Cross-Border Regulation*[6] under the Japanese Presidency of the G20, unintended market fragmentation[7] can be harmful to wholesale securities and derivatives markets.

Despite its flaws and inauspicious beginnings,[8] the CFTC's 2013 Cross-Border Guidance is the foundation for today's $600 trillion notional swaps markets[9] that spans

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Goldsmith Romero Regarding the Proposal for Strong Capital Requirements and Financial Reporting for Swap Dealers in Japan available at *https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement072722b. See also* CFTC Commissioner Christy Goldsmith Romero, *Promoting the Resilience of Swap Dealers in Mexico Through Strong Capital Requirements and Financial Reporting,* (Nov. 10, 2022) Statement of Commissioner Christy Goldsmith Romero on a Proposed Comparability Determination for Capital available at *https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatment111022b.*

[9] This CFTC capital rule substantially exceeds the EUR 5 million minimum capital required under EU capital rules.

[1] *See* Registration of Swap Dealers and Major Swap Participants (Final Rule), 77 FR 2613 (Jan. 19, 2012), *https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2012-792a.pdf.*

[2] These rules range from business conduct standards to thresholds for registration with the CFTC. *See, e.g.,* Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties (Final Rule), 77 FR 9734 (Feb. 17, 2012).

[3] *See generally,* 7 U.S.C. 2(i). The Commission created the comparable and comprehensive standard for substituted compliance determinations. *See* Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (Proposed Rule), 77 FR 41214, 41230 (July 12, 2012). The comparable standard is now in CFTC regulations 23.23 for swap dealer registration, 23.160 for margin, and 23.106 for capital. *See* 17 CFR 23.23, 23.160, and 23.106. The CFTC maintains its list of comparability determinations for substituted compliance purposes at *https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm.*

[4] Commissioner Pham ''Concurring Statement of Commissioner Caroline D. Pham Regarding Proposed Swap Dealer Capital and Financial Reporting Comparability Determination'' (July 27, 2022).

[5] Commissioner Pham ''Concurring Statement of Commissioner Caroline D. Pham Regarding Proposed Order and Request for Comment on an Application for a Capital Comparability Determination'' (Nov. 10, 2022).

[6] IOSCO Report ''Market Fragmentation & Cross Border Regulation'' (June 2019), *https://www.iosco.org/library/pubdocs/pdf/IOSCOPD629.pdf.*

[7] Both the Financial Stability Board and IOSCO have defined ''market fragmentation'' as ''global markets that break into segments, either geographically or by type of products or participants.'' *Id.* at 6–9.

[8] Commissioner O'Malia ''Statement of Dissent by Commissioner Scott D. O'Malia, Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations and Related Exemptive Order'' (July 12, 2013), *https://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement071213b.*

[9] *See* Bank for International Settlements ''OTC derivatives statistics at end-June 2022'' (Nov. 30, 2022), *https://www.bis.org/publ/otc_hy2211.pdf.*

the globe from one financial markets trading hub to another—New York, to London, Paris, Frankfurt, Tokyo, Hong Kong, Singapore, and beyond. The Commission and its staff have labored for the past 10 years to improve upon the Cross-Border Guidance and promote international regulatory harmonization through substituted compliance comparability determinations, rulemakings, guidance, advisories, and no-action letters. These efforts have helped to address features and indicators of market fragmentation set forth in the IOSCO 2019 report:

- Multiple liquidity pools in market sectors or for instruments of the same economic value which reduces depth and may reduce firms' abilities to diversify or hedge their risks and result in similar assets quoted at significantly different prices
- Reduction in cross-border flows that would otherwise occur to meet demand
- Increased costs to firms in both risks and fees
- Potential scope for regulatory arbitrage or hindrance of effective market oversight

I am pleased that the Commission is finishing what it started back in 2012 by taking these steps to complete comparability determinations necessary to providing a substituted compliance regime over the whole of the CFTC's swaps regulation. As I have stated before, global collaboration and coordination are critical to promoting regulatory cohesion and financial stability, and mitigating market fragmentation and systemic risk.[10]

I continue to believe that the CFTC should take an outcomes-based approach to substituted compliance that promotes efficient global markets and preserves access for U.S. persons to other markets. In particular, I encourage the Commission, its staff, and our regulatory counterparts around the world to adhere to the recommendations in IOSCO's 2020 report on *Good Practices on Processes for Deference,* which was developed to provide solutions to the challenges and drivers of market fragmentation.[11]

As set forth in the IOSCO 2020 report, such processes for deference[12] are typically outcomes-based; risk-sensitive; transparent; cooperative; and sufficiently flexible.

Conclusion

When used appropriately, substituted compliance can take a balanced approach to achieving these key objectives: (1) facilitating market access to foreign market participants seeking to conduct business on a cross-border basis; (2) maintaining appropriate levels of market participant protection; and (3) managing systemic risks.[13] I commend the staff for striking the appropriate balance in this proposed order and request for comment on a comparability determination for EU nonbank swap dealer capital and financial reporting requirements. I encourage the public to comment on this, and to especially note any areas where the proposed conditions may be unnecessarily burdensome, create operational complexity, or present implementation challenges.

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[10] Commissioner Pham ''Opening Statement of Commissioner Caroline D. Pham before the Global Markets Advisory Committee'' (Feb. 13, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement021323.*

[11] IOSCO Report, ''Good Practices on Processes for Deference'' (June 2020), *https://www.iosco.org/library/pubdocs/pdf/IOSCOPD659.pdf.*

[12] IOSCO uses ''deference'' as an ''overarching concept to describe the reliance that authorities place on one another when carrying out regulation or supervision of participants operating cross-border.'' *Id.* at 1. The CFTC's use of substituted compliance for swaps regulation is an example of regulatory deference mechanisms.

[13] These considerations for regulatory authorities were recognized by IOSCO in its 2015 *Report on Cross-Border Regulation. See* IOSCO Report, ''IOSCO Task Force on Cross-Border Regulation Final Report'' (Sept. 2015), *https://www.iosco.org/library/pubdocs/pdf/IOSCOPD507.pdf.*