

## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Chapter I

#### Order Granting Conditional Substituted Compliance in Connection With Certain Capital and Financial Reporting Requirements Applicable to Nonbank Swap Dealers Subject to Regulation by the Financial Services Agency of Japan

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Order.

**SUMMARY:** On August 8, 2022, the Commodity Futures Trading Commission issued a notice and request for comment on an application submitted by the Financial Services Agency of Japan requesting that the Commission determine that registered nonbank swap dealers organized and domiciled in Japan may comply with certain capital and financial reporting requirements under the Commodity Exchange Act and Commission regulations by being subject to, and complying with, corresponding capital and financial reporting requirements of Japan. The Commission also solicited public comment on a proposed comparability determination and related order providing for the conditional availability of substituted compliance in connection with the application.

The Commission is adopting the proposed order with certain modifications and clarifications to address comments. The final order provides that a nonbank swap dealer organized and domiciled in Japan may satisfy the capital requirements under the Commodity Exchange Act and applicable Commission regulations and the financial reporting rules under the Commodity Exchange Act and applicable Commission regulations by complying with certain specified Japanese laws and regulations and conditions set forth in the order.

**DATES:** This determination was made by the Commission on June 24, 2024.

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Participants Division; Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.

**SUPPLEMENTARY INFORMATION:** The Commodity Futures Trading Commission (“Commission” or “CFTC”) is issuing an order providing that registered nonbank swap dealers organized and domiciled in Japan (“Japanese nonbank SDs”) may satisfy certain capital and financial reporting requirements under the Commodity Exchange Act (“CEA”) <sup>1</sup> and Commission regulations <sup>2</sup> by being subject to, and complying with, comparable capital and financial reporting requirements under relevant Japanese laws and regulations, subject to certain conditions set forth in the order below. The order is based on the proposed comparability determination and related proposed order published by the Commission on August 8, 2022,<sup>3</sup> as modified in certain aspects to address comments and to clarify its terms.

### I. Introduction

#### A. Regulatory Background—CFTC Capital, Margin, and Financial Reporting Requirements for Swap Dealers and Major Swap Participants

Section 4s(e) of the CEA <sup>4</sup> directs the Commission and “prudential regulators” <sup>5</sup> to impose capital requirements on swap dealers (“SDs”) and major swap participants (“MSPs”) registered with the Commission.<sup>6</sup>

<sup>1</sup> 7 U.S.C. 1 *et seq.* The CEA may be accessed through the Commission’s website, [www.cftc.gov](http://www.cftc.gov).

<sup>2</sup> 17 CFR Chapter I. Commission regulations may be accessed through the Commission’s website, [www.cftc.gov](http://www.cftc.gov).

<sup>3</sup> *Notice of Proposed Order and Request for Comment on an Application for Capital Comparability Determination from the Financial Services Agency of Japan*, 87 FR 48092 (Aug. 8, 2022) (“2022 Proposal”).

<sup>4</sup> 7 U.S.C. 6s(e).

<sup>5</sup> The term “prudential regulators” 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. 7 U.S.C. 1a(39).

<sup>6</sup> 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 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. 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.

Section 4s(e) 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.<sup>7</sup> 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.<sup>8</sup>

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.<sup>9</sup> 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.<sup>10</sup> 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

banking system or financial markets; or (iii) is a financial entity that: (a) is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and (b) maintains a substantial position in outstanding swaps in any major swap category as determined by the Commission. 7 U.S.C. 1a(33).

<sup>7</sup> 7 U.S.C. 6s(e)(2).

<sup>8</sup> 7 U.S.C. 6s(e)(1) and (2).

<sup>9</sup> *Margin and Capital Requirements for Covered Swap Entities*, 80 FR 74840 (Nov. 30, 2015).

<sup>10</sup> *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 FR 636 (Jan. 6, 2016).

compliance date of October 6, 2021 (“CFTC Capital Rules”).<sup>11</sup>

Section 4s(f) of the CEA addresses SD and MSP financial reporting requirements.<sup>12</sup> Section 4s(f) 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) provides, in relevant part, that each registered SD and MSP must make financial condition reports as required by regulations adopted by the Commission.<sup>13</sup> The Commission’s financial reporting obligations were adopted with the Commission’s nonbank SD and nonbank MSP capital requirements, and also had a compliance date of October 6, 2021 (“CFTC Financial Reporting Rules”).<sup>14</sup>

#### *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 “Comparability Determination”).<sup>15</sup>

<sup>11</sup> *Capital Requirements of Swap Dealers and Major Swap Participants*, 85 FR 57462 (Sept. 15, 2020). On April 30, 2024, the Commission amended the capital and financial reporting requirements to revise certain financial reporting obligations, among other changes. See *Capital and Financial Reporting Requirements for Swap Dealers and Major Swap Participants*, 89 FR 45569 (May 23, 2024). The amendments have limited impact on nonbank SDs covered by this order.

<sup>12</sup> 7 U.S.C. 6s(f).

<sup>13</sup> 7 U.S.C. 6s(f)(1)(A).

<sup>14</sup> 85 FR 57462.

<sup>15</sup> 17 CFR 23.106. Commission Regulation 23.106(a)(1) provides that a request for a Comparability Determination may be submitted by a non-U.S. nonbank SD or non-US 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-US nonbank SDs or non-U.S. nonbank MSPs. However, Commission regulations also 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 Comparability Determination. 17 CFR 23.101(a)(5) and (b)(4), respectively.

Furthermore, substituted compliance is not available to non-U.S. bank SDs and non-U.S. bank MSPs with respect to their respective financial reporting requirements under Commission Regulation 23.105(p). Commission Regulation 23.105(p), however, permits non-U.S. bank SDs and

The Commission’s capital adequacy and financial reporting requirements are designed to address and manage risks that arise from a firm’s operation as an 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. The availability of such substituted compliance is conditioned upon the Commission issuing a Comparability Determination finding that the relevant foreign jurisdiction’s capital adequacy and financial reporting 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 would issue a Comparability Determination in the form of an order (“Comparability Order”).<sup>16</sup>

The Commission’s approach for conducting a Comparability Determination with respect to the CFTC Capital Rules and the CFTC Financial Reporting Rules is a principles-based, holistic approach that focuses on assessing whether the applicable foreign jurisdiction’s capital and financial reporting requirements have comparable objectives with, and achieve comparable outcomes to, corresponding CFTC requirements.<sup>17</sup> The Commission’s assessment is not a line-by-line evaluation or comparison of a foreign jurisdiction’s regulatory requirements with the Commission’s requirements.<sup>18</sup> In performing the analysis, the Commission recognizes that jurisdictions may adopt differing approaches to achieving regulatory objectives and outcomes, and the Commission will focus on whether the foreign jurisdiction’s capital and financial reporting requirements are based on regulatory objectives, and produce regulatory outcomes, that are comparable to the Commission’s in purpose and effect, and not whether they are comparable in every aspect or contain identical elements.

non-U.S. bank MSPs that do not submit financial reports to a U.S. prudential regulator to file with the Commission a statement of financial condition, certain regulatory capital information, and Schedule 1 of Appendix C to Subpart E of Part 23 of the Commission’s regulations prepared and presented in accordance with the accounting standards permitted by the non-U.S. bank SD’s or non-U.S. bank MSP’s home country regulatory authorities. 17 CFR 23.105(p)(2).

<sup>16</sup> 17 CFR 23.106(a)(3).

<sup>17</sup> 17 CFR 23.106(a)(3)(ii). See also 85 FR 57462 at 57521.

<sup>18</sup> See 85 FR 57462 at 57521.

A person requesting a 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 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 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.<sup>19</sup>

The Commission will consider an application for a 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.<sup>20</sup> Each non-U.S. nonbank SD or non-U.S. nonbank MSP that seeks to rely on a Comparability Order is responsible for determining whether it is subject to the foreign laws and regulations found comparable in the Comparability Order. A non-U.S. nonbank SD or non-U.S. nonbank MSP

<sup>19</sup> 17 CFR 23.106(a)(2).

<sup>20</sup> The Commission provides the applicant with an opportunity to review for accuracy and completeness the Commission’s description of relevant home country laws and regulations on which a proposed Comparability Determination and a proposed Comparability Order are based. The Commission relies on this review, and any corrections or feedback received, as part of the comparability assessment. A Comparability Determination and Comparability Order based on an inaccurate description of foreign laws and regulations may not be valid.

that is not legally required to comply with a foreign jurisdiction's laws and/or regulations determined to be comparable in a Comparability Order may not voluntarily comply with such laws and/or regulations in lieu of compliance with the CFTC Capital Rules or the CFTC Financial Reporting Rules.

The Commission may consider all relevant factors in making a 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 or similar arrangement that would facilitate supervisory cooperation.<sup>21</sup>

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 an assessment of the foreign jurisdiction's surveillance program for monitoring nonbank SDs' compliance with such capital adequacy and financial reporting requirements, and the disciplinary process imposed on firms that fail to comply with such requirements.<sup>22</sup>

Commission Regulation 23.106 further provides that the Commission may impose any terms or conditions that it deems appropriate in issuing a Comparability Determination.<sup>23</sup> Any specific terms or conditions with respect to capital adequacy or financial reporting requirements will be set forth in the Commission's Comparability Order. As a general condition to all Comparability Orders, the Commission will require notification from the 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 foreign jurisdiction's relevant laws and regulations, as well as changes to the relevant supervisory or regulatory regime.

To rely on a Comparability Order, 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 Comparability Order in lieu of all or parts of the CFTC Capital Rules and/or CFTC Financial Reporting Rules.<sup>24</sup> Notices must be filed electronically with the Commission's Market Participants Division ("MPD").<sup>25</sup> The filing of a notice by a non-U.S. nonbank SD or non-U.S. nonbank MSP provides MPD staff 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 Comparability Order and that it will comply with any listed conditions. MPD will issue a letter under delegated authority from the Commission confirming that the non-U.S. nonbank SD or non-U.S. nonbank MSP may comply with the foreign laws

<sup>22</sup> The Commission would conduct a similar analysis, adjusted as appropriate to account for regulatory distinctions, in performing a comparability assessment for foreign nonbank MSPs. 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).

<sup>23</sup> 17 CFR 23.106(a)(5).

<sup>24</sup> 17 CFR 23.106(a)(4)(i).

<sup>25</sup> Notices must be filed in electronic form to the following email address: [MPDFinancialRequirements@cftc.gov](mailto:MPDFinancialRequirements@cftc.gov).

and regulations cited in the Comparability Order in lieu of complying with the CFTC Capital Rules and CFTC Financial Reporting Rules upon MPD's confirmation through discussions with the non-U.S. nonbank SD or non-U.S. nonbank MSP that the firm is subject to, and complies with, such foreign laws and regulations, is subject to the jurisdiction of the applicable foreign regulatory authority (or authorities), and can meet the conditions in the Comparability Order.<sup>26</sup>

Each non-U.S. nonbank SD and each non-U.S. nonbank MSP that receives confirmation from the Commission that it may comply with a foreign jurisdiction's capital adequacy and 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.<sup>27</sup> A non-U.S. nonbank SD or non-U.S. nonbank MSP that receives confirmation of substituted compliance remains subject, however, to the Commission's examination and enforcement authority.<sup>28</sup> 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.<sup>29</sup> In addition, a finding of a violation by a foreign jurisdiction's regulatory authority is not a prerequisite for the exercise of such examination and enforcement authority by the Commission.

*C. Japan Financial Services Agency's Application for a Comparability Determination for Japan-Domiciled Nonbank Swap Dealers*

On September 30, 2021, the Financial Services Agency of Japan ("FSA") submitted an application ("FSA Application") requesting that the Commission conduct a Comparability Determination and issue a Comparability Order finding that compliance with certain designated capital requirements of Japan (the "Japanese Capital Rules") and certain designated financial reporting requirements of Japan (the "Japanese Financial Reporting Rules") by a Japanese nonbank SD registered with

<sup>26</sup> 17 CFR 23.106(a)(4)(ii) and 17 CFR 140.91(a)(11).

<sup>27</sup> 17 CFR 23.106(a)(4)(ii). Confirmation will be issued by MPD under authority delegated by the Commission. Commission Regulation 140.91(a)(11). 17 CFR 140.91(a)(11).

<sup>28</sup> 17 CFR 23.106(a)(4)(ii).

<sup>29</sup> *Id.*

<sup>21</sup> 17 CFR 23.106(a)(3) and 85 FR 57462 at 57520-57522.

the FSA as a Type I Financial Instruments Business Operator (“FIBO”) satisfies corresponding CFTC Capital Rules and CFTC Financial Reporting Rules applicable to a nonbank SD under Sections 4s(e) and (f) of the CEA and Commission Regulations 23.101 and 23.105.<sup>30</sup> There are currently three Japanese nonbank SDs registered with the Commission, and the FSA represented in its application that each of the three Japanese nonbank SDs are FSA-registered and regulated FIBOs.<sup>31</sup>

The FSA represented that the capital adequacy and financial reporting requirements for swap activities in Japan are governed by the Japanese legal framework for financial regulation, which is mainly composed of Acts, Cabinet Orders, Ministerial Orders, and FSA Notices.<sup>32</sup> With regard to the Japanese Capital Rules and the Japanese Financial Reporting Rules, the Financial Instruments and Exchange Act (Act No. 25 of 1948) (“FIEA”) and its related order, Cabinet Office Order on Financial Instruments Business (Cabinet Office Order No. 52 of 2007) (“COO”), set forth the prudential capital and financial reporting requirements applicable to FIBOs, including the Japanese nonbank SDs.<sup>33</sup> FIEA, COO, and related FSA Notices impose mandatory capital and reporting requirements on FIBOs, including Japanese nonbank SDs. Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc. (“Supervisory Guidelines for FIBO”) also supplement the framework.<sup>34</sup> The technical

<sup>30</sup> Letter from Yuji Yamashita, Deputy Commissioner for International Affairs, Financial Services Agency of Japan, dated September 30, 2021, pp. 4–5 (fn. 11). The FSA Application is available on the Commission’s website at: <https://www.cftc.gov/LawRegulation/DoddFrankAct/CDS/CP/index.htm>.

<sup>31</sup> The three Japanese nonbank SDs currently registered with the Commission are: BofA Securities Japan Co., Ltd.; Goldman Sachs Japan Co., Ltd.; and Morgan Stanley MUFG Securities Co., Ltd. The FSA’s application did not request a Comparability Determination with respect to nonbank MSPs as currently there are no MSPs registered with the Commission and, accordingly, no nonbank MSPs domiciled in Japan and registered with the FSA. Accordingly, the Commission’s Comparability Determination and Comparability Order do not address nonbank MSPs.

<sup>32</sup> FSA Application at p. 4.

<sup>33</sup> Businesses categorized as Type I Financial Instruments Business (Article 28(1) of the FIEA) can only be conducted by Type I FIBOs registered under Article 29 of the FIEA. Type I Financial Instruments Business includes market transactions of derivatives and foreign market derivatives transactions pertaining to certain highly liquid securities and over-the-counter transactions of derivatives.

<sup>34</sup> To implement and reinforce the legal framework, the FSA has developed and published supervisory guidelines. The supervisory guidelines are meant for FSA staff, but are public documents, which are expected to be followed by the applicable

requirements for FIBOs, including Japanese nonbank SDs, to calculate capital adequacy ratios are specified in the FSA Notice No. 59 of 2007 (“Notice on Capital”) in accordance with Article 177(8) and Article 178(1) of the COO.

#### *D. Proposed Comparability Determination and Proposed Comparability Order for Japan-Domiciled Nonbank Swap Dealers*

On August 8, 2022, the Commission published the 2022 Proposal, seeking comment on the FSA Application and the Commission’s proposed Comparability Determination and related Comparability Order.<sup>35</sup> The 2022 Proposal set forth the Commission’s preliminary Comparability Determination and proposed Comparability Order providing that, based on its review of the FSA Application and applicable Japanese laws and regulations, the Commission preliminarily found that the Japanese Capital Rules and the Japanese Financial Reporting Rules, subject to the conditions set forth in the proposed Comparability Order, achieve comparable outcomes and are comparable in purpose and effect to the CFTC Capital Rules and CFTC Financial Reporting Rules.<sup>36</sup> The Commission, however, noted that there were certain differences between the Japanese Capital Rules and CFTC Capital Rules and certain differences between the Japanese Financial Reporting Rules and the CFTC Financial Reporting Rules. As such, the Commission proposed certain conditions to the Comparability Order.<sup>37</sup> The proposed conditions were designed to promote consistency in regulatory outcomes, to reflect the scope of substituted compliance that would be available notwithstanding the differences, and to ensure that the Commission and National Futures Association (“NFA”) receive information to monitor Japanese

financial institutions. Financial institutions are consulted in connection with the establishment of, and any amendments to, the supervisory guidelines. FSA staff conducts supervision and enforcement based on the supervisory guidelines.

<sup>35</sup> 2022 Proposal, 87 FR 48092 (Aug. 8, 2022).

<sup>36</sup> See 2022 Proposal at 48092. Consistent with the process specified in section I.B. above for conducting Comparability Determinations, the Commission provided the FSA with an opportunity to review for factual accuracy and completeness the Commission’s description of relevant Japanese laws and regulations on which the proposed Comparability Determination and proposed Comparability Order were based. The Commission has relied on FSA’s review, and has incorporated feedback and corrections received from the FSA. As previously noted, a Comparability Determination and Comparability Order based on an inaccurate description of foreign laws and regulations may not be valid.

<sup>37</sup> See 2022 Proposal at 48114.

nonbank SDs for ongoing compliance with the Comparability Order.<sup>38</sup> The Commission further stated that, in its preliminary view, the identified differences would not be inconsistent with providing a substituted compliance framework for Japanese nonbank SDs subject to the conditions specified in the proposed Comparability Order.<sup>39</sup>

The proposed Comparability Order was limited to the comparison of the Japanese Capital Rules to the CFTC Capital Rules’ Bank-Based Capital Approach (“Bank-Based Approach”) for computing regulatory capital for nonbank SDs, which is based on certain capital requirements imposed by the Federal Reserve Board for bank holding companies.<sup>40</sup> As noted by the Commission in the 2022 Proposal, the FSA had not requested, nor has the Commission performed, a comparison of the Japanese Capital Rules to the Commission’s TNW Approach or NLA Approach.<sup>41</sup>

<sup>38</sup> NFA is a registered futures association under section 17 of the CEA (7 U.S.C. 21). Each SD registered with the Commission is required to be an NFA member. 17 CFR 170.16. NFA, as a registered futures association, is also required by the CEA to adopt rules imposing minimum capital, segregation, and other financial requirements, as applicable, to its members, including SDs, that are at least as stringent as the Commission’s minimum capital, segregation, and other financial requirements for such registrants, and to implement a program to audit and enforce such requirements. 7 U.S.C. 21(p). Therefore, the Commission’s proposed Comparability Order required Japanese nonbank SDs to file certain financial reports and notices with NFA so that it may perform oversight of such firms as required under section 17 of the CEA. The Commission will refer to NFA in this Comparability Determination when referring to the requirements or obligations of a registered futures association.

<sup>39</sup> 2022 Proposal at 48114.

<sup>40</sup> *Id.* As described in the 2022 Proposal, 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 Approach. See 2022 Proposal at 48095–48096, and 17 CFR 23.101. The Bank-Based Approach is consistent with the Basel Committee on Banking Supervision’s (“BCBS”) international framework for bank capital requirements (“BCBS framework” or “Basel standards”). 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](https://www.bis.org/basel_framework/index.htm).

<sup>41</sup> See 2022 Proposal at 48114.

*E. General Comments on the FSA Application and the Commission's Proposed Finding of Comparability Between the CFTC Capital Rules and CFTC Financial Reporting Rules and the Japanese Capital Rules and Japanese Financial Reporting Rules*

The public comment period on the FSA Application, the proposed Comparability Determination, and the proposed Comparability Order ended on October 7, 2022. The Commission received six comment letters from the following interested parties: Better Markets, Inc. (“Better Markets”); the FSA; the International Bankers Association of Japan (“IBAJ”); a joint letter from the Institute of International Bankers (“IIB”), the International Swaps and Derivatives Association (“ISDA”), and the Securities Industry and Financial Markets Association (“SIFMA”); and two letters from William J. Harrington.<sup>42</sup>

Two commenters expressed support for the proposed Comparability Determination and proposed Comparability Order, agreeing with the Commission's overall analysis and determination of comparability of the CFTC Capital Rules and CFTC Financial Reporting Rules and the Japanese Capital Rules and Japanese Financial Reporting Rules.<sup>43</sup> In addition, the FSA submitted a comment letter in support of the Commission's proposal, and recommending several technical amendments to the proposed Comparability Determination and Comparability Order that were corrective or typographical in nature.<sup>44</sup>

Conversely, two commenters disagreed with the CFTC's proposed Comparability Determination and proposed Comparability Order.<sup>45</sup> Better

Markets asserted that the principles-based, holistic approach applied by the Commission, which assesses whether the applicable foreign jurisdiction's capital and financial requirements achieve comparable outcomes to the corresponding Commission requirements, is “insufficiently rigorous, leaving far too much room for inaccurate and unwarranted comparability determinations.”<sup>46</sup>

The Commission does not believe that the principles-based, holistic assessment that it conducted on the comparability of the Japanese Capital Rules and Japanese Financial Reporting Rules with the CFTC Capital Rules and CFTC Financial Reporting Rules was “insufficiently rigorous,” nor does the Commission believe that it left “room for inaccurate and unwarranted comparability determinations.” The principles-based, holistic approach employed in the Comparability Determination was performed in accordance with the substituted compliance assessment framework adopted by the Commission for capital and financial reporting requirements for foreign nonbank SDs and set out in Commission Regulation 23.106. Consistent with this assessment framework, the Commission focused on whether the Japanese Capital Rules and Japanese Financial Reporting Rules are designed with the objective of ensuring overall safety and soundness of the Japanese nonbank SDs in a manner that is comparable with the Commission's overall objective of ensuring the safety and soundness of nonbank SDs.

As stated in the 2022 Proposal, due to the detailed and complex nature of the capital frameworks, differences in how jurisdiction approach and implement the requirements are expected, even among jurisdictions that base their requirements on the principles and standards set forth in the BCBS framework.<sup>47</sup> Furthermore, as discussed in Section I.B. above, when adopting Commission Regulation 23.106, the Commission stated that “its approach to substituted compliance is a principles-based, holistic approach that focuses on whether the foreign regulations are designed with the objectives of ensuring the overall safety and soundness of the [non-US nonbank SD] in a manner that is comparable with the Commission's overall capital and financial reporting requirements, and is not based on a line-by-line assessment or comparison of a foreign jurisdiction's regulatory

requirements with the Commission's requirements.”<sup>48</sup>

The approach and standards set forth in Commission Regulation 23.106, with the focus on “comparable outcomes,” are also consistent with the Commission's precedents of undertaking a principles-based, holistic assessment of the comparability of foreign regulatory regimes for purposes of substituted compliance for cross-border swap transactions. The Commission first outlined its approach to substituted compliance with respect to swaps requirements in 2013, when it issued an Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations.<sup>49</sup> In the Guidance, the Commission stated that “[i]n evaluating whether a particular category of foreign regulatory requirement(s) is comparable and comprehensive to the applicable requirement(s) under the CEA and Commission regulations, the Commission will take into consideration all relevant factors, including but not limited to, the comprehensiveness of those requirement(s), the scope and objectives of the relevant regulatory requirement(s), the comprehensiveness of the foreign regulator's supervisory compliance program, as well as the home jurisdiction's authority to support and enforce its oversight of the registrant.”<sup>50</sup> The Commission emphasized that in this context, “comparable does not necessarily mean identical.”<sup>51</sup> Rather, the Commission stated that it would evaluate whether the home jurisdiction's regulatory requirement is comparable to, and as comprehensive as, the corresponding U.S. regulatory requirement(s).<sup>52</sup> In conducting comparability determinations based on the policy set forth in the Guidance, the Commission noted that the “outcome-based” approach recognizes that “foreign regulatory systems differ and their approaches vary and may differ from how the Commission chose to address an issue, but that the foreign jurisdiction's regulatory requirements nonetheless achieve the regulatory outcome sought to be achieved by a certain provision of the CEA or Commission regulation.”<sup>53</sup>

<sup>42</sup> Letter From Stephen Hall, Legal Director and Securities Specialist, Better Markets (Oct. 7, 2022) (“Better Markets Letter”); Letter from Yuji Yamashita, Deputy Commissioner for International Affairs, FSA (Oct. 7, 2022) (“FSA Letter”); Letter From Philippe Avril, Chair, IBAJ (Oct. 6, 2022) (“IBAJ Letter”); Letter From Stephanie Webster, General Counsel, IIB; Steven Kennedy, Global Head of Public Policy, ISDA; Kyle L. Brandon, Managing Director, Head of Derivatives Policy, SIFMA (collectively, “Associations”) (Oct. 7, 2022) (“Associations Letter”); Letters from William J. Harrington (“Harrington”) (Oct. 7 and Oct. 20, 2022) (“Harrington 10/7/2022 Letter” and “Harrington 10/20/2022 Letter”) The comment letters for the 2022 Proposal are available at: <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7301>.

<sup>43</sup> Associations Letter at p. 1; IBAJ Letter at p. 1.

<sup>44</sup> FSA Letter. In particular, the FSA recommended that the Commission add Article 47 of the FIEA to the list of relevant provisions comprising the Japanese Capital Rules enumerated in proposed Condition 4. FSA Letter at p. 2. The Commission has revised final Condition 4 to that effect.

<sup>45</sup> Better Markets Letter at p. 2; Harrington 10/20/2022 Letter at p. 20.

<sup>46</sup> Better Markets Letter at p. 2.

<sup>47</sup> See 2022 Proposal at 48098.

<sup>48</sup> 85 FR 57462 at 57521.

<sup>49</sup> *Interpretative Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations*, 78 FR 45292 (July 26, 2013) (“Guidance”).

<sup>50</sup> Guidance at 45343.

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> See e.g., *Comparability Determination for the European Union: Certain Entity-Level*

The Commission further elaborated on the required elements of comparability in 2016, when it issued final rules to address the cross-border application of the Commission's margin requirements for uncleared swap transactions. Specifically, the Commission stated that its substituted compliance approach reflects an outcome-based assessment of the comparability of a foreign jurisdiction's margin requirements with the Commission's corresponding requirements.<sup>54</sup> The Commission further stated that it would evaluate the objectives and outcomes of the foreign margin requirements in light of foreign regulator(s)' supervisory and enforcement authority.<sup>55</sup> Consistent with its previously stated position, the Commission recognized that jurisdictions may adopt different approaches to achieving the same outcome and, therefore, the assessment would focus on whether the foreign jurisdiction's margin requirements are comparable to the Commission's in purpose and effect, not whether they are comparable in every aspect or contain identical elements.<sup>56</sup> The Commission's policy thus reflects an understanding that a line-by-line evaluation of a foreign jurisdiction's regulatory regime is not the optimum approach to assessing the comparability of complex structures whose individual components may differ based on jurisdiction-specific considerations, but which achieve the objective and outcomes set forth in the Commission's framework.

With respect to the FSA Application, the process leading to the Comparability Determination involved Commission staff obtaining English language translations of relevant Japanese laws, rules, and regulations cited in the FSA Application from the FSA.<sup>57</sup> Staff verified the assertions and citations contained in the FSA Application regarding the specific Japanese Capital Rules and Japanese Financial Reporting Rules to the relevant English language versions of the Japanese laws, rules, and regulations.<sup>58</sup>

*Requirements*, 78 FR 78923 (December 27, 2013) at 78926.

<sup>54</sup> *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements*, 81 FR 34817, 34836–34837 (May 31, 2016).

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> Commission staff received English translations on May 11, 2021.

<sup>58</sup> Staff also reviewed the FSA website to confirm various provisions of Japanese laws and regulations that were relevant to the proposed Comparability Determination and proposed Comparability Order.

Commission staff also evaluated the comparability of the Japanese Capital Rules and Japanese Financial Reporting Rules with the CFTC Capital Rules and CFTC Financial Reporting Rules with respect to the following areas: (i) the process of establishing minimum capital requirements for Japanese nonbank SDs and how such process addresses risk, including market risk and credit risk of the Japanese 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 a Japanese nonbank SD's minimum capital requirements; (iii) the financial reports and other financial information submitted by a Japanese nonbank SD to the FSA, and whether such information provides the FSA with the means necessary to effectively monitor the financial condition of the Japanese nonbank SD; and (iv) the regulatory notices and other communications between a Japanese nonbank SD and the FSA that address potential adverse financial or operational issues that may impact the firm.<sup>59</sup> With respect to the ability of the FSA to supervise and enforce compliance with the Japanese Capital Rules and Japanese Financial Reporting Rules, the Commission's assessment included a review of the FSA's surveillance program for monitoring Japanese nonbank SDs compliance with Japanese Capital Rules and Japanese Financial Reporting Rules, and the disciplinary process imposed on firms that fail to comply with such requirements.<sup>60</sup>

Contrary to the position articulated by Better Markets regarding the nature of the comparability assessment, the Commission believes that the principles-based, holistic assessment of the Japanese Capital Rules and Japanese Financial Reporting Rules against the CFTC Capital Rules and CFTC Financial Reporting Rules, as outlined above and discussed in detail in Section II below, was sufficiently rigorous for purposes of determining if the Japanese laws and regulations are comparable in purpose and effect to the CEA and Commission regulations.

Better Markets further asserted that even under a principles-based, holistic approach, the FSA capital and financial reporting requirements for Japanese nonbank SDs do not satisfy the test for an order granting substituted compliance because the FSA's regulatory framework governing capital and financial reporting is not comparable to the corresponding CFTC

requirements.<sup>61</sup> Better Markets cited the Commission's inclusion of conditions in the proposed Comparability Order as demonstrating the Commission's need "to compensate for the acknowledged obvious gaps in the FSA framework."<sup>62</sup> Better Markets further stated that the differences between the Japanese and the CFTC capital and financial reporting regimes mandate denial of the FSA Application for a comparability determination.<sup>63</sup>

The Commission disagrees that the inclusion of conditions in the Comparability Order precludes a finding of comparability with respect to the Japanese Capital Rules and Japanese Financial Reporting Rules. The Commission's comparability assessment process, consistent with the holistic approach, contemplates the potential need for a Comparability Order to contain conditions. Specifically, Commission Regulation 23.106(a)(5) states that the Commission may impose any terms and conditions it deems appropriate in issuing a Comparability Order, including conditions with respect to capital adequacy and financial reporting requirements of non-U.S. nonbank SDs.<sup>64</sup>

The process employed in this Comparability Determination is consistent with the Commission's established approach to conducting comparability assessments. Upon a finding of comparability, the Commission's policy generally is that eligible entities may comply with a substituted compliance regime subject to the conditions the Commission places on its finding, and subject to the Commission's retention of its examination authority and its enforcement authority.<sup>65</sup> In this regard, the Commission has stated that certain conditions included in a Comparability Order may be designed to ensure the

<sup>61</sup> Better Markets Letter at p. 2.

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> 17 CFR 23.106(a)(5), which provides that in issuing a Capital Comparability Determination, the Commission may impose *any terms and conditions it deems appropriate*, including certain capital adequacy and financial reporting requirements on swap dealers. . . (Emphasis added). Commission Regulation 23.106(a)(3) establishes the Commission's standard of review for performing a Comparability Determination and provides that the Commission may consider all relevant factors, including whether the relevant foreign jurisdiction's capital adequacy and financial reporting requirements achieve comparable outcomes to the Commission's corresponding capital adequacy and financial reporting requirements for SDs. 17 CFR 23.106(a)(3)(ii).

<sup>65</sup> 85 FR 57462 at 57520. See also Guidance at 45342–45344 and *Comparability Determination for the European Union: Certain Transaction Level Requirements*, 78 FR 78878 (December 27, 2013) at 78880.

<sup>59</sup> 2022 Proposal at 48098–48112.

<sup>60</sup> *Id.* at 48112–48113.

Commission's direct access to books and records required to be maintained by an SD registered with the Commission.<sup>66</sup> Other conditions may address areas where the foreign jurisdiction lacks analogous requirements.<sup>67</sup> The inclusion of conditions in a Comparability Order was contemplated as an integral part of the Commission's holistic, principle-based approach to conducting comparability assessments and is not inconsistent with a grant of substituted compliance. In particular, Commission Regulation 23.106(a)(5) states the Commission's authority to impose conditions in issuing a Comparability Determination in connection with the CFTC Capital Rules and the CFTC Financial Reporting Rules. As further discussed below, the conditions proposed in the 2022 Proposal are clearly of the nature contemplated by Commission Regulation 23.106(a)(5).

The Commission also does not believe that the inclusion of the conditions in the proposed Comparability Order demonstrates "obvious gaps in the FSA framework" as asserted by Better Markets. Consistent with the Commission's policy described above, a majority of the conditions contained in the proposed Comparability Order are designed to ensure that: (i) the Japanese nonbank SD is eligible for substituted compliance based on the Japanese laws and regulations that were reviewed by the Commission in performing the comparability assessment, and (ii) the Commission and the NFA receive timely financial information and notices to effectively monitor a Japanese nonbank SD's compliance with the Comparability Order and to assess the ongoing safety and soundness of the Japanese nonbank SD. Specifically, there are 23 conditions in the final Comparability Order. Four conditions set forth criteria that a Japanese nonbank SD must meet to be eligible for substituted compliance pursuant to the Comparability Order.<sup>68</sup> The four conditions ensure that only Japanese nonbank SDs that are within the scope of, and comply with, the Japanese Capital Rules and Japanese Financial Reporting Rules that were part of the Commission's comparability

assessment may apply for substituted compliance. Eight additional conditions require Japanese nonbank SDs within scope of the Comparability Order to provide notice to the Commission and NFA of certain defined events,<sup>69</sup> and a further three conditions require Japanese nonbank SDs to file with the Commission and NFA copies of certain unaudited and audited financial reports that the firms provide to the FSA.<sup>70</sup> In addition, two additional conditions reflect administrative matters necessary to implement the substituted compliance framework.<sup>71</sup> Lastly, five

<sup>69</sup> The eight conditions require a Japanese nonbank SD to provide notice to the Commission in the event that the firm: (i) is informed by the FSA that it failed to comply with any component of the Japanese Capital Rules or Japanese Financial Reporting Rules (Condition 15); (ii) fails to maintain regulatory capital in the form of Basic Items of at least the equivalent of \$20 million (Condition 16); (iii) its capital adequacy ratio is below the early warning level of 140 percent (Condition 17); (iv) its capital adequacy ratio is below the minimum requirement of 120 percent (Condition 18); (v) fails to make or keep current financial books and records (Condition 19); (vi) fails to post or collect margin for uncleared swaps and non-cleared security-based swaps with one or more counterparties in amounts that exceed defined limits (Condition 20); (vii) changes its fiscal year-end date (Condition 21); and (viii) is subject to material changes to the Japanese Capital Rules, Japanese Financial Reporting Rules, or the supervisory authority of the Japanese Commission (Condition 22).

<sup>70</sup> The three conditions provide that a Japanese nonbank SD must file with the Commission and NFA: (i) English language copies of certain financial reporting forms that the Japanese nonbank SD is required to submit to the FSA pursuant to Article 56–2(1) of the FIEA (Condition 8); (ii) an English language copy of the annual business report that the Japanese nonbank SDs is required to submit to the FSA pursuant to Article 46–3(1) of the FIEA and Article 172 of the COO (Condition 9); and (iii) English language copies of the Japanese nonbank SD's annual audited financial statements and management report that are required to be prepared pursuant to Article 435(2) of the Japanese Companies Act (Act No. 86 of 2005) (Condition 10).

<sup>71</sup> One of the administrative conditions provides that a Japanese nonbank SD must provide a notice to the Commission of its intent to comply with the Comparability Order and the Japanese Capital Rules and Japanese Financial Reporting Rules in lieu of the CFTC Capital Rules and CFTC Financial Reporting Rules. The notice must include the Japanese nonbank SD's representation that the firm is organized and domiciled in Japan, is a registered FIBO, and is subject to and complies with the Japanese Capital Rules and the Japanese Financial Reporting Rules (Condition 6). The second administrative condition provides that a Japanese nonbank SD must file any documents with the Commission and NFA via electronic transmission (Condition 23). With respect to Condition 6, the Commission also notes that the language of the proposed condition required that a Japanese nonbank SD provide a notice of its intent to comply with "applicable" Japanese Capital Rules and Japanese Financial Reporting Rules. Given that "Japanese Capital Rules and Japanese Financial Reporting Rules" is a term defined in the Comparability Order to include laws and regulations that apply to Japanese nonbank SDs, the word "applicable" is superfluous and is, therefore, not included in final Condition 6 of the Comparability Order.

conditions impose obligations on Japanese nonbank SDs that align with certain of the Commission's requirements for nonbank SDs. The five conditions require a Japanese nonbank SD to: (i) maintain a minimum level of capital defined as Basic Items<sup>72</sup> in an amount equivalent to at least \$20 million (Condition 5); (ii) prepare and keep current financial books and records (Condition 7); (iii) file a monthly schedule of the firm's financial positions on Schedule 1 of appendix B to Subpart E of part 23 of the Commission's regulations (Condition 11); (iv) file a monthly report listing the custodians holding margin posted by, and collected by, the Japanese nonbank SD, the amount of margin held by each custodian, and the aggregate amount of margin required to be posted and collected by the Japanese nonbank SD (Condition 13); and (v) submit, with each filing of financial information, a statement by an authorized representative that, to the best knowledge and belief of the person making the representation, the information is true and correct (Condition 14).<sup>73</sup>

As the substance of these conditions demonstrates, the primary objective of a majority of the conditions is not to compensate for regulatory gaps in the Japanese capital and financial reporting framework, but rather to ensure that the Commission and NFA receive information to conduct ongoing monitoring of Japanese nonbank SDs for compliance with relevant capital and financial reporting requirements. As discussed above, in issuing the Comparability Order, the Commission is not ceding its supervisory and enforcement authorities. The Comparability Order permits Japanese nonbank SDs to satisfy the Commission's capital and financial reporting requirements by complying with certain laws and/or regulations of Japan that have been found comparable to the Commission's laws and/or regulations in purpose and effect. The Commission and NFA, however, have a continuing obligation to conduct

<sup>72</sup> "Basic Items" are analogous to common equity tier 1 capital as defined in the CFTC Capital Rules. See discussion in section II.B.

<sup>73</sup> Another condition specifies that Japanese nonbank SDs that are registered with the U.S. Securities and Exchange Commission ("SEC") as security-based swap dealers ("SBSDs") and required to file with the SEC, or its designee, Form X-17A-5 ("FOCUS Report"), must file a copy of such FOCUS Report with the Commission and NFA within 35 calendar days after the end of each month (Condition 12). A Japanese nonbank SD that files a FOCUS Report pursuant to Condition 12 will not be required to file the reports and schedules specified in Conditions 8 and 11. Currently, no Japanese nonbank SD is registered as a SBSB.

<sup>66</sup> *Comparability Determination for the European Union: Certain Transaction Level Requirements*, 78 FR 78878 (December 27, 2013) at 78880.

<sup>67</sup> Guidance at 45343.

<sup>68</sup> The four criteria provide that the Japanese nonbank SD: (i) is not subject to capital rules of a U.S. prudential regulator (Condition 1); (ii) is organized and domiciled in Japan (Condition 2); (iii) is registered as a FIBO (Condition 3); and (iv) is subject to the Japanese Capital Rules and Japanese Financial Reporting Rules that are part of the Commission's comparability assessment (Condition 4).

ongoing oversight, including potential examination, of Japanese nonbank SDs to ensure compliance with the Comparability Order, including its conditions. To that effect, the notice and financial reporting conditions set forth in the Comparability Order provide the Commission and NFA with information necessary to monitor for such compliance, and to evaluate the operational condition and ongoing financial condition of Japanese nonbank SDs. The Commission may also initiate an enforcement action against a Japanese nonbank SD that fails to comply with the conditions of the Comparability Order.<sup>74</sup>

Furthermore, to the extent that a condition imposes a new obligation on Japanese nonbank SDs, the imposition of such condition is also consistent with Commission Regulation 23.106 and the Commission's established policy with regard to comparability determinations. As discussed above, the Commission contemplated that even in circumstances where the Commission finds two regulatory regimes comparable, the Commission may impose requirements on entities relying on substituted compliance where the Commission determines that the home jurisdiction's regime lacks comparable and comprehensive regulation on a specific issue.<sup>75</sup> The Commission's authority to impose such conditions is set out in Commission Regulation 23.106(a)(5), which states that the Commission may impose "any terms and conditions it deems appropriate, including certain capital adequacy and financial reporting requirements [on SDs]."<sup>76</sup>

Better Markets further stated that if the Commission grants substituted compliance with regard to materially different regulatory requirements, it must make a well-supported comparability determination by, at a minimum, clearly and specifically

setting forth the desired regulatory outcome and providing a detailed, evidence-based explanation as to how the jurisdiction's different legal requirements nonetheless lead to a comparable regulatory outcome.<sup>77</sup> Better Markets also stated that if the Commission grants the Comparability Determination and Comparability Order, it must, at a minimum, ensure that the conditions are applied and enforced with full force and without exception or dilution.<sup>78</sup> Better Markets asserted that "[a] determination that a foreign jurisdiction's nonbank SDs rules would produce comparable regulatory outcomes is the beginning, not the end, of the CFTC's obligation to ensure that the activities of the foreign nonbank SD entities do not pose risks to the U.S. financial system. As time goes on, regulatory requirements that, in theory, are expected to produce one regulatory outcome may, in practice, produce a different one. And, of course, the regulatory requirements may themselves be changed in a variety of ways. Finally, the effectiveness of an authority's supervision and enforcement program can become weakened for any number of reasons—the CFTC cannot assume that an enforcement program that is presently effective will continue to be effective."<sup>79</sup> Better Markets further asserted that to fulfill its obligation to protect the U.S. financial system, the Commission must ensure, on an ongoing basis, that each grant of substituted compliance remains appropriate over time by, at a minimum, requiring each Comparability Order to impose an obligation on the applicant, as appropriate, to: (i) periodically apprise the Commission of the activities and results of its supervision and enforcement programs, to ensure that they remain sufficiently robust to deter and address violations of the law; and (ii) immediately apprise the Commission of any material changes to the regulatory regime, including changes to rules or interpretations of rules.<sup>80</sup>

Although the Commission disagrees that the Japanese Capital Rules and the Japanese Financial Reporting Rules, as a whole, are materially different or do not achieve comparable regulatory outcomes, the Commission concurs that granting substituted compliance should be the result of a well-supported comparability assessment. Consistent with that view, the Commission believes that this final Comparability

Determination articulates the Commission's analysis in sufficient detail and provides an appropriate explanation of how the foreign jurisdiction's requirements are comparable in purpose and effect with the Commission's requirements, and lead to comparable regulatory outcomes with the Commission's requirements. Specifically, Section III of the 2022 Proposal and Section II of the final Comparability Determination reflect, among other observations, the Commission's detailed analysis with respect to each of the elements for consideration listed in Commission Regulation 23.106(a)(3).

The Commission also concurs that the availability of substituted compliance is conditioned upon a non-US nonbank SD's ongoing compliance with the terms and conditions of the final Comparability Order, and the Commission's ongoing assessment that the Japanese Capital Rules and Japanese Financial Reporting Rules remain comparable in purpose and effect with the CFTC Capital Rules and CFTC Financial Reporting Rules. As noted above, and discussed in more detail in Sections II.D. and E. below, Japanese nonbank SDs are subject to notice and financial reporting requirements under the final Comparability Order that provide Commission and NFA staff with the ability to monitor the Japanese nonbank SDs' ongoing compliance with the conditions set forth in the final Comparability Order. In addition, the final Comparability Order requires Japanese nonbank SDs or the FSA to inform the Commission of changes to the relevant Japanese Capital Rules and Japanese Financial Reporting Rules so that the Commission may assess the continued effectiveness of the Comparability Order in ensuring that the Japanese laws and regulations have the comparable regulatory objectives of the CEA and Commission regulations of ensuring the safety and soundness of nonbank SDs.<sup>81</sup> Commission staff will also monitor the Japanese nonbank SDs directly as part of its supervisory program and will discuss with the firms any proposed or pending revisions to specific laws and rules cited in the final

<sup>81</sup> Condition 22 of the final Comparability Order requires Japanese nonbank SDs or the FSA to notify the Commission of any material changes to the information submitted in the FSA Application, including, but not limited to, proposed and final material changes to the Japanese Capital Rules or Japanese Financial Reporting Rules and proposed and final material changes to the FSA's supervisory authority or supervisory regime over Japanese nonbank SDs. The Commission notes that it also made certain non-substantive, clarifying changes to the language of final Condition 22 as compared to the proposed condition.

<sup>74</sup> As the Commission stated in the 2022 Proposal, a non-U.S. nonbank SD that operates under a Comparability Order issued by the Commission remains subject to the Commission's examination and enforcement authority. Specifically, the Commission may initiate an enforcement action against a non-U.S. nonbank SD that fails to comply with its home-country capital adequacy and/or financial reporting requirements cited in a Comparability Order. See 2022 Proposal at 48094–48095. See also 17 CFR 23.106(a)(4)(ii), which provides that the Commission may examine all nonbank SDs, regardless of whether the nonbank SDs rely on substituted compliance, and that the Commission may initiate an enforcement action under the Commission's capital and financial reporting regulations against a non-U.S. nonbank SD that fails to comply with a foreign jurisdiction's capital adequacy and financial reporting requirements.

<sup>75</sup> Guidance at 45343.

<sup>76</sup> 17 CFR 23.106(a)(5).

<sup>77</sup> Better Markets at p. 6.

<sup>78</sup> *Id.* at p. 2.

<sup>79</sup> *Id.* at p. 6.

<sup>80</sup> *Id.*



Comparability Order. Lastly, in addition to assessing the effectiveness of the Comparability Order as a result of revisions or proposed revisions to the Japanese laws, regulations, or supervisory regime, the Commission further notes that future material changes to the CFTC Capital Rules or CFTC Financial Reporting Rules, or the Commission's or NFA's supervisory programs, may necessitate an amendment to the Comparability Determination and Comparability Order to reflect those changes.<sup>82</sup>

Another commenter, Harrington, stated that the Commission "must prevent every regulated [SD] globally from providing a swap contract with a "flip clause [ . . . ]."<sup>83</sup> Harrington further recommended that the Commission condition the Comparability Order on specifying that a Japanese nonbank SD that is party to a swap contract with a flip clause must hold additional capital determined based on the required margin and the contract market value.<sup>84</sup> Alternatively, Harrington argued that the Commission should prohibit a Japanese nonbank SD from entering into a new swap contract with a flip clause or extending an existing one.<sup>85</sup> Harrington has elsewhere referred to a description of a "flip clause" as a provision in swap contracts with structured debt issuers that reverses or "flips" the priority of payment obligations owed to the swap counterparty on the one hand and the noteholders on the other, following a specified event of default.<sup>86</sup> Based on Harrington's description, flip clauses present a risk to the SD in synthetic transactions where payments under a swap contract are secured with the same collateral that would serve to cover payments under the notes issued by a structured debt issuer. In such circumstances, an "event of default" by the SD would cause the SD's priority of payment from the collateral under a swap to "flip" to a more junior priority position, including for mark-to-market gains on "in the money" swaps.<sup>87</sup>

Harrington argued that no element of the CFTC Capital Rules or the Japanese Capital Rules addresses "the 100% self-exposure that [an SD] incurs with each

swap with flip clause."<sup>88</sup> Harrington recognized, however, that the CFTC margin requirements for uncleared swap transactions address his concerns associated with the inclusion of a flip clause.<sup>89</sup> Nonetheless, according to Harrington, risks arise in circumstances when non-U.S. margin rules exempt SDs from margin obligations in connection with swaps with a structured debt issuer.<sup>90</sup>

The Commission recognizes that given some definitional differences and differences in the activity thresholds with respect to the scope of application of the CFTC margin requirements and non-U.S. margin requirements, some transactions that are subject to the CFTC margin requirements for uncleared swaps may not be subject to margin requirements in another jurisdiction. In connection with this Comparability Determination, however, the Commission notes that both under the CFTC Capital Rules and the Japanese Capital Rules, uncollateralized exposures from uncleared swap transactions would generate a higher counterparty credit risk charge than the exposures resulting from transactions under which the counterparties have posted collateral.<sup>91</sup> Accordingly, the Commission does not believe that the respective sets of rules adopt a conflicting approach or lead to a disparate outcome with respect to the capital treatment of uncollateralized uncleared swap exposures that would warrant a finding of non-comparability of the CFTC Capital Rules and the Japanese Capital Rules.

With regard to Harrington's general recommendations, also included in a submission by Harrington in connection with the adoption of the CFTC Capital Rules, that the Commission impose additional capital charges for swap contracts with a flip clause,<sup>92</sup> the Commission notes that any change in its

<sup>82</sup> 2022 Proposal at 48098 (n. 72).

<sup>83</sup> Harrington 10/20/2022 Letter at p.3 (noting that the requirement for SDs to post and collect variation margin for swap contracts with a securitization or structured debt issuer "generates the immense benefit of inducing U.S. securitization and structured debt issuers to forswear all swap contracts, both with and without a flip clause").

<sup>84</sup> Harrington 10/20/2022 Letter at p.3 (arguing that "non-U.S. swap margin rules de facto exempt a swap provider from collecting or posting variation margin under a new contract with most securitization and structured debt issuers").

<sup>85</sup> 12 CFR 217.34 and 12 CFR 217.132 (indicating that nonbank SDs may recognize the risk-mitigating effects of financial collateral for collateralized derivatives contracts) and Notice on Capital, Article 15.5, and 15-2.5 (similarly indicating that Japanese nonbank SDs are allowed to recognize the risk-mitigating effect of collateral by deducting the amount of collateral from the exposure at default amount).

<sup>86</sup> Harrington 10/20/2022 Letter at p.24.

capital requirements and approach, if deemed appropriate, would be addressed separately from the Comparability Determination. As the Commission stated in adopting the CFTC Capital Rules, over time the Commission may consider adjusting the capital charges applicable to nonbank SDs that engage in bespoke swap transactions, including contracts involving flip clauses, as a result of its experience and as market developments may warrant.<sup>93</sup> If the Commission proceeds with adjustments to the CFTC Capital Rules, the Commission may reconsider the comparability between the CFTC Capital Rules and the Japanese Capital Rules in light of these changes.

Finally, IBAJ proposed several technical amendments to the 2022 Proposal that were corrective or clarifying in nature.<sup>94</sup> As further discussed below, several of the proposed changes have been incorporated, as appropriate, throughout the final Comparability Determination and Comparability Order.

## II. Final Capital and Financial Reporting Comparability Determination and Comparability Order

The following section provides the Commission's comparative analysis of the Japanese Capital Rules and the Japanese Financial Reporting Rules with the corresponding CFTC Capital Rules and CFTC Financial Reporting Rules, as described in the 2022 Proposal, further modified to address comments received. As emphasized in the 2022 Proposal, the capital and financial reporting regimes are complex structures comprised of a number of interrelated regulatory components.<sup>95</sup> 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 framework.

The Commission performed the analysis by assessing the comparability of the Japanese Capital Rules for Japanese nonbank SDs as set forth in the FSA Application and in the English language translation of certain applicable Japanese laws and regulations with the Commission's Bank-Based Approach for nonbank SDs.

<sup>87</sup> 85 FR 57462 at 57475. As stated in the adopting release to the CFTC Capital Rules, the Commission considered that its rules were appropriately calibrated to account for a wide variety of possible uncleared swap transactions, including bespoke transactions involving flip clauses or other unique features. *See id.*

<sup>88</sup> IBAJ Letter.

<sup>89</sup> *See* 2022 Proposal at 48098.

<sup>82</sup> 2022 Proposal at 48098 (n. 72).

<sup>83</sup> Harrington 10/20/2022 Letter at p. 3.

<sup>84</sup> Harrington 10/20/2022 Letter at p. 23.

<sup>85</sup> *Id.*

<sup>86</sup> William J. Harrington, Submission to the U.S. Securities and Exchange Commission Re: File No. S7-08-12 (Nov. 19, 2018) at p.8.

<sup>87</sup> For additional information on the legal mechanics of a flip clause, *see* Lehman Brothers Special Financing Inc v. Bank of America N.A., No. 18-1079 (2nd Cir. 2020).

The Commission understands that, as of the date of the final Comparability Determination and Comparability Order, the three Japanese nonbank SDs registered with the Commission are subject to a bank-based capital approach under the Japanese Capital Rules. Accordingly, when the Commission makes its final determination herein about the comparability of the Japanese Capital Rules with the CFTC Capital Rules, the determination pertains to the comparability of the Japanese Capital Rules with the Bank-Based Approach under the CFTC Capital Rules. The Commission notes that any material changes to the information submitted in the FSA Application, including, but not limited to, proposed and final material changes to the Japanese Capital Rules or Japanese Financial Reporting Rules, as well as any proposed and final material changes to the FSA's supervisory authority or supervisory regime, will require notification to the Commission and NFA pursuant to Condition 22 of the final Comparability Order.<sup>96</sup> Therefore, if there are subsequent material changes to the Japanese Capital Rules, Japanese Financial Reporting Rules, or the supervisory authority or supervisory regime, the Commission will review and assess the impact of such changes on the final Comparability Determination and Comparability Order as they are then in effect, and may amend or supplement the Comparability Order as appropriate.<sup>97</sup>

#### A. Regulatory Objectives of CFTC Capital Rules and CFTC Financial Reporting Rules and Japanese Capital Rules and Japanese Financial Reporting Rules

##### 1. Preliminary Determination

As reflected in the 2022 Proposal and discussed above, the Commission preliminarily determined that the overall objectives of the Japanese Capital Rules and the CFTC Capital Rules are comparable in that both sets of rules are intended to ensure the safety and soundness of nonbank SDs by establishing regulatory regimes that require 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.<sup>98</sup> The Commission further noted that the Japanese Capital Rules and CFTC Capital Rules are also based on, and consistent with, the BCBS framework, which was designed to ensure that banking entities hold sufficient levels of capital to absorb losses and decreases in the value of firm assets and increases in the value of firm liabilities without the banks becoming insolvent.<sup>99</sup>

The Commission also preliminarily found that the Japanese Capital Rules are comparable in purpose and effect to the CFTC Capital Rules given that both regulatory approaches compute the minimum capital requirements based on the level of a nonbank SD's on-balance sheet and off-balance sheet exposures, with the objective and purpose of ensuring that the nonbank SD's capital is adequate to absorb losses or decreases in the value of firm assets or increases in the value of firm liabilities resulting from such exposures.<sup>100</sup> The Commission observed that the Japanese Capital Rules and CFTC Capital Rules provide for a comparable approach to the calculation of on-balance sheet and off-balance sheet risk exposures using standardized or internal model-based approaches.<sup>101</sup> In addition, as discussed in the 2022 Proposal, the Japanese Capital Rules' and CFTC Capital Rules' requirements for identifying and measuring on-balance sheet and off-balance sheet exposures under standardized or internal model-based approaches are also consistent with the requirements set forth under the BCBS framework for identifying and measuring on-balance sheet and off-balance sheet exposures.<sup>102</sup>

Finally, the Commission preliminarily noted that the Japanese Capital Rules and CFTC Capital Rules further achieve comparable outcomes and are comparable in purpose and effect in that both sets of rules limit the types of capital instruments that qualify as regulatory capital to cover the on-balance sheet and off-balance sheet risk exposures to high quality equity capital and qualifying subordinated debt instruments that meet conditions designed to ensure that the holders of

the debt have effectively subordinated their claims to other creditors of the nonbank SD.<sup>103</sup> As discussed in the 2022 Proposal and in Section II.B. below, both the Japanese Capital Rules and the CFTC Capital Rules define high quality capital by the degree to which the capital represents permanent capital that is contributed, or readily available to a nonbank SD, on an unrestricted basis to absorb unexpected losses, including losses from swaps trading and other activities, without the nonbank SD becoming insolvent.<sup>104</sup>

The Commission further stated that it preliminarily found the Japanese Financial Reporting Rules to be comparable in purpose and effect to the CFTC Financial Reporting Rules as both the FSA and CFTC require nonbank SDs to file 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.<sup>105</sup> As discussed in the 2022 Proposal, in addition to providing the CFTC and FSA with information necessary to comprehensively assess the financial condition of a nonbank SD on an ongoing basis, the financial reports further provide the CFTC and FSA with information regarding potential changes in a nonbank SD's risk profile by disclosing changes in account balances reported over a period of time.<sup>106</sup> Such changes in account balances may indicate, among other things, 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.<sup>107</sup>

In assessing the comparability between the CFTC Financial Reporting Rules and the Japanese Financial Reporting Rules, the Commission noted that 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 FSA in meeting their respective objectives of ensuring the safety and soundness of nonbank SDs. In this regard, the Commission stated that the early identification of potential financial issues provides the Commission and FSA with an opportunity to address such issues with the nonbank SD before they develop to a state where the financial condition of the firm is

<sup>96</sup> Condition 22 of the final Comparability Order. The Commission notes that it made certain non-substantive, clarifying changes to the language of final Condition 22 as compared to the proposed condition.

<sup>97</sup> See 2022 Proposal at 48098. As stated in the 2022 Proposal, the Commission may also amend or supplement the Comparability Order to address any material changes to the CFTC Capital Rules and CFTC Financial Reporting Rules, including rule amendments to capital rules of the Federal Reserve Board that are incorporated into the CFTC capital Rules' Bank-Based Approach under Commission Regulation 23.101(a)(1)(i), that are adopted after the final Comparability Order is issued. See *id.* (fn. 72).

<sup>98</sup> See 2022 Proposal at 48099.

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

<sup>103</sup> *Id.* at 48099–48100.

<sup>104</sup> *Id.*

<sup>105</sup> *Id.* at 48100.

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

impaired such that it may no longer hold a sufficient amount of qualifying regulatory capital to absorb decreases in the value of firm assets, absorb increases in the value of firm liabilities, or cover losses from its business activities, including the firm's swap dealing activities and obligations to swap counterparties.<sup>108</sup>

## 2. Comment Analysis and Final Determination

In response to the Commission's request for comment, Better Markets identified certain differences between the CFTC Capital Rules and CFTC Financial Reporting Rules and the Japanese Capital Rules and Japanese Financial Reporting Rules and stated that the differences mandated denial of the request for a comparability determination.<sup>109</sup> Better Markets further stated that the imposition of conditions to achieve comparability between the regimes implicitly concedes that the regimes are not comparable, and is suboptimal and undesirable, as it creates a set of capital and reporting requirements that Japanese nonbank SDs must abide by and that the Commission must monitor.<sup>110</sup>

As described herein and in the 2022 Proposal, Commission staff has engaged in a detailed, comprehensive study and evaluation of the Japanese capital and financial reporting framework and has confirmed that its understanding of the elements and application of the framework is accurate. The Commission has also concluded, based on its evaluation, that the FSA has a comprehensive oversight program for monitoring Japanese nonbank SD's compliance with relevant Japanese Capital Rules.

Furthermore, as discussed in Section I.E. above, the conditions set forth in the Comparability Order are generally intended to ensure that: (i) only Japanese nonbank SDs that are subject

to the laws and regulations assessed under the Comparability Determination are eligible for substituted compliance; (ii) the Japanese nonbank SDs are subject to supervision by the FSA; and (iii) the Japanese nonbank SDs provide information to the Commission and NFA that is relevant to the ongoing supervision of their operations and financial condition. Considering this thorough analysis and the ongoing requirement for Japanese nonbank SDs to provide information to the Commission and NFA demonstrating compliance with the Comparability Order, the Commission is confident that it is capable of effectively conducting, together with NFA, appropriately tailored oversight of the Japanese nonbank SDs. In light of the Commission's ultimate conclusion that the Japanese capital and financial reporting requirements are comparable based on the standards articulated in Commission Regulation 23.106(a)(3), the Commission believes that a failure to issue a Comparability Determination and Comparability Order would in fact be "suboptimal and undesirable" as it would impose duplicative requirements that would result in increased costs for registrants and market participants without a commensurate benefit from an oversight perspective.

As discussed in Sections I.B. and E. above, and detailed herein, the Commission finds that the CFTC Capital Rules and Financial Reporting Rules and the Japanese Capital Rules and Financial Reporting Rules are comparable in purpose and effect, and have overall comparable objectives, notwithstanding the identified differences. In this regard, the Commission notes that instead of conducting a line-by-line assessment or comparison of the Japanese Capital and Japanese Financial Reporting Rules and the CFTC Capital and CFTC Financial Reporting Rules, it has applied in the assessment set forth in this determination and order, a principles-based, holistic approach in assessing the comparability of both regimes, consistent with the standard of review it adopted in Commission Regulation 23.106(a)(3). Based on that principles-based, holistic assessment, the individual elements of which are described in more detail in Sections II.B. through II.F. below, the Commission has determined that both sets of rules are designed to ensure the safety and soundness of nonbank SDs and achieve comparable outcomes. As such, the Commission adopts the Comparability Determination and Comparability Order as proposed with respect to the analysis

of the regulatory objectives of the CFTC Capital Rules and Financial Reporting Rules and the Japanese Capital and Financial Reporting Rules.

## B. Nonbank Swap Dealer Qualifying Capital

### 1. Preliminary Determination

As discussed in the 2022 Proposal, the Commission preliminarily determined that the Japanese Capital Rules are comparable in purpose and effect to 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.<sup>111</sup> The Commission explained that the Japanese Capital Rules and the CFTC Capital Rules for nonbank SDs both require a nonbank SD to maintain a quantity of high-quality and permanent capital 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 firm assets and increases in the value of firm liabilities without resulting in the firm becoming insolvent.<sup>112</sup> The Commission observed that the Japanese Capital Rules and the CFTC Capital Rules permit nonbank SDs to recognize comparable forms of equity capital and qualifying subordinated debt instruments toward meeting minimum capital requirements, with both the Japanese Capital Rules and the CFTC Capital Rules emphasizing high quality capital instruments.<sup>113</sup>

In support of its preliminary Comparability Determination, the Commission noted that 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.<sup>114</sup> 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 that is last in line to receive distributions in the event of the entity's insolvency.<sup>115</sup> Additional tier 1 capital is generally composed of

<sup>111</sup> See 2022 Proposal at 48101.

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

<sup>114</sup> 17 CFR 23.101(a)(1)(i) and 2022 Proposal at 48100. 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.

<sup>115</sup> 12 CFR 217.20(b).

<sup>108</sup> *Id.*

<sup>109</sup> Better Markets Letter at pp. 7–11. For example, Better Markets asserts that while the CFTC requires non-bank SDs to hold qualifying capital in an amount equal to at least 8 percent of the nonbank SDs uncleared swap margin amount, Japan's capital rules are based on an "arbitrary percentage" of a company's operating expenses. Better Markets also asserted that while the CFTC's capital rules require nonbank SDs to "maintain regulatory capital in the form of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital, Japan's capital rules require nonbank SDs to maintain a "capital adequacy amount" in the form of "Basic Items and Supplemental Items" and that the Japanese framework has no dollar minimum capital requirement. These distinctions between the CFTC Capital Rules and Financial Reporting Rules, and the Japanese Capital and Financial Reporting Rules are discussed in detail in sections II.C. and II.B., respectively, below.

<sup>110</sup> *Id.*

equity instruments such as preferred stock and certain hybrid securities that may be converted to common stock if triggering events occur and may have a preference in distributions over common equity tier 1 capital in the event of an insolvency.<sup>116</sup> Total tier 1 capital is composed of common equity tier 1 capital and further includes additional tier 1 capital. Tier 2 capital includes certain types of instruments that include both debt and equity characteristics such as qualifying subordinated debt.<sup>117</sup> Subordinated debt must meet certain conditions to qualify as tier 2 capital under the CFTC Capital Rules.<sup>118</sup>

The preliminary Comparability Determination also noted that the Japanese Capital Rules require each Japanese nonbank SD to maintain a “capital adequacy amount” (*i.e.*, an aggregate of Basic Items and Supplemental Items, after deducting carrying value of fixed assets, with Basic Items representing at least 50 percent of the total capital adequacy amount)<sup>119</sup> that equals or exceeds 120 percent of the firm’s “risk equivalent amount,” which is the sum of the firm’s market risk, credit risk, and basic risk.<sup>120</sup> Basic Items are composed of the Japanese nonbank SD’s balance sheet capital, including: (i) issued and outstanding shares; (ii) the payment for an application for new shares; (iii) the capital surplus; (iv) the earned surplus; (v) the negative valuation difference on available-for-sale securities; and (vi) the firm’s own treasury stock.<sup>121</sup> Supplemental Items include the positive valuation difference on available-for-sale securities and certain subordinated debt instruments.<sup>122</sup> Subordinated debt

instruments also must meet certain conditions to qualify as Supplemental Items under the Japanese Capital Rules, including containing appropriate provisions subordinating the rights of the lender to the payment of principal and interest to other creditors of the Japanese nonbank SD.<sup>123</sup> In addition, any accelerated payment of the subordinated debt may only be made on a voluntarily basis by the Japanese nonbank SD after obtaining approval from the FSA.<sup>124</sup>

Based on its comparative assessment, the Commission preliminarily found that the types and characteristics of the equity instruments included in Basic Items under the Japanese Capital Rules are comparable to the types and characteristics of equity instruments comprising common equity tier 1 capital and additional tier 1 capital under the CFTC Capital Rules.<sup>125</sup> Specifically, the Commission noted that the Japanese Capital Rules’ Basic Items and the CFTC Capital Rules’ common equity tier 1 capital and additional tier 1 capital are comparable in that these forms of equity capital have similar characteristics (*e.g.*, the equity must be in the form of high-quality, committed, and permanent capital) and represent contributed equity capital that generally has no priority to the distribution of firm assets or income with respect to other shareholders or creditors of the firm, which allows a nonbank SD to use this equity to absorb decreases in the value of firm assets, absorb increases in the value of firm liabilities, and cover losses from business activities, including the firm’s swap dealing activities.<sup>126</sup>

The Commission also found the Supplemental Items under the Japanese Capital Rules to be comparable to tier 2 capital under the CFTC Capital Rules.<sup>127</sup> Specifically, the Commission noted that the qualifying conditions imposed on subordinated debt instruments are comparable under the Japanese Capital Rules and the CFTC Capital Rules in that they are designed to ensure that the debt has qualities supporting its recognition by a nonbank SD as equity for capital purposes, including by effectively subordinating the lenders’ claims for repayment on the debt, or interest payments on the debt, to the claims of other creditors of the nonbank SD, and by limiting or restricting repayment or accelerated payments of the subordinated loans if such repayments or accelerated prepayments

would result in the nonbank SD’s equity falling below certain defined thresholds.<sup>128</sup> The Commission preliminarily concluded that the terms and conditions provided assurances that the subordinated debt was appropriate to be recognized as regulatory capital available to a nonbank SD to meet its regulatory obligations and to absorb business losses and decreases in the value of firm assets and increases in the value of firm liabilities.<sup>129</sup>

The Commission also noted that the Japanese Capital Rules differ from the CFTC Capital Rules in that the Japanese Capital Rules require Japanese nonbank SDs to exclude the carrying value of fixed assets from the sum of the Basic Items and Supplemental Items in computing the capital adequacy amount, whereas the CFTC Capital Rules do not require a nonbank SD to exclude the carrying value of fixed assets from the firm’s common equity tier 1 capital or additional tier 1 capital.<sup>130</sup> As discussed in the 2022 Proposal, the deduction of the carrying value of fixed assets under the Japanese Capital Rules is a more conservative standard as it imposes an obligation on Japanese nonbank SDs to meet minimum regulatory capital requirements with capital that reflects or represents balance sheet assets that are more liquid than fixed assets.<sup>131</sup>

## 2. Comment Analysis and Final Determination

In response to the Commission’s request for comment on the qualifying capital analysis, Better Markets objected to the Commission’s determination that the Japanese Capital Rules are comparable to the CFTC Capital Rules with respect to the type and characteristics of equity that qualifies as regulatory capital.<sup>132</sup> Better Markets asserted that the Commission did not adequately analyze the differences between the two regulatory regimes with respect to the items of qualifying capital.<sup>133</sup> More specifically, Better Markets stated that Basic Items under the Japanese Capital Rules include treasury stock, whereas, under the CFTC Capital Rules, which are based on definitions of capital from the Federal

<sup>116</sup> 12 CFR 217.20(c).

<sup>117</sup> 12 CFR 217.20(d).

<sup>118</sup> Subordinated debt must meet requirements set forth in SEC Rule 18a–1d. 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. 17 CFR 23.101(a)(1)(i)(B) and 17 CFR 240.18a–1d.

<sup>119</sup> See 2022 Proposal at 48100. The phrase “after deducting carrying value of fixed assets” has been added after “Supplemental Items” in response to a technical comment by IBAJ. IBAJ Letter at p. 5. As the Commission explained in the 2022 Proposal, the deduction of the carrying value of fixed assets is a conservative approach to the computation of a Japanese nonbank SD’s capital adequacy amount as it excludes the value of non-liquid fixed assets from the firm’s total Basic Items. See 2022 Proposal at 48101.

<sup>120</sup> Article 46–6(2) of the FIEA, Article 176 of the COO and section IV–2–1 (Preciseness of Capital Adequacy Ratio) of the Supervisory Guidelines for FIBO.

<sup>121</sup> Article 176(1)(i) through (vi) of the COO.

<sup>122</sup> Article 176(1)(vii) of the COO.

<sup>123</sup> Article 176(2) and (3) of the COO.

<sup>124</sup> *Id.*

<sup>125</sup> See 2022 Proposal at 48101.

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> The IBAJ noted that the Japanese Capital Rules require the carrying value of fixed assets to be deducted from both Basic Items and Supplemental Items (and not just Basic Items as stated in the 2022 Proposal). The Commission has incorporated this clarification into the final Comparability Determination. IBAJ Letter at p. 5.

<sup>131</sup> See Article 177 of the COO for a breakdown of the fixed assets to be deducted.

<sup>132</sup> Better Markets Letter at p. 9.

<sup>133</sup> *Id.* at p. 8.

Reserve Board, common equity tier 1 capital is net of treasury stock.<sup>134</sup>

The Commission recognizes that the Japanese Capital Rules list treasury stock, which represents previously issued shares of stock that have been repurchased by the firm, as a Basic Item.<sup>135</sup> In application of the Japanese Rules of Corporate Accounting, however, treasury stock must be deducted from the shareholders' equity component of the firms' balance sheet.<sup>136</sup> As such, consistent with the treatment received under the CFTC Capital Rules, the treasury stock is not counted towards the Japanese nonbank SD's Basic Items or Supplemental Items in meeting its minimum regulatory capital requirement. Accordingly, the Commission does not find that the CFTC Capital Rules and the Japanese Capital Rules diverge with respect to their respective approach to exclude treasury stock from regulatory capital.

In addition, upon further analysis, the Commission not only reiterates its observations that the Japanese Capital Rules' Basic Items present characteristics that are comparable to the characteristics of common equity tier 1 and additional tier 1 capital, but the Commission further concludes that, despite certain definitional differences, the Japanese Capital Rules' Basic Items are more closely equated to common equity tier 1 capital. In particular, the Basic Items' categories of "issued and outstanding shares," "capital surplus," and "earned surplus," correspond to the CFTC Capital Rules' common equity tier 1 categories of "common stock and related surpluses," and "retained earnings" as the categories represent equity contributions and earnings that have been retained by the nonbank SDs and represent residual ownership interest in the nonbank SDs. Similarly, whereas the CFTC Capital Rules provide for the inclusion of unrealized losses and gains on available-for-sale securities in the common equity tier 1 category of "accumulated other comprehensive income," the Japanese Capital Rules require that the positive valuation of available-for-sale securities (*i.e.*, unrealized gain) be excluded and the negative valuation difference (*i.e.*, unrealized loss) of available-for-sale

securities be included in Basic Items, thus mandating a similar, if not more conservative, treatment for this category of capital items. Finally, as clarified above, the CFTC Capital Rules and the Japanese Capital Rules treat treasury stock consistently for purposes of determining qualifying capital. More generally, the Commission is of the view that the Japanese Capital Rules' Basic Items are comparable to the CFTC Capital Rules' common equity tier 1 items in that both categories represent a more conservative, permanent form of capital that is last in line to receive distributions in the event of the entity's insolvency.

In conclusion, the Commission finds that the Japanese Capital Rules and the CFTC Capital Rules, are comparable in purpose and effect, and achieve comparable regulatory outcomes, with respect to the types of capital instruments that qualify as regulatory capital. Both the Japanese Capital Rules and the CFTC Capital Rules limit regulatory capital to permanent and conservative forms of capital, including common equity, capital surpluses, retained earnings, and subordinate debt where debt holders effectively subordinate their claims to repayment to all other creditors of the nonbank SD in the event of the firm's insolvency. Limiting regulatory capital to the above categories of equity and debt instruments promotes the safety and soundness of the nonbank SD by helping to ensure that the regulatory capital is not withdrawn or converted to other equity instruments that may have rights or priority with respect to payments, such as dividends or distributions in insolvency, over other creditors, including swap counterparties. The Commission, therefore, is adopting the Comparability Order as proposed with respect to the types and characteristics of equity and subordinated debt that qualify as regulatory capital to meet minimum capital requirements under the Japanese Capital Rules.

### C. Nonbank Swap Dealer Minimum Capital Requirement

#### 1. Introduction to Nonbank Swap Dealer Minimum Capital Requirements

As reflected in the 2022 Proposal, 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 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; (iii) 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;<sup>137</sup> and (iv) the amount of capital required by NFA.<sup>138</sup>

In comparison, the Japanese Capital Rules require each Japanese nonbank SD to maintain a "capital adequacy amount" that equals or exceeds 120 percent of the firm's "risk equivalent amount."<sup>139</sup> As explained in the 2022 Proposal, the "capital adequacy amount" is calculated as the Japanese nonbank SD's qualifying balance sheet equity capital in the form of Basic Items and Supplemental Items, after deducting the carrying value of fixed assets from both Basic Items and Supplemental Items.<sup>140</sup> The Commission noted that the Japanese Capital Rules further require that at least 50 percent of the Japanese nonbank SD's capital used to meet the 120 percent minimum requirement must be composed of Basic Items, and any subordinated debt included in Supplemental Items must meet regulatory requirements designed to ensure that the debt is adequately subordinated to claims of other potential creditors of the firm.<sup>141</sup>

#### 2. Preliminary Determination and Comment Analysis

While noting certain differences in the minimum capital requirements and

<sup>137</sup> 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. 17 CFR 23.154.

<sup>138</sup> 17 CFR 23.101(a)(1)(i)(D). *See also* 2022 Proposal at 48101 and 48104. Commission Regulation 23.101(a)(1)(i) sets forth one of the minimum thresholds that a nonbank SD must meet as the "the amount of capital required by a registered futures association." As previously noted, NFA is currently the only entity that is a registered futures association. NFA has adopted the Commission's capital requirements as its own requirements, and has not adopted any additional or stricter minimum capital requirements. *See* NFA rulebook, Financial Requirements section 18 Swap Dealer and Major Swap Participant Financial Requirements, available at [nfa.futures.org](http://nfa.futures.org).

<sup>139</sup> *See* 2022 Proposal at 48103.

<sup>140</sup> *Id.*

<sup>141</sup> *See* 2022 Proposal at 48099 and Article 176(1)(vii) of the COO.

<sup>134</sup> *Id.* at p. 9.

<sup>135</sup> Article 176 of the COO.

<sup>136</sup> Article 76(2) of Rules of Corporate Accounting (Ordinance of the Ministry of Justice No. 13 of February 7, 2006). To account for the accurate treatment of treasury stock, the Commission has revised final Condition 4 of the final Comparability Order to include Article 76 of the Rules of Corporate Accounting to the list of laws comprising the Japanese Capital Rules that a Japanese nonbank SD must comply with under the Comparability Order.

calculation of regulatory capital between the Japanese Capital Rules and the CFTC Capital Rules, the Commission preliminarily found that the Japanese Capital Rules and CFTC Capital Rules achieve, subject to the proposed conditions in the proposed Comparability Determination and proposed Comparability Order, comparable outcomes by requiring a nonbank SD to maintain a minimum level of qualifying regulatory capital and subordinated debt to absorb losses from the firm's business activities, including its swap dealing activities, and decreases in the value of the firm's assets and increases in the firm's liabilities without the nonbank SD becoming insolvent.<sup>142</sup> As further discussed below, the Commission's preliminary finding of comparability was based on a principles-based, holistic comparative analysis of the three minimum capital requirement thresholds of the CFTC Capital Rules' Bank-Based Approach referenced above and the respective elements of the Japanese Capital Rules' requirements.

#### a. Fixed Amount Minimum Capital Requirement

As noted above, 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 equity tier 1 capital. The Commission'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.<sup>143</sup> In contrast, the Japanese Capital Rules do not impose a capital requirement on Japanese nonbank SDs based on a minimum dollar amount.

The Commission expressed the preliminary view that each CFTC-registered nonbank SD should maintain a minimum level of regulatory capital to help ensure that it satisfies its regulatory obligations and meets its financial commitments to swap counterparties and creditors without the firm becoming insolvent.<sup>144</sup> Accordingly, the Commission proposed to condition the Comparability Order to require each Japanese nonbank SD to maintain, at all times, a minimum level of regulatory capital in the form of Basic Items, as

defined in Article 176 of the COO, in an amount denominated in yen that is equivalent to, or greater than, \$20 million in U.S. dollars.<sup>145</sup>

One commenter, Better Markets, argued that the absence of a base level requirement in the Japanese Capital Rules that is equivalent to the CFTC Capital Rules' requirement for each nonbank SD to maintain a minimum of \$20 million of common equity tier 1 capital "demonstrates a fatal lack of comparability."<sup>146</sup> Better Markets further asserted that the Commission's proposed condition requiring that Japanese nonbank SDs maintain a minimum level of regulatory capital of at least \$20 million inadequately compensates for the gap in the Japanese framework.<sup>147</sup> Specifically, Better Markets argued that by allowing Japanese nonbank SD to meet the proposed minimum capital level with Basic Items, which the Commission preliminarily found to be equivalent to the combination of common equity tier 1 and additional tier 1 capital, instead of limiting the qualifying items to the higher form of common equity tier 1 capital, the Commission would impose a materially weaker capital requirement.<sup>148</sup>

As noted above, the Commission recognized the difference between the Japanese Capital Rules and the CFTC Capital Rules with respect to the \$20 million minimum dollar amount of regulatory capital a nonbank SD is required to maintain. The Commission's proposed condition, however, effectively addresses this difference by providing that a Japanese nonbank SD may not avail itself of substituted compliance unless it maintains a minimum of \$20 million of regulatory capital in the form of Basic Items. The imposition of the condition was consistent with the Commission authority under Commission Regulation 23.106(a)(5). Furthermore, as discussed in Section I.E. above, the Commission has stated that entities relying on substituted compliance may be required to comply with certain Commission-imposed requirements in situations where comparable regulations in their home country jurisdiction are deemed to be lacking.<sup>149</sup>

As discussed in Section II.B.2. above, the Commission is also of the view that

<sup>145</sup> *Id.* The Commission also proposed to allow a Japanese nonbank SD to convert the yen-denominated amount of its Basic Items to the U.S. dollar equivalent based on a commercially reasonable and observed exchange rate.

<sup>146</sup> Better Markets Letter at p. 9.

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> Guidance at 45343.

the Japanese Capital Rules' Basic Items are comparable to the CFTC Capital Rules' common equity tier 1 items in that both categories represent a conservative, permanent form of capital that is last in line to receive distributions in the event of the entity's insolvency. Specifically, the capital that may be recognized by a nonbank SD and Japanese nonbank SD to meet its common equity tier 1 capital requirement and Basic Items requirement, respectively, is generally limited to common stock, related common stock surpluses, and retained earnings. As such, the Commission concludes that the requirement for Japanese nonbank SDs to maintain an amount of regulatory capital in the form of Basic Items equal to or in excess of the equivalent of \$20 million will impose a comparable standard to the analogue requirement under the CFTC Capital Rules and will appropriately address the lack of a minimum fixed amount capital requirement under the Japanese Capital Rules.

In conclusion, the Commission finds that the Japanese Capital Rules and the CFTC Capital Rules, with the imposition of the condition for Japanese nonbank SDs to maintain a minimum level of Basic Items in an amount equivalent to at least \$20 million, are comparable in purpose and effect and achieve comparable regulatory outcomes with respect to capital requirements based on a minimum dollar amount. The requirement for a nonbank SD with limited swap dealing or other business activities to maintain a minimum level of regulatory capital equivalent to \$20 million helps to ensure the firm's safety and soundness by allowing it to absorb decreases in firm assets, absorb increases in firm liabilities, and meet obligations to swap counterparties, other creditors, and market participants, without the firm becoming insolvent.

#### b. Minimum Capital Requirement Based on Risk-Weighted Assets

Prong (ii) of the CFTC Capital Rules' minimum capital requirements described above requires each nonbank SD electing the Bank-Based Approach 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.<sup>150</sup> Risk-weighted assets are a nonbank SD's on-balance sheet and off-balance sheet exposures, including market risk and credit risk exposures, and include

<sup>150</sup> 17 CFR 23.101(a)(1)(i)(B).

<sup>142</sup> See 2022 Proposal at 48104.

<sup>143</sup> 85 FR 57462 at 57492.

<sup>144</sup> See 2022 Proposal at 48106.

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 (ii) are based on the Federal Reserve Board's capital requirements for bank holding companies<sup>151</sup> and are consistent with the BCBS framework.<sup>152</sup> 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, absorb increases in the value of the firm's liabilities, and cover unexpected losses resulting from the firm's business activities, including losses resulting from collateralized and uncollateralized defaults from swap counterparties, without the nonbank SD becoming insolvent.<sup>153</sup>

The Japanese Capital Rules contain capital requirements for Japanese nonbank SDs that the Commission preliminarily found comparable in purpose and effect to the requirements in prong (ii) of the CFTC Capital Requirements.<sup>154</sup> Specifically, the Japanese Capital Rules require a Japanese nonbank SD to maintain regulatory capital in an amount equal to or in excess of 120 percent of the firm's risk "risk equivalent amount" (*i.e.*, the firm's risk-weighted assets).<sup>155</sup> A Japanese nonbank SD's "risk equivalent amount" is calculated as the sum of the firm's: (i) market risk equivalent amount (*i.e.*, the amount equivalent to possible risks which may accrue due to fluctuations in the prices of securities and other proprietary assets and

transactions held);<sup>156</sup> (ii) counterparty risk equivalent amount (*i.e.*, the amount equivalent to possible risks which may accrue due to the default in performance of contracts by the counterparties to transactions or any other reason);<sup>157</sup> and (iii) basic risk equivalent amount (*i.e.*, the amount equivalent to possible risk which may accrue in the ordinary course of executing business, such as errors in business handling).<sup>158</sup>

The Commission also preliminarily found that the Japanese Capital Rules and the CFTC Capital Rules are comparable with respect to the approaches used in the calculation of risk-weighted amounts for market risk and credit risk in determining the nonbank SD's risk-weighted assets.<sup>159</sup> In this connection, the Commission noted that both regimes require a nonbank SD to use standardized approaches to compute market risk and credit risk amounts, unless the firm is approved to use internal models.<sup>160</sup>

As the Commission observed, the standardized approaches to calculating risk-weighted asset amounts for market risk and credit risk under both the Japanese Capital Rules and the CFTC Capital Rules 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 finally, (vi) for credit risk exposures, multiplying the sum of net exposures to each counterparty by their corresponding risk factor.<sup>161</sup>

More specifically, with respect to the calculation of standardized risk-weighted asset amounts for market risk, the Commission explained that the CFTC Capital Rules incorporate by reference the standardized market risk charges set forth in Commission

Regulation 1.17 for FCMs and SEC Rule 18a-1 for nonbank security-based swap dealers ("SBSDs").<sup>162</sup> 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 assets, including 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.<sup>163</sup> For example, the CFTC Capital Rules require nonbank SDs to calculate standardized market risk-weighted asset amounts for uncleared swaps based on notional values of the swap positions multiplied by percentages set forth in the applicable rules.<sup>164</sup> In addition, market risk-weighted asset amounts for readily marketable equity securities are calculated by multiplying the fair market value of the securities by 15 percent.<sup>165</sup>

Under the CFTC Capital Rules, the resulting total market risk-weighted asset 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 under prong (ii) of the rules' minimum capital requirements described above. As a result, a nonbank SD is effectively required to hold qualifying regulatory capital equal to or greater than 100 percent of the amount of its market risk exposure amount.<sup>166</sup>

Comparable to the CFTC Capital Rules, the Japanese Capital Rules

<sup>162</sup> See paragraph (3) of the definition of the term *BHC equivalent risk-weighted assets* in 17 CFR 23.100.

<sup>163</sup> 17 CFR 1.17(c)(5) and 17 CFR 240.18a-1(c)(1).

<sup>164</sup> 17 CFR 1.17(c)(5)(iii).

<sup>165</sup> 17 CFR 1.17(c)(5)(v), referencing SEC Rule 15c3-1(c)(2)(vi) (17 CFR 240.15c3-1(c)(2)(vi)).

<sup>166</sup> 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 equals or exceeds 8 percent of its risk-weighted assets. The regulations, however, require the nonbank SD to effectively maintain qualifying capital equal to or in excess of 100 percent of its market risk-weighted assets by requiring the nonbank SD to multiply its market-risk weighted assets by a factor of 12.5. For example, the market risk exposure amount for marketable equity securities with a current fair market value of \$250,000 is \$37,500 (market value of \$250,000 × .15 standardized market risk factor). The nonbank SD is required to maintain regulatory capital equal to or in excess of full market risk exposure amount of \$37,500 (risk exposure amount of \$37,500 × 8 percent regulatory capital requirement equals \$3,000; the regulatory capital requirement is then multiplied by a factor of 12.5, which effectively requires the nonbank SD to hold regulatory capital in an amount equal to at least 100 percent of the market risk exposure amount (\$3,000 × 12.5 factor equals \$37,500)).

<sup>151</sup> 12 CFR 217.10(a)(1). The minimum capital requirement for a bank holding company under the Federal Reserve Board's rules requires bank holding companies to satisfy their 8 percent minimum capital ratio requirement with a minimum of 4.5 percent of common equity tier 1 capital. The CFTC Capital Rules, however, require a nonbank SD to meet its minimum 8 percent capital ratio with at least 6.5 percent of common equity tier 1 capital. 17 CFR 23.101(a)(1)(i)(B).

<sup>152</sup> *Risk-based capital requirements RBC20, Calculation of minimum risk-based capital requirements* (Version effective as of 01 January 2023), published by the BCBS and available here: [https://www.bis.org/basel\\_framework/chapter/RBC/20.htm?inforce=20230101&published=20201126](https://www.bis.org/basel_framework/chapter/RBC/20.htm?inforce=20230101&published=20201126).

<sup>153</sup> See generally 85 FR 57462 at 57530.

<sup>154</sup> See 2022 Proposal at 48105.

<sup>155</sup> See discussion in 2022 Proposal at 48105. The Japanese Capital Rules require a Japanese nonbank SD to maintain a capital adequacy amount that equals or exceeds 120 percent of its "risk equivalent amount." Article 46-6(2) of the FIEA, Article 176 of the COO, and section IV-2-1 (Precision of Capital Adequacy Ratio) of the Supervisory Guidelines for FIBO.

<sup>156</sup> Article 178(1)(i) of the COO and Articles 10 through 14 of the Notice on Capital. The "market risk equivalent amount" corresponds to "market risk" in the CFTC Capital Rules' Bank-Based Approach and the BCBS framework.

<sup>157</sup> Article 178(1)(ii) of the COO and Articles 15 through 15-7 of the Notice on Capital. The "counterparty risk equivalent amount" corresponds to "credit risk" in the BCBS and Bank-Based Approach frameworks.

<sup>158</sup> Article 178(1)(iii) of the COO and Article 16 of the Notice on Capital.

<sup>159</sup> See 2022 Proposal at 48105.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

require a Japanese nonbank SD to calculate its standardized market risk equivalent amount by multiplying specified market risk weights set forth in the Japanese Capital Rules by the notional or market value of the relevant assets and positions.<sup>167</sup> A Japanese nonbank SD is further required to include the full value of its market risk equivalent amount in its aggregate risk equivalent amount, which effectively requires the Japanese nonbank SD to hold qualifying equity capital and subordinated debt in an amount that equals or exceeds 120 percent of the market risk equivalent amount.<sup>168</sup>

With respect to standardized risk-weighted asset amounts for credit risk from non-derivatives positions, the Commission explained that under the CFTC Capital Rules, a nonbank SD must compute its on-balance sheet and off-balance sheet exposures in accordance with the standardized risk-weighting requirements 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.<sup>169</sup> Standardized risk-weighted asset amounts for credit risk are computed by multiplying the amount of the exposure by defined counterparty credit risk factors that range from 0 percent to 150 percent.<sup>170</sup> A nonbank SD with off-balance sheet exposures is required to calculate a risk-weighted asset amount for credit risk by multiplying each exposure by a credit conversion factor that ranges from 0 percent to 100 percent, depending on the type of exposure.<sup>171</sup>

In comparison, the Commission noted that Japanese Capital Rules require a Japanese nonbank SD to calculate its standardized counterparty risk equivalent amount by multiplying its

exposure under a given transaction by the specific risk weight applicable to the counterparty under the provisions of the Japanese Capital Rules.<sup>172</sup> In this regard, the Japanese Capital Rules impose risk weights ranging from 0 percent to 25 percent on exposures to governmental financial institutions, non-governmental financial institutions, general corporations, and individuals.<sup>173</sup> For certain exposures, credit ratings are used to determine the percentage of the counterparty credit risk exposure and, if no credit ratings are available, the Japanese nonbank SD generally applies a 25 percent risk weight.<sup>174</sup> A Japanese nonbank SD is required to include the full amount of the counterparty risk equivalent amount in its aggregate risk equivalent amount.<sup>175</sup> As noted above, a Japanese nonbank SD is also required to maintain a “capital adequacy amount” that equals or exceeds 120 percent of the firm’s “risk equivalent amount.” Therefore, a Japanese nonbank SD is effectively required to maintain an amount of qualifying capital that is equal to or in excess of 120 percent of its credit risk equivalent amount.

With respect to credit risk for derivatives positions, the Commission explained that under the CFTC Capital Rules, a nonbank SD may compute standardized credit risk exposures, using either the current exposure method (“CEM”) or the standardized approach for measuring counterparty credit risk (“SA-CCR”).<sup>176</sup> 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.<sup>177</sup> 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.<sup>178</sup>

In comparison, the Japanese Capital Rules require a Japanese nonbank SD that is not approved to use credit risk models to calculate its exposure using the CEM.<sup>179</sup> Under the CEM, a Japanese nonbank SD calculates its exposures for over-the-counter derivatives using a standardized rules-based approach, and is required to hold an amount of qualifying capital that equals or exceeds 120 percent of the aggregate derivatives exposures.

As discussed in the 2022 Proposal, both the CFTC Capital Rules and the Japanese Capital Rules also provide that, if approved by NFA or the FSA, respectively, nonbank SDs may also use internal models to calculate market and/or credit risk exposures.<sup>180</sup> The Commission noted that the internal market and credit risk models under the Japanese Capital Rules and the CFTC Capital Rules are based on the BCBS framework and preliminarily found that such models must meet comparable quantitative and qualitative requirements covering the same risks, including comparable model risk management requirements.<sup>181</sup> In this regard, the Commission observed that both rule sets address the same types of risk, with similar allowed methodologies, calibrated to similar risk levels and under similar controls.<sup>182</sup> The Commission also noted that the Japanese Capital Rules and the CFTC Capital Rules contain comparable

<sup>178</sup> 12 CFR 217.132(c).

<sup>179</sup> See 2022 Proposal at 48104.

<sup>180</sup> *Id.* at 48102–48104.

<sup>181</sup> *Id.* For a discussion of the qualitative and quantitative requirements that models must meet under the CFTC Capital Rules and the Japanese Capital Rules, see 2022 Proposal at 48102–48103 and 48104, respectively. In this context, the Commission notes that, as emphasized by IBAJ, the expected exposure method is the only internal model allowed for purposes of calculating credit risk under the Japanese Capital Rules. IBAJ Letter at pp. 5–6. The Commission had erroneously indicated, in referring to credit risk models under the Japanese Capital Rules, that internal credit risk models can also further include estimation of the likelihood of default of counterparties and that credit risk models may include internal ratings based on the estimation of default probabilities, consistent with the Basel framework and subject to the same model risk management guidelines. 2022 Proposal at 48098 and 48104. The Commission hereby rectifies its summary of the relevant Japanese Capital Rules and specifies that these statements do not apply to credit risk models under the Japanese Capital Rules. The Commission, however, maintains its conclusion that model requirements under the CFTC Capital Rules and the Japanese Capital Rules are comparable.

<sup>182</sup> See 2022 Proposal at 48105.

<sup>167</sup> See 2022 Proposal at 48103.

<sup>168</sup> *Id.* Using the example above, if the market risk exposure amount for the equity securities under the Japanese Capital Rules was calculated to be \$37,500, the Japanese nonbank SD would be required to hold an amount of regulatory capital equal to or in excess of \$45,000 (market risk exposure amount of \$37,500 × 120 percent).

<sup>169</sup> 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. See also 2022 Proposal at 48102.

<sup>170</sup> 12 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 percent is applied to exposures to the U.S. government, the Federal Reserve Bank, and U.S. government agencies (12 CFR 217.32(a)(1)), and a credit risk factor of 100 percent is assigned to an exposure to foreign sovereigns that are not members of the Organization of Economic Co-operation and Development (12 CFR 217.32(a)(2)). See also discussion in 2022 Proposal at 48102.

<sup>171</sup> 12 CFR 217.33. See also discussion in 2022 Proposal at 48102.

<sup>172</sup> See 2022 Proposal at 48103–48104.

<sup>173</sup> Article 15(3) of the Notice on Capital. See also discussion in 2022 Proposal at 48104.

<sup>174</sup> *Id.*

<sup>175</sup> *Id.*

<sup>176</sup> 17 CFR 217.34 and 17 CFR 23.100 (defining the term *BHC risk-weighted assets* and providing 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 with respect to the use of a calculation approach under the Federal Reserve Board’s capital rules). See also discussion in 2022 Proposal at 48102.

<sup>177</sup> 12 CFR 217.34.



requirements for the management of model risk, which depend on a series of controls, including the independence of validation, ongoing monitoring and audit.

In addition, the Japanese Capital Rules require a Japanese nonbank SD to calculate a basic risk equivalent amount (*i.e.*, an operational risk exposure amount) as a component of the firm's risk equivalent amount. The basic risk equivalent amount is computed as an amount equal to 25 percent of the Japanese nonbank SD's defined annual operating expenses, and is intended to provide a capital cushion to cover risks that may occur in the course of executing ordinary business operations, such as errors in business transactions.<sup>183</sup>

One commenter, Better Markets, noted that the CFTC Bank-Based Approach requires nonbank SDs to maintain 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 non-bank SD's total risk-weighted assets, provided that common equity tier 1 capital must comprise at least 6.5 percent of the 8 percent of risk-weighted assets.<sup>184</sup> Better Markets stated that, in contrast, the Japanese Capital Rules require Japanese nonbank SDs to hold capital equal to or greater than 120 percent of their risk-weighted assets, including 50 percent that must be held in Basic Items.<sup>185</sup> Better Markets further asserted that in stating that the 120 percent of risk-weighted assets required by the Japanese capital rules equates to an "effective minimum capital requirement of 9.6 percent of risk-weighted assets," the Commission did not provide an analysis of how the CFTC calculated that effective minimum and did not disclose how much of the 9.6 percent is held in Basic Items as opposed to Supplementary Items.<sup>186</sup> In Better Markets' view, without this information and analysis, no comparability determination can be made because U.S. nonbank SDs are required to maintain 6.5 percent of the total 8 percent of risk-weighted assets in the highest form of capital, namely common equity tier 1 capital.<sup>187</sup>

Another commenter, IBAJ, offered a contrasting view, stating that Japanese nonbank SDs must maintain capital equal to 120 percent of market risk, credit risk, and basic risk equivalent

amounts and that such amount of capital translated into an effective capital ratio requirement of 9.6 percent of risk weighted assets, which is higher than the 8 percent capital ratio required by the Basel standards or CFTC Capital Rules.<sup>188</sup> As discussed immediately below, the Commission agrees with the IBAJ that the capital ratio required by the Japanese Capital Rules exceeds the capital ratio required by the CFTC Capital Rules under the Bank-Based Approach.

In response to the comment asserting that the Commission did not provide an analysis supporting the statement that the Japanese Capital Rules impose on Japanese nonbank SDs "an effective minimum requirement of 9.6 percent of the risk-weighted assets," the Commission notes that the 9.6 percent figure is intended to express the Japanese minimum capital as a capital ratio in a manner consistent with the CFTC Capital Rules for purposes of a comparison. Specifically, the Japanese Capital Rules require a Japanese nonbank SD to maintain regulatory capital in an amount that equals or exceeds 120 percent of the aggregate of the firm's risk-weighted assets. In contrast, the CFTC Capital Rules require a nonbank SD to maintain a minimum capital ratio to total risk-weighted assets of 8 percent. Converting the Japanese Capital Rules' requirement to an equivalent capital ratio under the CFTC Capital Rules would result in the capital ratio of 8 percent being increased by 20 percent, effectively requiring nonbank SDs to maintain a ratio of total regulatory capital to risk-weighted assets of 9.6 percent (*i.e.*, 8 percent plus 20 percent of 8 percent).<sup>189</sup>

In addition, the Japanese Capital Rules' standardized approach to calculating minimum capital requirements also results in a higher regulatory capital requirement for counterparty credit risk. Although the standardized credit risk weights under the Japanese Capital Rules range from 0 to 25 percent, whereas those applicable under the CFTC Capital Rules range from 0 to 150 percent, the Japanese Capital Rules' requirement that Japanese nonbank SDs hold 120 percent of the firm's risk-weighted assets would yield a higher capital requirement. For example, for an exposure that is subject to the highest risk weight for counterparty credit risk, the Japanese Capital Rules would require a Japanese nonbank SD to hold capital equal to 30 percent of the exposure amount (*i.e.*, 25 percent risk weight multiplied by 120

percent capital requirement), whereas the CFTC Capital Rules would require a nonbank SD to hold capital equal to 12 percent of the exposure amount (*i.e.*, 150 percent risk weight multiplied by 8 percent capital requirement).

Furthermore, the Commission notes that under the Japanese Capital Rules, the total risk-weighted assets include amounts for operational and similar risks arising from a Japanese nonbank SD's activities (*i.e.*, basic risk equivalent amount). These risk-weighted asset amounts are included in the risk equivalent amount in all circumstances, whether the nonbank SD uses a standardized approach or a model approach to calculating risk-weighted assets.<sup>190</sup> As such, the basic risk equivalent amount increases the amount of the risk-weighted assets and thus the amount of regulatory capital that a Japanese nonbank SD is required to maintain. Taking these factors into account in the computation of risk-weighted assets and regulatory capital under the Japanese Capital Rules, the Commission believes that a nonbank SD is generally required to maintain a higher level of regulatory capital under the Japanese Capital Rules than it would be under the CFTC Capital Rules.

Moreover, to the extent the Japanese Capital Rules might require a lesser amount of common equity tier 1 capital than the CFTC Capital Rules, the Commission believes that the difference will be generally offset and mitigated by the higher amount of regulatory capital required by the Japanese Capital Rules. Accordingly, the Commission finds that the Japanese Capital Rules and the CFTC Capital Rules are comparable in purpose and effect with respect to the minimum amount of capital and type of capital required by these rules.

In conclusion, the Commission finds that the Japanese Capital Rules and the CFTC Capital Rules are comparable in purpose and effect with respect to the computation of minimum capital requirements based on a nonbank SD's risk-weighted assets. The Commission finds that notwithstanding the differences discussed above, the Japanese Capital Rules and the CFTC Capital rules have a comparable approach to the computation of market

<sup>183</sup> Article 178(1)(iii) of the COO and Article 16 of the Notice on Capital. *See also* discussion in 2022 Proposal at 48104.

<sup>184</sup> Better Markets Letter at p. 9.

<sup>185</sup> *Id.* at p. 10.

<sup>186</sup> *Id.*

<sup>187</sup> *Id.*

<sup>188</sup> IBAJ Letter at p. 2.

<sup>189</sup> *See* 2022 Proposal at 48104 and fn. 125.

<sup>190</sup> In contrast, the CFTC Capital Rules do not require nonbank SDs to include an operational risk charge in the firm's risk-weighted assets if the firm uses a standardized approach to calculating risk-weighted asset amounts. An operational risk component is included in the firm's risk-weighted assets only if the firm uses a model to calculate risk-weighted asset amounts for credit risk. *See* definition of *BHC equivalent risk-weighted assets* in Commission Regulation 23.100 (cross referencing subparts E and D of 12 CFR part 217). 17 CFR 23.100.

risk exposure amounts and credit risk exposure amounts for on-balance sheet and off-balance sheet exposures, which are intended to achieve comparable regulatory outcomes by ensuring that a nonbank SD maintains a sufficient level of regulatory capital to absorb decreases in firm assets, absorb increases in firm liabilities, and meet obligations to counterparties and creditors, without the firm becoming insolvent.

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

As noted above, prong (iii) 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.<sup>191</sup>

The Japanese Capital Rules differ from the CFTC Capital Rules in that they do not impose a capital requirement on Japanese nonbank SDs based on a percentage of the margin for uncleared swap transactions.<sup>192</sup> In the 2022 Proposal, the Commission described, however, how certain Japanese capital and liquidity requirements may compensate for the lack of direct analogue to the 8 percent uncleared swap margin amount requirement.<sup>193</sup> Specifically, the Commission noted that under the Japanese Capital Rules the risk equivalent amount (*i.e.*, the firm's risk-weighted assets) is calculated as the sum of the market risk equivalent amount, the counterparty risk equivalent amount, and the basic risk equivalent amount.<sup>194</sup> As discussed, the basic risk equivalent amount is computed as an amount equal to 25 percent of the Japanese nonbank SD's defined annual operating expenses, and is intended to provide a capital cushion to cover risks that may accrue in the course of executing ordinary business

<sup>191</sup> More specifically, 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, the Commission stated that the intent of the uncleared swap margin amount was to establish a method of developing a minimum amount of capital for a nonbank SD to meet its obligations as an SD to market participants, and to cover potential operational risk, legal risk and liquidity risk, and not just the risks of its trading portfolio. See 85 FR 57462 at 57485.

<sup>192</sup> See 2022 Proposal at 48104.

<sup>193</sup> *Id.* at 48105.

<sup>194</sup> Article 178(1)(iii) of the COO and Article 16 of the Notice on Capital. The basic risk equivalent amount is calculated as 25 percent of certain defined operating expenses incurred by the Japanese nonbank SD over a 12-month period, and includes general expenses, selling expenses, and financial expenses.

operations, such as errors in business transactions.<sup>195</sup> In addition, the Japanese Capital Rules require a Japanese nonbank SD to deduct the carrying value of fixed assets from its Basic Items and Supplemental Items in computing its regulatory capital, which promotes a degree of liquidity into the Japanese nonbank SD's regulatory capital by requiring assets that are more liquid than fixed assets to support the Basic Items and Supplemental Items that are used to meet the Japanese nonbank SD's minimum capital requirement. As stated in the 2022 Proposal, the Commission preliminarily determined that the inclusion of an operational risk charge as a separate component of the risk equivalent amount, including by Japanese nonbank SDs that do not use internal models, and the deduction of the carrying value of fixed assets from regulatory capital, would 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.<sup>196</sup>

Focusing on the absence of a capital requirement based on a percentage of the margin for uncleared swap transactions under the Japanese Capital Rules, Better Markets asserted that the Japanese Capital Rules are not only different from the CFTC Capital Rules in form and substance, but lead to a regulatory outcome that is not comparable.<sup>197</sup> In support, Better Markets noted that, whereas the CFTC relies on an approach that requires nonbank SDs to hold qualifying capital in an amount equal to at least 8 percent of the nonbank SD's uncleared swap margin amount, the Japanese Capital Rules are based on "an arbitrary percentage of a company's operating expenses, which would be closer in concept to liquidity needs."<sup>198</sup>

Other commenters agreed with the Commission's preliminary determination that the Japanese Capital Rules and CFTC Capital Rules are comparable notwithstanding the absence in the Japanese Capital Rules of a capital requirement based on uncleared swap margin.<sup>199</sup> In this regard, FSA asserted that the Japanese Capital Rules are largely comparable in outcome even in the absence of the uncleared swap margin requirement because the Japanese capital adequacy

ratio takes into account operational risk.<sup>200</sup>

The Associations and IBAJ expressed the view that the Japanese Capital Rules are comparable in purpose and effect to the Commission's requirements for a nonbank SD to hold regulatory capital equal to or greater than 8 percent of its uncleared swap margin amount.<sup>201</sup> The commenters explained that under the Japanese Capital Rules, liquidity risk is covered through the deduction of the balance sheet carrying value of fixed assets, and operational risk and legal risk are covered by the basic risk equivalent amount, which is a simplified but conservative approach to calculating a proxy for operational risks under the Basel standards.<sup>202</sup> Under the approach, basic risk is incrementally added to market risk and credit risk, which further increases the required capital amount under the Japanese Capital Rules.<sup>203</sup> The commenters further explained that the Japanese Capital Rules' basic risk equivalent amount is computed as an amount equal to 25 percent of the Japanese nonbank SD's defined annual operating expenses, and is intended to provide a capital cushion to cover risk that may accrue in the course of executing ordinary business operations, such as errors in business transactions.<sup>204</sup> According to the commenters, such amount combined with market risk, credit risk, and the deduction of the carrying value of fixed assets will broadly capture obligations to market participants, potential operational risk, legal risk, and liquidity risk, as well as market risk and credit risk.<sup>205</sup> The commenters further noted that the calculation will capture both the trading portfolio as well as non-trading assets, whereas the CFTC's requirement to hold 8 percent of nonbank SD's uncleared swap margin amount will not capture non-trading assets.<sup>206</sup> As such, the commenters concluded that the Japanese Capital Rules' basic risk equivalent requirement is sufficiently comparable to the CFTC Capital Rules' uncleared swap margin requirement.<sup>207</sup>

The Commission believes that the Japanese Capital Rules' approach to calculating the basic risk equivalent amount, which accounts for operational risk and legal risk, and the deduction of the balance sheet carrying value of fixed

<sup>200</sup> FSA Letter at p. 1.

<sup>201</sup> Associations Letter at p. 2; IBAJ Letter at p. 2.

<sup>202</sup> *Id.*

<sup>203</sup> *Id.*

<sup>204</sup> Associations Letter at p. 3; IBAJ Letter at p. 3.

<sup>205</sup> *Id.*

<sup>206</sup> *Id.*

<sup>207</sup> *Id.*

<sup>195</sup> See 2022 Proposal at 48105.

<sup>196</sup> *Id.*

<sup>197</sup> Better Markets Letter at p. 7.

<sup>198</sup> *Id.*

<sup>199</sup> Associations Letter at p. 2; FSA Letter at p. 1; IBAJ Letter at p. 2.

assets to reflect liquidity risk, support the comparability of the Japanese Capital Rules and the CFTC Capital Rules even in the absence of a separate capital requirement in the Japanese Capital Rules requiring Japanese nonbank SDs to have qualified capital equal to or greater than 8 percent of the amount of uncleared swap margin.

In conclusion, the Commission finds that the Japanese Capital Rules and the CFTC Capital Rules are comparable in purpose and effect with respect to the requirement that a nonbank SD's minimum level of regulatory capital reflects potential operational risk exposures in addition to market risk and credit risk exposures. The Commission emphasizes that the intent of the minimum capital requirement based on a percentage of the nonbank SD's uncleared swap margin is to establish a minimum capital requirement that would help ensure that the nonbank SD meets its obligations as an 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.<sup>208</sup> The Commission further notes that the minimum capital requirement based on a percentage of the nonbank SD's uncleared swap margin amount was conceived as a proxy, not an exact measure, for inherent risk in the SD's positions and operations, including operational risk, legal risk, and liquidity risk.<sup>209</sup> As the Commission noted in adopting the CFTC Capital Rules, although the amount of capital required of a nonbank SD under the uncleared swap margin calculation is directly related to the volume, size, complexity, and risk of the covered SD's positions, the minimum capital requirement is intended to cover a multitude of potential risks faced by the SD.<sup>210</sup> The Commission understands that other jurisdictions may adopt alternative measures to cover the same risks. In this regard, the Japanese Capital Rules address comparable risks albeit not through a requirement based on a Japanese nonbank SD's uncleared swap margin amount. Specifically, Japanese nonbank SDs are required to maintain a minimum level of regulatory capital based on an aggregate of the firm's total risk-weighted asset exposure amounts for market risk, credit risk, and operational risk. The Commission further notes that a Japanese nonbank SD is required to maintain regulatory capital in an amount that exceeds 120

percent of the total risk-weighted assets, which is 20 percent higher than the CFTC Capital Rules. Accordingly, the Commission has determined that, notwithstanding the differences in approaches, the Japanese Capital Rules and CFTC Capital Rules are comparable in purpose and effect, and achieve comparable regulatory outcomes, by requiring nonbank SDs to maintain a sufficient minimum level of regulatory capital to address potential market risk, credit risk, and operational risk, and to help ensure the safety and soundness of the firm by requiring it to hold capital to absorb decreases in firm assets, absorb increases in firm liabilities, and meet its obligations to counterparties and creditors, without the firm becoming insolvent.

### 3. Final Determination

Based on its analysis of comments and its holistic assessment of the respective requirements discussed in Section I.C.2.a., b., and c. above, the Commission adopts the Comparability Determination and Comparability Order as proposed with respect to the minimum capital requirements and calculation of regulatory capital, subject to the condition that Japanese nonbank SDs must maintain a minimum level of regulatory capital in the form of Basic Items that equals or exceeds the equivalent of \$20 million U.S. dollars.

#### D. Nonbank Swap Dealer Financial Reporting Requirements

##### 1. Proposed Determination

The Commission detailed the requirements of the CFTC Financial Reporting Rules in the 2022 Proposal.<sup>211</sup> Specifically, the 2022 Proposal notes that the CFTC Financial Reporting Rules require nonbank SDs to file with the Commission and NFA periodic unaudited and annual audited financial reports.<sup>212</sup> The unaudited financial reports must include: (i) a statement of financial condition; (ii) a statement of income/loss; (iii) a statement demonstrating compliance with, and calculation of, the applicable regulatory minimum capital requirement; (iv) a statement of changes in ownership equity; (v) a statement of changes in liabilities subordinated to claims of general creditors; and (vi) such further material information necessary to make the required statements not misleading.<sup>213</sup> The annual audited financial reports must include the same financial statements that are required to be included in the unaudited financial

reports, and must further include: (i) a statement of cash flows; (ii) appropriate footnote disclosures; and (iii) a reconciliation of any material differences between the financial statements contained in the annual audited financial reports and the financial statements contained in the unaudited financial reports prepared as of the nonbank SD's year-end date.<sup>214</sup> In addition, a nonbank SD must 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.<sup>215</sup> 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.<sup>216</sup>

The CFTC Financial Reporting Rules also require a nonbank SD to file the following financial information with the Commission and NFA on a monthly basis: (i) a schedule listing the nonbank SD's financial positions reported at fair market value;<sup>217</sup> (ii) schedules showing the nonbank SD's 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;<sup>218</sup> and (iii) for nonbank SDs approved to use internal capital models, certain model metrics, such as aggregate value-at-risk ("VaR") and counterparty credit risk information.<sup>219</sup>

The CFTC Financial Reporting Rules further require a nonbank SD to provide the Commission and NFA with information regarding the custodianship of margin for uncleared swap transactions ("Margin Report").<sup>220</sup> The Margin Report must contain: (i) the name and address of each custodian holding initial margin or variation margin on behalf of the nonbank SD or

<sup>214</sup> *Id.* and 17 CFR 23.105(e)(4).

<sup>215</sup> *Id.* and 17 CFR 23.105(f).

<sup>216</sup> *Id.*

<sup>217</sup> *Id.* and 17 CFR 23.105(l) and Schedule 1 of Appendix B to Subpart E of part 23 ("Schedule 1"). Schedule 1 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, and cleared and uncleared swaps, security-based swaps, and mixed swaps in addition to other position information.

<sup>218</sup> *Id.* and schedules 2, 3 and 4, respectively, of Commission Regulation 23.105(l). 17 CFR 23.105(l).

<sup>219</sup> *Id.* and 17 CFR 23.105(k) and (l), and appendix B to Subpart E of part 23.

<sup>220</sup> *Id.* and 17 CFR 23.105(m).

<sup>208</sup> See 2022 Proposal at 48102 (referencing 85 FR 57462).

<sup>209</sup> 85 FR 57462 at 57497.

<sup>210</sup> 85 FR 57462 at 57485 and 57497.

<sup>211</sup> 2022 Proposal at 48106–48107.

<sup>212</sup> *Id.* and 17 CFR 23.105(d) and (e).

<sup>213</sup> *Id.* and 17 CFR 23.105(d)(2).

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.<sup>221</sup>

A nonbank SD electing the Bank-Based Capital Approach is required to file the unaudited financial report, Schedule 1, schedules of counterparty credit exposures, and the Margin Report with the Commission and NFA no later than 17 business days after the applicable month end reporting date.<sup>222</sup> A nonbank SD must file its annual report with the Commission and NFA no later than 60 calendar days after the end of its fiscal year.<sup>223</sup>

The 2022 Proposal also detailed relevant financial reporting requirements of the Japanese Financial Reporting Rules.<sup>224</sup> The Japanese Financial Reporting Rules require a Japanese nonbank SD to submit monthly monitoring survey reports (“Monthly Monitoring Report”) to the FSA.<sup>225</sup> The Monthly Monitoring Report must include information on the Japanese nonbank SD’s capital adequacy ratio, and the status of the firm’s business operations and accounting (including a balance sheet and profit/loss statement), market risk, counterparty risk, operational risk, and liquidity risk.<sup>226</sup> The Monthly Monitoring Report are typically submitted by a Japanese nonbank SD within two to three weeks of the end of each month.<sup>227</sup>

<sup>221</sup> *Id.*

<sup>222</sup> *Id.*

<sup>223</sup> *Id.*

<sup>224</sup> 2022 Proposal at 48106–48110.

<sup>225</sup> *Id.* and section II–1–4 (General Supervisory Process) of the Supervisory Guidelines for FIBO, which directs the FSA as part of its offsite monitoring to require FIBOs (including the Japanese nonbank SDs) to submit a monitoring survey report regarding the following matters: capital adequacy ratio, status of business operations and accounting (including a balance sheet and profit and loss statement), status of segregated management of customer assets, market risk, counterparty risk, operational risk, and liquidity risk. The FSA has, pursuant to Article 56–2(1) of the FIEA, ordered the Japanese nonbank SDs to submit monthly monitoring reports to the FSA.

<sup>226</sup> *Id.*

<sup>227</sup> The Commission noted that there are various types of reports which are required of the Japanese nonbank SDs under “Reporting orders” issued by the FSA in accordance with Article 56–2(1) of the FIEA. Some of these reports are required to be submitted on a monthly basis, whereas other reports are required to be submitted on a quarterly basis, semi-annual basis, or annual basis. The FSA typically does not set a specific filing deadline and instead requests all reports to be submitted “without delay.” In case of monthly reports, the

A Japanese nonbank SD is also required to submit a business report to the Commissioner of the FSA within three months of the end of the firm’s fiscal year (“Annual Business Report”).<sup>228</sup> The Annual Business Report must include a balance sheet, profit/loss statement, statement of changes in shareholders’ equity, balance of subordinated debt, and a statement of capital adequacy ratio.<sup>229</sup> Furthermore, a Japanese nonbank SD is required to prepare financial statements and business reports every business year pursuant to the Japanese Companies Act (“Annual Audited Financial Report”).<sup>230</sup> The Annual Audited Financial Report includes the firm’s balance sheet, profit/loss statement, and statement of changes in shareholders’ equity, and such statements are required to be audited by an accounting auditor.<sup>231</sup> The Annual Audited Financial Report must be submitted to, and approved by, the shareholders at a meeting within three months of the Japanese nonbank SD’s fiscal year-end.<sup>232</sup>

Based on its review of the FSA Application and the relevant Japanese laws and regulations, the Commission preliminarily determined that, subject to the conditions specified in the 2022 Proposal and discussed below, the Japanese Financial Reporting Rules are comparable to CFTC Financial Reporting Rules in purpose and effect.<sup>233</sup> The Commission noted that both sets of rules provide the FSA and the Commission with financial information necessary to monitor a nonbank SD’s compliance with capital requirements and to assess a nonbank

normal practice is for firms to submit such reports within two to three weeks from the prior month-end.

<sup>228</sup> 2022 Proposal at 48107 and Article 46–3(1) of the FIEA and Article 172 of the COO.

<sup>229</sup> 2022 Proposal at 48107 and Appended Forms No. 12 of the COO.

<sup>230</sup> 2022 Proposal at 48107 and Japanese Companies Act (Act No. 86 of 2005).

<sup>231</sup> 2022 Proposal at 48107 and Article 328(1) and (2), Article 435(2), and 436(2)(i) of the Companies Act, and Article 59 of the Rules of Corporate Accounting (Ordinance of the Ministry of Justice No. 13 of 2006). The audit requirement applies to a “Large Company,” which is defined by Article 2(vi) of the Companies Act as a stock company that satisfies any of the following requirements: (i) that the amount of stated capital in the balance sheet as of the end of the firm’s most recent business year is JPY 500 million or more; or (ii) that the total sum of the liabilities section of the balance sheet as of the end of the firm’s most recent business year is JPY 20 billion or more. The FSA has represented that each of the current CFTC-registered Japanese nonbank SDs is a Large Company under the Companies Act, and is subject to the audit requirement for its financial statements. FSA Application p. 18.

<sup>232</sup> *Id.*

<sup>233</sup> See 2022 Proposal at 48106–48110.

SD’s overall safety and soundness. Specifically, both CFTC Financial Reporting Rules and the Japanese Financial Reporting Rules require a nonbank SD to file statements of financial condition, statements of profit and loss, and statements of regulatory capital that, collectively, provide information for the FSA, Commission, and NFA to assess a nonbank SD’s overall ability to absorb decreases in the value of firm assets, absorb increases in the value of firm liabilities, and cover losses from business activities, including swap dealing activities, without the firm becoming insolvent.<sup>234</sup>

The proposed conditions in the proposed Comparability Order were intended to ensure that the Commission and NFA receive appropriate and timely financial information from Japanese nonbank SDs in order to monitor the firms’ compliance with FSA capital requirements and to assess the firms’ overall safety and soundness. The proposed conditions would require a Japanese nonbank SD to provide the Commission and NFA with copies of its Monthly Monitoring Report, Annual Business Report, and Annual Audited Financial Report.<sup>235</sup> The proposed conditions would also require the Monthly Monitoring Report, Annual Business Report, and Annual Audited Financial Report to be translated into the English language.<sup>236</sup> The Monthly Monitoring Report and the Annual Business Report also must have balances converted from yen to U.S. dollars. The Commission further recognized that the requirement to translate balances denominated in yen to U.S. dollars on the audited financial statements may have an unintended impact on the opinion expressed by the public accountant on the financial statements. The Commission, therefore, proposed to accept the Annual Audited Financial Report denominated in yen, but required the report to be translated into the English language.<sup>237</sup>

The proposed conditions also would require a Japanese nonbank SD to file with the Commission and NFA its: (i) Monthly Monitoring Reports within 15 business days of the earlier of the date

<sup>234</sup> *Id.*

<sup>235</sup> See 2022 Proposal at 48107 and Article 46–3(1) of the FIEA, Article 172 of the COO, and Appended Forms No. 12 of the COO.

<sup>236</sup> In the 2022 Proposal, the Commission proposed that the translation of audited financial statements into the English language would not be required to be subject to the audit of the public accountants. A Japanese nonbank SD would be required to report the exchange rate that it used to convert balances from yen to U.S. dollars to the Commission and NFA as part of the financial reporting.

<sup>237</sup> See 2022 Proposal at 48108.

the report is filed with the FSA or 35 calendar days after the month-end reporting date;<sup>238</sup> (ii) Annual Business Report within 15 business days of the earlier of the date the report is filed with the FSA or the date that the report is required to be filed with the FSA;<sup>239</sup> and (iii) Annual Audited Financial Report within 15 business days of the approval of the report at the Japanese nonbank SD's shareholder meeting.<sup>240</sup> The Commission stated that, in its preliminary view, the proposed filing dates provided sufficient time for the respective reports to be translated into the English language with balances converted from yen to U.S. dollars, as applicable.<sup>241</sup>

The Commission also proposed a condition to require Japanese nonbank SDs to file with the Commission and NFA, on a monthly basis, Schedule 1 showing the aggregate securities, commodities, and swap positions of the firm at fair market value as of the reporting date.<sup>242</sup> The Commission explained that Schedule 1 provides the Commission and NFA with detailed information regarding the fair market value of the nonbank SD's financial positions as of the end of each month, including the firm's swaps positions, which allows the Commission and NFA to monitor the types of investments and other activities that the firm engages in and would assist the Commission and NFA in monitoring the safety and soundness of the firm.<sup>243</sup> The Commission proposed to require that Schedule 1 be filed by a Japanese nonbank SD along with the firm's Monthly Monitoring Report. The Commission also proposed to require that Schedule 1 be prepared in the English language with balances reported in U.S. dollars.

The Commission also proposed a condition to require a Japanese nonbank SD to submit a statement by an

<sup>238</sup> 2022 Proposal at 48108 and proposed Condition 8. As noted, the FSA does not set a specific filing date for Monthly Monitoring Reports, electing to instead require firms to file such reports "without delay." The Commission proposed to establish a due date that is no later than 35 calendar days from the reporting date to set a definitive filing date that also provides Japanese nonbank SDs with sufficient time to translate the reports into English and convert balances to U.S. dollars.

<sup>239</sup> 2022 Proposal at 48108 and proposed Condition 9.

<sup>240</sup> 2022 Proposal at 48108 and proposed Condition 10.

<sup>241</sup> See 2022 Proposal at 48108.

<sup>242</sup> See *id.* In response to a comment by the IBAJ, the Commission confirms that its intent was to require that Schedule 1 of Appendix B to Subpart E of part 23 be filed at the same time as the Monthly Monitoring Report, consistent with Condition (11) of the Order. IBAJ Letter at p. 6.

<sup>243</sup> See 2022 Proposal at 48108.

authorized representative or representatives of the Japanese nonbank SD that, to the best knowledge and belief of the person(s), the information contained within each Monthly Monitoring Report, Schedule 1, Annual Business Report, and Annual Audited Financial Report, is true and correct, including as it relates to the translation of the report into the English language and the conversion of balances to U.S. dollars.<sup>244</sup> The statement by an authorized representative or representatives of the Japanese nonbank SD was intended to be the equivalent of the oath or affirmation required of nonbank SDs under Commission Regulation 23.105(f),<sup>245</sup> to ensure that reports filed with the Commission and NFA were 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.<sup>246</sup>

The Commission further proposed a condition that would require a Japanese nonbank SD to file a Margin Report with the Commission and NFA on a monthly basis.<sup>247</sup> The Commission noted that a Margin Report would assist the Commission and NFA in their assessment of the safety and soundness of the Japanese nonbank SDs by providing information regarding the firm's swaps book and the extent to which it has uncollateralized swap exposures to counterparties or has not met its margin obligations to swap counterparties. The Commission explained that this information, along with the list of custodians holding both the firm's and counterparties' swaps collateral, would assist with identifying potential financial impacts to the nonbank SD resulting from defaults on its swap transactions.

In the Commission's preliminary view, its proposed approach of requiring Japanese nonbank SDs to provide the Commission and NFA with copies of the Monthly Monitoring Reports, Annual Business Reports, and Annual Audited Financial Reports that the firms currently file with the FSA or otherwise prepare struck an appropriate balance of

<sup>244</sup> *Id.* at 48108–48109 and proposed Condition 12.

<sup>245</sup> 17 CFR 23.105(f). Commission Regulation 23.105(f) requires 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. 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.

<sup>246</sup> See 2022 Proposal at 48109.

<sup>247</sup> *Id.*

ensuring that the Commission and NFA receive the financial reporting necessary for the effective monitoring of the financial condition of the nonbank SDs, while also recognizing the appropriateness of providing substituted compliance based on the existing FSA financial reporting requirements and regulatory structure.<sup>248</sup>

The Commission's preliminary determination did not require a Japanese nonbank SD to file the model metrics and counterparty credit exposure information required by Commission Regulations 23.105(k) and (l),<sup>249</sup> respectively, in recognition that NFA's current SD risk monitoring program requires all SDs, including Japanese nonbank SDs, to file with NFA on a monthly basis certain risk metrics that are comparable with the risk metrics contained in Commission Regulation 23.105(k) and (l) and address the market risk and credit risk of the SD's positions.<sup>250</sup> Specifically, the Commission noted that 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.<sup>251</sup>

Furthermore, the Commission recognized that although the Japanese Financial Reporting Rules do not contain an analogue to the CFTC's requirements for nonbank SDs to file monthly model metric information and counterparty exposure information, the FSA has access to comparable

<sup>248</sup> *Id.*

<sup>249</sup> 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 requires certain credit risk exposure information from model and non-model approved firms. 17 CFR 23.105(k). 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).

<sup>250</sup> 2022 Proposal at 48109.

<sup>251</sup> See 2022 Proposal at 48109 and 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) ("NFA Notice 17-10"), available here: <https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4817>.

information.<sup>252</sup> More specifically, the Commission noted that the FSA would perform the initial approval and ongoing assessment of the performance of a Japanese nonbank SD's models as part of its oversight function and may be better positioned to monitor a Japanese nonbank SD's model metrics and performance and to assess the Japanese nonbank SD's credit exposures as part of the FSA's overall monitoring of the financial condition of the firm.<sup>253</sup> As such, the FSA would have access to information allowing it to assess the ongoing performance of risk models and to monitor the Japanese nonbank SD's credit exposures, which may be comprised of credit exposures to primarily Japanese counterparties.

## 2. Comment Analysis and Final Determination

The Commission received comments regarding the comparability of financial reporting and specific comments addressing several of the financial reporting issues on which the Commission solicited feedback. Regarding the scope of the financial information that a Japanese nonbank SD should be required to file, Better Markets stated that the 2022 Proposal does not adequately support the Commission's preliminary conclusion that the content of the Monthly Monitoring Reports, Annual Business Reports, and Annual Audited Financial Reports required pursuant to the Japanese Capital Rules are comparable with the requirements of the CFTC Financial Reporting Rules.<sup>254</sup> In contrast, FSA stated that the Commission should limit the request of financial information to the extent consistent and sufficient with the purpose of the Commission's capital requirements to efficiently and effectively achieve its supervisory and monitoring objectives.<sup>255</sup> IBAJ stated that the Commission should limit the financial information required to be filed to the types of financial information required of nonbank SDs under Commission Regulation 23.105.<sup>256</sup> IBAJ further stated that, consistent with the types of schedules and data nonbank SDs are required to file under Commission Regulation 23.105, the Commission should require

Japanese nonbank SDs to file the following information from the Monthly Monitoring Report: (i) Form 1–1 Capital Ratio Summary; (ii) Form 1–2 Capital Ratio: Deductible Assets; (iii) Form 1–3 Market Risk; (iv) Form 1–4 Counterparty Risk; (v) Form 2–1 Monthly Financial Statement (1); and (vi) Form 2–2 Monthly Financial Statement (2). IBAJ also stated that other financial information contained within the Monthly Monitoring Report should not be required as the information is either not submitted by nonbank SDs under Commission Regulation 23.105, such as client assets segregation status and transaction volume, or the information is similar to the information contained in the quarterly risk exposure report and monthly risk data report that Japanese nonbank SDs already provide to the Commission and NFA.<sup>257</sup> IBAJ also asserted that limiting the scope of information to the six items noted above from the Monthly Monitoring Report would be consistent with the financial information that Commission staff has required from Japanese nonbank SDs under CFTC Staff Letter 22–10.<sup>258</sup>

The Commission has reviewed the comments and believes that the Japanese Financial Reporting Requirements, subject to the conditions below, are comparable to the CFTC Financial Reporting Requirements in purpose and effect in that both the Japanese rules and the CFTC regulations provide information necessary for the monitoring of the financial condition of a nonbank SD. In response to the comments, the Commission is modifying the conditions in the final Comparability Order to list specific

<sup>257</sup> *Id.*

<sup>258</sup> *Id.* and CFTC Staff Letter No. 22–10, *Extension of Time-Limited No-Action Position for Foreign Based Nonbank Swap Dealers domiciled in Japan, Mexico, the United Kingdom, and the European Union*, issued by the Market Participants Division on August 17, 2022. CFTC Staff Letter No. 22–10, which extended the expiration of CFTC Staff Letter 21–20, provides that the Market Participants Division (“MPD”) would not recommend an enforcement action to the Commission if a non-U.S. nonbank SD covered by the letter (“covered nonbank SDs”), subject to certain conditions, complied with their respective home-country capital and financial reporting requirements in lieu of the Commission's capital and financial reporting requirements set forth in Commission Regulations 23.100 through 23.106, pending the Commission's determination of whether the capital and financial reporting requirements of certain foreign jurisdictions are comparable to the Commission's corresponding requirements. The relevant conditions include that a covered nonbank SD domiciled in Japan must: (i) be registered as a Type I FIBO with the FSA; (ii) submit to MPD financial information required by the FSA within 15 days of submitting such information to the FSA; and (iii) submit to the Commission a statement of financial condition, statement of income/loss, and statement of regulatory capital to the extent that such financial information is not required by the FSA.

schedules of the Monthly Monitoring Report that each Japanese nonbank SD is required to file with the Commission and NFA. Specifically, the Commission agrees that the Comparability Order should specify the required information that a Japanese nonbank SD must submit to the Commission and NFA from its Monthly Monitoring Report to be consistent with the types of capital and general financial statement information that a nonbank SD is required to file under Commission Regulation 23.105. This modification would ensure that the Commission receives the relevant financial information necessary to monitor the general financial condition and capital compliance of a Japanese nonbank SD, while eliminating the requirement for Japanese nonbank SDs to provide other information contained in the Monthly Monitoring Report that is specific to certain requirements in Japan and beyond the overall financial condition and capital compliance of the firm.

Therefore, consistent with the statement above, the Commission is modifying Condition 8 of the Comparability Order to provide that a Japanese nonbank SD must file Form 1–1 Capital Ratio Summary (“Form 1–1”), Form 1–2 Capital Ratio: Deductible Assets (“Form 1–2”), Form 1–3 Market Risk (“Form 1–3”), Form 1–4 Counterparty Risk (“Form 1–4”), Form 2–1 Monthly Financial Statement (1) (“Form 2–1”), and Form 2–2 Financial Statement (2) (“Form 2–2”) of the Monthly Monitoring Report with the Commission and with NFA on a monthly basis. Final Condition 8 will continue to require a Japanese nonbank SD to file such forms translated into the English language with balances converted to U.S. dollars,<sup>259</sup> and, as further discussed below, will require that such forms be filed with the Commission and NFA within 35 calendar days after the end of each month.

The Commission finds that the financial information provided by Japanese nonbank SDs in the specified forms of the Monthly Monitoring Report, the Annual Business Report, and the Annual Audited Financial Report is comparable to the unaudited and audited financial information provided by nonbank SDs under the relevant provisions of Commission Regulation 23.105(d) and (e), respectively. With respect to Better Markets' comment regarding the

<sup>259</sup> The condition will also specify that Japanese nonbank SDs must use a commercially reasonable and observable yen/U.S. dollar spot rate as of the date of the reports.

<sup>252</sup> Under the Japanese Financial Reporting Rules, the FSA has broad powers to request any information necessary for the exercise of its functions. FSA Application at p. 16 (referencing Article 56–2 of the FIEA) and discussion in 2022 Proposal at 48113.

<sup>253</sup> See 2022 Proposal at 48109.

<sup>254</sup> Better Markets Letter at p. 10.

<sup>255</sup> FSA Letter at p. 2.

<sup>256</sup> IBAJ Letter at p. 4.

sufficiency of the support for a finding of comparability of the financial reporting requirements, the Commission believes that the description of the reporting forms' content demonstrates the similarity between the required information. In this regard, Form 2-1 and Form 2-2 of the Monthly Monitoring Report present a Japanese nonbank SD's statement of financial condition and statement of profit/loss, respectively. Form 2-1 and Form 2-2 provide information that is necessary for the monitoring of the financial condition of a Japanese nonbank SD and are comparable to the statement of financial condition and statement of profit/loss required by the Commission of nonbank SDs under Commission Regulation 23.105(d)(2).

Form 1-1, Form 1-2, Form 1-3, and Form 1-4 detail the calculation of a Japanese nonbank SD's capital ratio. Form 1-3 and Form 1-4 provide details concerning a Japanese nonbank SD's calculation of market risk and counterparty credit risk, respectively, that is incorporated into the firm's calculation of its risk-weighted assets. Form 1-3 details market risk by asset class (e.g., equity, interest rate, foreign exchange, commodity, and crypto assets) and contract type (e.g., spot transactions or forward transactions). Form 1-4 details counterparty credit risk by transaction type (e.g., foreign exchange, interest rates, and equity). Form 1-2 details the deductions that a Japanese nonbank SD must take in computing its Basic and Supplemental capital to reflect illiquid assets (e.g., fixed assets). Form 1-1 summarizes the Japanese nonbank SD's capital calculation of its Basic and Supplemental Items and further contains the firm's overall capital ratio to demonstrate compliance with the Japanese Capital Rules. Forms 1-1 through 1-4 of the Monthly Monitoring Report require a Japanese nonbank SD to file financial information regarding its capital ratio that is comparable to the capital ratio reporting requirements under Commission Regulation 23.105(d)(2), which requires a nonbank SD to submit a statement of its capital requirement calculation and the firm's compliance with such capital requirement.

The Commission is also adopting Conditions 9 and 10 of the proposed Comparability Order substantially as proposed.<sup>260</sup> Final Conditions 9 and 10 require a Japanese nonbank SD to file a

copy of its Annual Business Report and Annual Audited Financial Report, respectively, with the Commission and NFA. The Annual Business Report and Annual Audited Financial Report are comparable to the annual audited financial report that each nonbank SD is required to file with the Commission and NFA pursuant to Commission Regulation 23.105(e). Specifically, information included in the Annual Business Report and Annual Audited Financial Reports includes the Japanese nonbank SD's statements of financial condition, statement of income or loss, a statement demonstrating the firm's capital levels and its compliance with the Japanese Capital Rules, a statement of changes in ownership equity and a statement of subordinated debt. This information is comparable to the audited financial information required by the Commission from nonbank SDs under Commission Regulation 23.105(e) and detailed above.

The Annual Business Report and Annual Audited Financial Report must be translated into English, and balances in the Annual Business Report must be converted into U.S. dollars.<sup>261</sup> The Annual Business Report is required to be filed with the Commission and NFA within 15 business days of the earlier of the date that the report is filed, or is required to be filed, with the FSA, and the Annual Audited Financial Report is required to be filed with the Commission and NFA within 15 business days of the approval of the report at the shareholders' meeting.

For purposes of clarity, the Commission notes that Japanese nonbank SDs may present the financial information required to be provided to the Commission and NFA under the final Comparability Order in accordance with generally accepted accounting principles that the Japanese nonbank SD uses to prepare general purpose financial statements in Japan. This clarification is consistent with proposed Condition 7, which the Commission adopts subject to a minor modification in the final Comparability Order, requiring that the Japanese nonbank SD prepares and keeps current ledgers and other similar records "in accordance

with accounting principles permitted by the [FSA]."<sup>262</sup>

In taking the position that Japanese nonbank SDs may provide financial reporting prepared in accordance with the accounting standards applicable in their home jurisdiction, the Commission considered the nature of the financial reporting information required from nonbank SDs for purposes of monitoring their overall financial condition and compliance with capital requirements. Specifically, the Commission notes that the requirements for how nonbank SDs calculate their risk-weighted assets and capital ratio, in both Japan and the U.S., follow a rules-based approach consistent with the Basel standards, and, consequently, the Commission does not anticipate that a variation in the applicable accounting standards would materially impact this calculation.<sup>263</sup> In this regard, the

<sup>262</sup> 2022 Proposal at 48114. Proposed Condition 7 stated that Japanese nonbank SDs must prepare and keep current ledgers and other similar records "in accordance with accounting principles required by the [FSA]". To promote consistency across the Comparability Determinations the Commission is adopting with respect to several other jurisdictions and to reflect the fact that certain jurisdictions may not issue a formal approval of the accounting standards used by nonbank SDs, the Commission is replacing the adjective "required" with the adjective "permitted" in the reference to the accounting standards to be used by Japanese nonbank SDs.

<sup>263</sup> Furthermore, the Commission's approach to permitting Japanese nonbank SDs to maintain financial books and records, and to file financial reports and other financial information, prepared in accordance with local accounting standards is consistent with the SEC's final comparability determinations for non-U.S. SBSBs. 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) at 59812 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 Manner and Format Order") at 59219. Specifically, the SEC stated that the use of local reporting requirements will avoid non-U.S. SBSBs "having to perform and present two Basel capital calculations (one pursuant to local requirements and one pursuant to U.S. requirements)." SEC Manner and Format Order at 59219. The SEC noted, in this regard, that the Basel standards are international standards that have been adopted in the U.S. and in jurisdictions where substituted compliance is available for capital under the SEC comparability determinations and that, therefore, requirements for how firms calculate capital pursuant to the Basel standards generally should be similar. *Id.* In addition, if a Japanese nonbank SD becomes registered with the SEC as an SBSB and is required to file a FOCUS Report, the

<sup>260</sup> Subject to the specification in final Condition 9 that the conversion of balances to U.S. dollars must be done using a commercially reasonable and observable yen/U.S. dollar spot rate as of the date of the report.

<sup>261</sup> As noted above, the 2022 Proposal included a proposal to permit balances in the Annual Audited Financial Report to be presented in yen to avoid raising potential issues with respect to the audit opinion expressed on the financial statements by the accountant engaged to conduct the audit of the Japanese nonbank SD's financial statements. See 2022 Proposal at 48108 and proposed Condition 10 at 48115. As previously stated herein, the Commission is adopting Condition 10 in the final Comparability Order as proposed.

Commission notes that Japanese nonbank SDs currently submit financial reports, including a statement of financial condition and a statement of regulatory capital, pursuant to CFTC Staff Letter 22–10.<sup>264</sup> The reports provide the Commission with appropriate information to assess the financial and operational condition of Japanese nonbank SDs, as well as the firms' compliance with the capital ratios imposed on Japanese nonbank SDs under the Japanese Capital Rules.

In addition, the Commission is adding a condition in the final Comparability Order to specify that Japanese nonbank SDs that are registered with the SEC as an SBSB and required to file a FOCUS Report with the SEC or its designee, must file a copy of the FOCUS Report with the Commission and NFA within 35 calendar days after the end of each month. Currently, no Japanese nonbank SD is registered as an SBSB. The Commission, however, is including the condition in anticipation of potential future dual registrants. Under final Condition 12, a Japanese nonbank SD that files a copy of the FOCUS Report will not be required to file the financial reports and schedules specified in final Conditions 8 and 11 of the Comparability Order. Final Condition 12 is also consistent with Commission Regulation 23.105(d)(3), which mandates the filing of a FOCUS Report by dual registrants.<sup>265</sup>

One commenter, Better Markets, disagreed with the 2022 Proposal to the extent that the Commission proposed not to require Japanese nonbank SDs that have been approved by the FSA to use capital models to file the monthly model metric information required by Commission Regulation 23.105(k) with the Commission or NFA.<sup>266</sup> Commission Regulation 23.105(k) requires nonbank SDs that have been approved by the Commission or NFA to use models to compute market risk or credit risk for computing capital requirements to file certain information with the Commission and NFA on a monthly basis.<sup>267</sup> The information required to be

filed includes: (i) for nonbank SDs approved to use market risk models, a listing of any products that the nonbank SD excludes from the approved market risk model and the amount of the standardized market risk charge taken on such products; (ii) a graph reflecting, for each business line of the nonbank SD, the daily intra-month VaR; (iii) the aggregate VaR for the nonbank SD; and (iv) certain credit risk information for swaps, mixed swaps and security-based swaps, including: (a) overall current exposure, (b) current exposure listed by counterparty for the 15 largest exposures, (c) the 10 largest commitments listed by counterparty, (d) maximum potential exposure listed by counterparty for the 15 largest exposures, (e) aggregate maximum potential exposure, (f) a summary report reflecting the SD's current and maximum potential exposures by credit rating category, and (g) a summary report reflecting current exposure for each of the top ten countries to which the nonbank SD is exposed.<sup>268</sup> Better Markets stated that by not requiring the information contained in Commission Regulation 23.105(k), the Commission was proposing to “take a back seat to the FSA and blindly accept [Japanese nonbank SDs'] assessments resulting from their use of internal models to calculate risk,” and that such an approach undercuts the comparability of the financial reporting and risk assessment of both regimes.<sup>269</sup>

The Commission does not agree that its approach is effectively deferring model oversight to the FSA or that it is otherwise “blindly accept[ing]” the internal model-based assessments of the Japanese nonbank SDs. As noted above, pursuant to NFA rules, all registered SDs, including Japanese nonbank SDs, are required to submit to NFA, on a monthly basis, a list of specified risk metrics related to the SD's market risk and credit risk exposures.<sup>270</sup> As part of its regulatory oversight program, NFA uses the risk metrics information to identify firms that may pose heightened risk and allocates appropriate oversight resources. NFA also may request additional information from a nonbank SD to the extent it determines that information in the risk metrics or other financial filings warrants a need for additional follow-up. Furthermore, Commission staff has access to the

collected risks metrics information and participates in NFA's risk monitoring function by regularly exchanging information and discussing potential risks with NFA staff.

As the list of specified risk metrics discussed above indicates, although the information collected by NFA is not identical to the information required under Commission Regulation 23.105(k), there is a significant overlap in the data items. Working with industry participants, NFA identified the risk data items listed in NFA Notice I–17–10 as relevant risk metrics to be collected for oversight purposes, noting that most SDs use these or similar metrics as part of their own risk management program. The Commission believes that the information required pursuant to NFA Notice I–17–10 would provide the Commission and NFA with key data allowing them to monitor nonbank SDs' risk exposures. In addition, the Commission and NFA have the ability to request additional information from its registrants, including Japanese nonbank SDs, at any time.<sup>271</sup> Finally, the Commission notes that the FSA, which will be conducting the initial approval and ongoing assessment of the performance of the Japanese nonbank SDs' internal models, under a regulatory framework that the Commission finds comparable to the CFTC Capital Rules, will have access to additional information that the FSA deems relevant in the conduct of such approval and assessment. The Commission, therefore, concludes that it is not necessary to require Japanese nonbank SDs relying on the final Comparability Order to submit the model metric information mandated by Commission Regulation 23.105(k).

Better Markets also noted that the proposed Comparability Determination was conditioned on a Japanese nonbank SD submitting a statement by an authorized representative that to the best knowledge and belief of the person the information contained in reports submitted to the Commission is true and correct, in lieu of the oath or affirmation required by Commission Regulation 23.105(f).<sup>272</sup> Better Markets stated that there are significant legal differences between a statement and the oath or affirmation required by the CFTC Financial Reporting Rules, further highlighting the differences between the

Commission's approach to permitting Japanese nonbank SDs to maintain financial books and records, and file financial information, prepared in accordance with local accounting standards would facilitate financial reporting by such dually-registered entities. In such case, dually-registered entities would not have to perform multiple calculations under different accounting standards or submit two different FOCUS Reports.

<sup>264</sup> CFTC Staff Letter No. 22–10, *Extension of Time-Limited No-Action Position for Foreign Based Nonbank Swap Dealers domiciled in Japan, Mexico, the United Kingdom, and the European Union*, August 17, 2022.

<sup>265</sup> 17 CFR 23.105(d)(3).

<sup>266</sup> Better Markets Letter at p. 11.

<sup>267</sup> 17 CFR 23.105(k).

<sup>268</sup> 17 CFR 23.105(k)(1).

<sup>269</sup> Better Markets Letter at p. 11.

<sup>270</sup> NFA Rulebook, Financial Requirements, section 17 Swap Dealer and Major Swap Participant Reporting Requirements, available here: <https://www.nfa.futures.org/rulebooksql/rules.aspx?RuleID=SECTION%2017&Section=7>, and NFA Notice I–17–10.

<sup>271</sup> 17 CFR 23.105(h), which provides that the Commission or NFA may, by written notice, require any SD to file financial operational information at such time as may be specified by the Commission or NFA.

<sup>272</sup> Better Markets Letter at p.10.



regulatory reporting requirements of the U.S. and those of Japan.<sup>273</sup>

For completeness, the Commission notes that the proposed condition requires that an authorized representative of the Japanese nonbank SD provide a statement that, to the best of the knowledge and belief of the representative, the information contained in the financial reports filed with the Commission and NFA is true and correct, including the applicable translation of the reports to the English language and the conversion of balances to U.S. dollars. The proposed condition was based on current Commission Regulation 23.105(f), which provides that a nonbank SD must attach to each unaudited and annual audited financial report filed with the Commission and NFA an oath or affirmation that to the best knowledge and belief of the individual making the oath or affirmation the information in the financial reports is true and correct. Similar to the intent of Commission Regulation 23.105(f), the purpose of the proposed condition is to obtain a formal attestation from a representative with the appropriate knowledge and authority that the information provided in the requisite financial reports is accurate and properly translated. The Commission's choice of language in using the term "statement" was not intended to make a legal distinction between this term and the terms "oath" or "affirmation," but rather to select a generic term that is universally understood across jurisdictions to reflect the above-referenced purpose. In practice, the Commission does not believe that there is a material legal difference between the language of the proposed condition and the required oath or affirmation required under Commission Regulation 23.105(f). Instead, the Commission is of the view that the proposed condition would have the same legal effect as Commission Regulation 23.105(f) of providing the Commission with a stronger basis to take legal action if a Japanese nonbank SD files erroneous information.

Commenters also addressed the Commission's request for comment on the proposed filing dates for the reports and information specified above and the compliance dates for any new reporting obligations that the Comparability Order would impose on Japanese nonbank SDs. IBAJ stated that the proposed filing of reports and information with the Commission and NFA within 15 days of the date when the filing is made with the FSA is sufficient.<sup>274</sup> Other

commenters requested that the Commission set the compliance date at least six months following the issue date of the Comparability Order to adequately prepare for compliance with the reporting conditions imposed by the Order.

The Commission believes that granting an additional period of time to allow Japanese nonbank SDs to develop and implement the necessary systems and processes for compliance with the Comparability Order is appropriate with respect to new reporting obligations imposed on Japanese nonbank SDs under the final Order. For other reporting obligations, for which a process already exists, such as the reports that Japanese nonbank SDs currently submit to the Commission and NFA pursuant to CFTC Staff Letter 22–10 and/or prepare pursuant to the Japanese Financial Reporting Rules, additional time for compliance does not appear necessary. Accordingly, the Commission is setting a compliance date of 180 calendar days from the date of publication of the final Comparability Order in the **Federal Register**, to comply with final Conditions 11 and 13, which require Japanese nonbank SDs to file Schedule 1 and the Margin Report with the Commission and NFA.

In an effort to align, where appropriate, the filing deadlines for financial reporting obligations imposed by the Comparability Order on Japanese nonbank SDs with the filing deadlines that the Commission proposed for nonbank SDs domiciled in several other jurisdictions, the Commission is also setting the filing deadline in final Condition 8 to 35 calendar days after the end of each month.<sup>275</sup> The filing deadline will apply to the selected forms of the Monthly Monitoring Report, as well as to Schedule 1 and the Margin Report, which pursuant to final Conditions 11 and 13 must be filed with the selected forms of the Monthly Monitoring Report.

In summary, the Commission is adopting the Comparability Order and conditions as proposed with respect to the comparability of the CFTC Financial Reporting Requirements and Japanese

Financial Reporting Requirements, subject to the adjustments to the required content of the Monthly Monitoring Report, the filing deadlines discussed above, the minor change in the language of final Condition 7 to specify that Japanese nonbank SDs must keep current ledgers or similar records in accordance with accounting principles "permitted" by the FSA, and the specifications in final Conditions 8, 9, 11, and 13 that the conversion of balances to U.S. dollars must be done using a commercially reasonable and observable yen/U.S. dollar spot rate as of the date of the respective report. The Commission also grants an additional compliance period for the new reporting obligations imposed on Japanese nonbank SDs as set forth in the final Comparability Order below.

#### *E. Notice Requirements*

##### 1. Proposed Determination

The Commission noted in the 2022 Proposal that the CFTC Financial Reporting Rules require nonbank SDs to provide the Commission and NFA with written notice of certain defined events.<sup>276</sup> Commission Regulation 23.105(c) requires a nonbank SD to file written notice with the Commission and NFA of the following events: (i) the nonbank SD's regulatory capital is less than the minimum amount required; (ii) the nonbank SD's regulatory capital is less than 120 percent of the minimum amount required; (iii) the nonbank SD fails to make or to keep current required financial books and records; (iv) the nonbank SD experiences a reduction in the level of its excess regulatory capital of 30 percent or more from the amount last reported in a financial report filed with the Commission; (v) the nonbank SD plans to distribute capital to equity holders in an amount in excess of 30 percent of the firm's excess regulatory capital; (vi) the nonbank SD fails to post to, or collect from, a counterparty (or group of counterparties under common ownership or control) required initial and variation margin, and the aggregate amount of such margin equals or exceeds 25 percent of the nonbank SD's minimum capital requirement; (vii) the nonbank SD fails to post to, or collect from, swap counterparties required initial and variation margin, and the aggregate amount of such margin equals or exceeds 50 percent of the nonbank SD's minimum capital requirement; and (viii) the nonbank SD is registered with the SEC as an SBSB and files a notice

<sup>275</sup> See *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*, 88 FR 41774 (June 27, 2023) and *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 Capital and Financial Reporting Requirements of the United Kingdom and Regulated by the United Kingdom Prudential Regulation Authority*, 89 FR 8026 (Feb. 5, 2024).

<sup>276</sup> 2022 Proposal at 48110. See, also, 17 CFR 23.105(c).

<sup>273</sup> *Id.*

<sup>274</sup> IBAJ Letter at p. 6.

with the SEC under applicable SEC Rules.<sup>277</sup>

The notices are part of the Commission's overall program of helping to ensure the safety and soundness of nonbank SDs and the swaps markets in general.<sup>278</sup> Notices provide the Commission and NFA with an opportunity to assess whether there is an actual or potential financial and/or operational issue at a nonbank SD. In situations where there is an underlying issue, Commission and NFA staff engage with the nonbank SD in an effort to minimize potential adverse impacts on the firm, swap counterparties, and the larger swaps market.<sup>279</sup>

The 2022 Proposal also noted that the Japanese Financial Reporting Rules include notice requirements for Japanese nonbank SDs, although in a more limited manner than the Commission's notice requirements. The Japanese Financial Reporting Rules require a Japanese nonbank SD to provide immediate notice to the FSA if the firm's capital adequacy ratio falls below 140 percent (*i.e.*, "Japanese Early Warning Notice").<sup>280</sup> The Japanese Early Warning Notice must be accompanied by a Plan Regarding Specific Voluntary Measures to Be Taken in Order to Maintain the Capital Adequacy Ratio, which includes the concrete measures that the Japanese nonbank SD will take to maintain a capital adequacy ratio above 140 percent.<sup>281</sup> The FSA also has the authority to examine the future outlook of the Japanese nonbank SD's capital adequacy ratio through hearings and to urge the firm to make voluntary improvement efforts.<sup>282</sup>

A Japanese nonbank SD is also required to file immediate notice with the FSA if the firm's capital adequacy ratio falls below the 120 percent minimum requirement.<sup>283</sup> The notification must include the Japanese nonbank SD's Plan Regarding Specific Voluntary Measures to Be Taken in Order to Improve the Capital Adequacy Ratio.<sup>284</sup> The FSA will review the plan and, when necessary, identify the specific method by which a Japanese nonbank SD must bring its capital adequacy ratio back above the

prescribed minimum level and the estimated date of the recovery. In situations where the Japanese nonbank SD fails to maintain the minimum level of regulatory capital, the FSA will also examine other aspects of the firm's operations, including the status of segregated management of customer assets and fund-raising. If the FSA finds it to be necessary and appropriate in the public interest or for the protection of investors, the Commissioner of the FSA may order a change of business methods, order assets to be deposited, or issue orders with respect to matters that are otherwise necessary from a supervisory perspective.<sup>285</sup>

If a Japanese nonbank SD's capital adequacy ratio falls below 100 percent, the Commissioner of the FSA may order the suspension of all or part of the firm's business activities for a period not to exceed three months if the FSA deems such action to be necessary and appropriate for the public interest or for the protection of investors.<sup>286</sup> If the Japanese nonbank SD's capital adequacy ratio does not exceed 100 percent, and the FSA determines that the firm's capital adequacy ratio status is not likely to recover, the Commissioner of the FSA may rescind the registration of the firm.<sup>287</sup>

Furthermore, in addition to the above measures, the FSA may order a Japanese nonbank SD to change its business methods or to otherwise take measures that are necessary for improving its business operations or the state of its assets if the FSA finds such action necessary and appropriate in the public interest or for the protection of investors.<sup>288</sup> Finally, the Prime Minister of Japan may rescind the registration of a Japanese nonbank SD, or order the suspension of all or a part of its business

activities for a period of no longer than six months, if the Japanese nonbank SD violates a disposition by a government agency,<sup>289</sup> or is likely to become insolvent due to the state of its business and assets.<sup>290</sup>

Based on its review of the FSA Application and the relevant Japanese laws and regulations, the Commission preliminarily determined that the Japanese Financial Reporting Rules and the CFTC Financial Reporting Rules were comparable in purpose and effect with respect to the requirements in Commission Regulation 23.105(c)(1) and (2) for nonbank SDs to provide notice if the firm fails to maintain the minimum level of regulatory capital or falls below 120 percent of the minimum level of regulatory capital. Therefore, the Commission proposed to condition the Comparability Order on a Japanese nonbank SD providing the Commission and NFA with written notice within 24 hours of the firm filing notice with the FSA, pursuant to Article 179(3) of the COO, that its capital adequacy ratio had fallen below 140 percent or 120 percent.<sup>291</sup> The Commission noted that upon receipt of a notice, Commission staff and NFA staff would engage with the FSA and the Japanese nonbank SD to obtain an understanding of the facts that led to the filing of the notice and would discuss with the FSA its plan for any ongoing monitoring of the Japanese nonbank SD. Accordingly, the Commission stated that its proposal would not require the Japanese nonbank SD to file copies of its recovery plan that it filed with the FSA with the Commission or NFA. The Commission stated that to the extent it needed further information from the Japanese nonbank SD, the Commission expected to request such information as part of its interaction with the Japanese nonbank SD and from its discussions with the FSA.<sup>292</sup> The Commission believed that its proposed conditions would ensure that the Commission and NFA received the appropriate information covered by Commission Regulation 23.105(c)(1) and (2), while also removing the obligation for the Japanese nonbank SD to file separate and duplicative notices with the Commission/NFA and the FSA.

The Commission, however, also acknowledged that the notice provisions of the Japanese Financial Reporting Rules differ in certain respects from the CFTC Financial Reporting Rules.<sup>293</sup>

<sup>289</sup> *Id.* Article 52(1)(vii) of the FIEA.

<sup>290</sup> *Id.* Article 52(1)(viii) of the FIEA.

<sup>291</sup> *Id.*

<sup>292</sup> See 2022 Proposal at 48112.

<sup>293</sup> *Id.*

<sup>285</sup> 2022 Proposal at 48110–48111. Article 53(1) of the FIEA. Section IV–2–2 (Supervisory Response to Cases of Financial Instruments Business Operators' Capital Adequacy Ratio Falling Below Prescribed Level) (3) of the Supervisory Guidelines for FIBO indicates four examples of the order: (i) to draft and implement measures (including the drafting of specifics and the implementation schedule) to bring the capital adequacy ratio back above the legally prescribed level and maintain the ratio above that level on a permanent basis; (ii) to implement measures to ensure the protection of investors in preparation for an unexpected event, through appropriate management of securities and cash and careful management of fund-raising; (iii) to avoid activities that could lead to wasteful use of corporate assets; and (iv) to compile the projections of the balance sheet and fund-raising status on a daily basis and the projection of the capital adequacy ratio in ways to reflect the specific measures to be implemented, in order to bring the capital adequacy ratio back above the legally prescribed level.

<sup>286</sup> 2022 Proposal at 48111. Article 53(2) of the FIEA.

<sup>287</sup> *Id.* Article 53(3) of the FIEA.

<sup>288</sup> *Id.* Article 51 of the FIEA.

<sup>277</sup> 17 CFR 23.105(c).

<sup>278</sup> *Id.*

<sup>279</sup> See 2022 Proposal at 48110.

<sup>280</sup> *Id.*, citing Article 179 of the COO.

<sup>281</sup> *Id.*

<sup>282</sup> *Id.* citing section IV–2–2 (Supervisory Response to Cases of Financial Instruments Business Operators' Capital Adequacy Ratio Falling Below Prescribed Level) (1) of the Supervisory Guidelines for FIBO.

<sup>283</sup> 2022 Proposal at 48110, citing Article 179 of COO.

<sup>284</sup> *Id.*

Specifically, unlike the CFTC Financial Reporting Rules, the Japanese Financial Reporting Rules do not contain explicit requirements for a Japanese nonbank SD to notify the FSA if the firm fails to make or keep current books and records required by the FSA, experiences a specified decrease in its capital adequacy ratio when compared to levels previously reported, or fails to collect or post required initial margin and/or variation margin for uncleared swap and non-cleared security-based swap transactions with counterparties that exceed certain threshold levels.<sup>294</sup> The Japanese Financial Reporting Rules also do not require a Japanese nonbank SD to provide the FSA with advance notice of capital withdrawals initiated by equity holders that exceed defined amounts or percentages of the firm's excess regulatory capital.<sup>295</sup>

To address these differences and to ensure that the Commission and NFA receive appropriate notices of events that may have potential adverse impacts on registered SDs, the Commission proposed to condition the Comparability Order to require Japanese nonbank SDs to file certain additional notices directly with the Commission and NFA. In this regard, the Commission stated 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 ensuring compliance with regulatory requirements, including regulatory capital requirements.<sup>296</sup> As such, the Commission proposed to condition the proposed Comparability Order on a Japanese nonbank SD providing the Commission and NFA with a written notice within 24 hours if the firm fails to make or to keep current books and records required by the FSA.<sup>297</sup> The Commission stated that, in this context, 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 Japanese nonbank SD's asset, liability, income, expense, and capital accounts in accordance with the

accounting principles permitted by the FSA.<sup>298</sup>

The Commission further proposed to condition the Comparability Order on a Japanese nonbank SD filing a 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 non-cleared security-based swap positions that, in the aggregate, exceeds 25 percent of the Japanese nonbank SD's minimum capital requirement; (ii) counterparties fail to post required initial margin or pay required variation margin to the Japanese nonbank SD for uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 50 percent of the Japanese nonbank SD's minimum capital requirement; (iii) a Japanese 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 Japanese nonbank SD's minimum capital requirement; and (iv) a Japanese 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, exceed 50 percent of the Japanese nonbank SD's minimum capital requirement. The Commission proposed to require this notice so that, in the event that such a notice is filed, the Commission and NFA may commence communication with the Japanese nonbank SD and the FSA to obtain an understanding of the facts that led to the failure to exchange material amounts of initial margin or 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.<sup>299</sup>

The Commission also proposed to require that a Japanese nonbank SD file any notices required under the proposed Comparability Order with the Commission and NFA in English and,

where applicable, with any balances reported in U.S. dollars. The Commission stated that each notice required by the proposed Comparability Order had to be filed in accordance with instructions issued by the Commission or NFA.<sup>300</sup>

The Commission did not propose to require a Japanese nonbank SD to file notices with the Commission concerning withdrawals of capital or changes in capital levels as such information would be reflected in the financial statement reporting filed with the Commission and NFA as conditions of the order, and because the Japanese nonbank SD's capital levels are also monitored by the FSA. As such, the Commission preliminarily considered that the separate reporting of the information to the Commission would be superfluous.<sup>301</sup>

## 2. Comment Analysis and Final Determination

The Commission received several comments with respect to the notice provisions. IBAJ noted, with respect to the proposed requirement in proposed Condition 18 that a Japanese nonbank SD file notice with the Commission and NFA within 24 hours of the firm failing to make or keep current the financial books and records required by the FSA, that it is practically challenging for a firm to submit a notification prior to the discovery of the relevant failure.<sup>302</sup> IBAJ recommended that the condition require a notice "following the discovery" by the Japanese nonbank SD of its failure to maintain current financial books and records.<sup>303</sup>

Maintaining current books and records of all financial transactions is a fundamental recordkeeping requirement for a registered nonbank SD, and is essential in order to provide management with the information necessary to ensure that financial transactions are timely and accurately reported and that the firm is in compliance with capital and other regulatory requirements. The Commission believes that it is necessary for a nonbank SD to maintain internal controls and procedures to affirmatively monitor that books and records are being maintained on a current basis. Therefore, the Commission is adopting Condition 18 (renumbered as final Condition 19) as proposed.<sup>304</sup> For

<sup>300</sup> *Id.*

<sup>301</sup> *Id.*

<sup>302</sup> IBAJ Letter at p. 7.

<sup>303</sup> *Id.*

<sup>304</sup> The Commission also notes that final Condition 19 is consistent with Commission Regulation 23.105(c)(3), which requires nonbank SDs subject to the Commission's notice

<sup>294</sup> See 17 CFR 23.105(c)(3), (4), and (7).

<sup>295</sup> See 17 CFR 23.105(c)(5) (requiring 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). See 2022 Proposal at 48111.

<sup>296</sup> 2022 Proposal at 48111.

<sup>297</sup> *Id.* at 48111–48112. See also, proposed Condition 18 at 48115.

<sup>298</sup> *Id.* at 48111. For comparison, see Commission Regulation 23.105(b) (similarly defining the term "current books and records" as used in the context of Commission's requirements). 17 CFR 23.105(b).

<sup>299</sup> *Id.* See also, proposed Condition 19 at 48115.

further clarification of this condition, the Commission also confirms that the requirement for Japanese nonbank SDs to file a notice with the Commission if the firm fails to maintain current books and records will apply with respect to books and records addressing the Japanese nonbank SD's financial condition and financial reporting requirements.

IBAJ also recommended a technical edit to the proposed condition requiring Japanese nonbank SDs to file a notice in case of a failure to exchange material amounts of initial margin or variation margin. Specifically, IBAJ suggested that the phrase "to the Japanese nonbank SD" be added after the phrase "a single counterparty, or group of counterparties under common ownership or control, fails to post required initial margin or pay required variation margin" in prong (i) of proposed Condition 19.<sup>305</sup> The Commission considers this edit appropriate as it reflects the intent of the Condition as set forth in the 2022 Proposal, and has revised proposed Condition 19 (renumbered as Condition 20 of the final Order) by adding the phrase "to the Japanese nonbank SD." Separately, for purposes of clarity, the Commission notes that, in proposing a notice condition based on thresholds of "required" margin, the Commission's intent was to set the notice trigger by reference to margin amounts that are legally required to be exchanged under the applicable margin requirements. To determine the applicable margin requirements, the Commission will consider the framework set forth in Commission Regulation 23.160.<sup>306</sup> To the extent Japanese nonbank SDs intending to rely on the Comparability Order have inquiries regarding the scope of uncleared swap margin transactions to be monitored for purposes of complying with final Condition 20, MPD will discuss such inquiries with the Japanese nonbank SD during the confirmation process referenced in final Condition 6 of the Comparability Order.

Finally, IBAJ requested that the Commission clarify the meaning of the term "minimum capital requirement" in proposed Condition 19.<sup>307</sup> The

requirements to file notice within 24 hours if the firm does not maintain current books and records. 17 CFR 23.105(c)(3).

<sup>305</sup> IBAJ Letter at p. 7.

<sup>306</sup> Commission Regulation 23.160 governs the cross-border application of the CFTC margin requirements for uncleared swaps depending on the category of entities involved in the transactions and the availability of substituted compliance. 17 CFR 23.160.

<sup>307</sup> *Id.* at p. 8 (asking whether "minimum capital requirement" in this context meant the amount calculated by multiplying the risk equivalent

Commission notes that the concept of "minimum capital requirement" refers to the minimum amount of capital that a Japanese nonbank SD is required to hold pursuant to the Japanese Capital Rules. The Commission understands that this amount corresponds to the Japanese nonbank SD's required "capital adequacy amount" (*i.e.*, 120 percent of the Japanese nonbank SD's risk equivalent amount). To more accurately reflect the intent of the condition, however, the Commission will set forth the notice requirement in proposed Condition 19 (renumbered as final Condition 20) by reference to the Japanese nonbank SD's risk equivalent amount. By using the Japanese nonbank SD's risk equivalent amount as a threshold reference, the Commission will more closely align the condition with Commission Regulation 23.105(c)(7).

As discussed in Section II.E.1. above, the notice provisions are central part of the Commission's and NFA's oversight of nonbank SDs. To ensure that the Commission and NFA receive appropriate and timely notice of potential capital issues with Japanese nonbank SDs, the Commission is adopting proposed Conditions 16 and 17, which require a Japanese nonbank SD to file notice with the Commission and NFA within 24 hours of filing notice with the FSA that the firm's capital adequacy requirement has fallen below 140 percent and 120 percent, respectively.<sup>308</sup>

Furthermore, the Commission did not receive any comments with respect to the following proposed notice conditions: (i) the Japanese nonbank SD files notice with the Commission and NFA within 24 hours of being informed by the FSA that the firm is not in compliance with any component of the Japanese Capital Rules or Japanese Financial Reporting Rules (proposed Condition 14); (ii) the Japanese nonbank SD files notice with the Commission and NFA within 24 hours if the firm fails to maintain regulatory capital in the form of Basic Items, as defined in Article 176 of the COO, equal to or in excess of the U.S. dollar equivalent of \$20 million (proposed Condition 15); or (iii) the Japanese nonbank SD files notice of the FSA approving a change in the firm's fiscal year-end date, which must be filed with the Commission and NFA at least 15 business days prior to the effective date of the change

amount and 120 percent under the Japanese Capital Rules).

<sup>308</sup> Proposed Conditions 16 and 17 have been renumbered as Conditions 17 and 18, respectively, in the final Comparability Order.

(proposed Condition 20). The Commission, having considered the 2022 Proposal, is adopting the above conditions as proposed.<sup>309</sup>

Commenters also requested that the Commission set the compliance date at least six months following the issue date of the Comparability Order to allow Japanese nonbank SDs to adequately prepare for compliance with the notice reporting obligations imposed by the Comparability Order.<sup>310</sup> Similar to its position with regard to the financial reporting obligations, the Commission believes that granting an additional period of time to allow Japanese nonbank SDs to establish and implement the necessary processes to comply with the notice requirements imposed by the Comparability Order is appropriate with respect to certain notice obligations. Specifically, the Commission understands that establishing a process for monitoring failures to collect or post initial margin or variation margin for uncleared swap transactions that exceed specified thresholds for purposes of complying with final Condition 20 may take time. Conversely, the Commission does not believe that additional time is necessary for implementing a process of providing a notice to the Commission and NFA in connection with the occurrence of events that Japanese nonbank SDs currently monitor and/or report to the FSA. The Commission is also of the view that, given the nature of the notice obligation, Japanese nonbank SDs should be in a position to comply with all other notice obligations, including those requiring Japanese nonbanks SDs to provide notice to the Commission and NFA if they fail to make or keep current financial books and records, or if they fail to maintain regulatory capital in the form of Basic Items equal to, or in excess of, the U.S. dollar equivalent of \$20 million, immediately upon effectiveness of the Comparability Order. Accordingly, the Commission is setting a compliance date of 180 calendar days after the publication of the Comparability Order in the **Federal Register** with respect to the notice reporting obligations under final Condition 20 of the Comparability Order. Commenters did not address any other aspects of the proposed Comparability Determination or Comparability Order concerning the

<sup>309</sup> The Commission is renumbering proposed Conditions 14, 15, 19, and 20 as Conditions 15, 16, 20, and 21, respectively, in the final Comparability Order.

<sup>310</sup> IBAJ Letter at p. 4 and Associations Letter at p. 4.

comparability of the Japanese and CFTC nonbank SD notice requirements.

In conclusion, the Commission finds that the regulatory notice provisions of Japanese Financial Reporting Rules and the CFTC Financial Reporting Rules, after consideration of the conditions imposed in the final Comparability Order, are comparable in purpose and effect, and achieve comparable regulatory outcomes, by providing timely notice to the FSA, and to the Commission and NFA, of specified events at a nonbank SD that may potentially indicate an ongoing issue with the safety and soundness of the firm and/or its ability to meet its obligations to swap counterparties, creditors, or other market participants without the firm becoming insolvent. As such, the Commission adopts the final Comparability Order and conditions as proposed with respect to the Commission's analysis of comparability of the Japanese and Commission's nonbank SD notice reporting requirements, subject to the technical edits in Condition 20 discussed above. The Commission is also adopting a compliance date for certain notice reporting requirements as discussed above in the final Comparability Order.

#### F. Supervision and Enforcement

##### 1. Proposed Determination

In the 2022 Proposal, the Commission discussed the oversight of nonbank SDs, noting that 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.<sup>311</sup> As discussed, the Commission and NFA also conduct periodic examinations as part of their supervision of nonbank SDs, including routine onsite examinations of nonbank SDs' books, records, and operations to ensure compliance with CFTC and NFA requirements.<sup>312</sup>

The Commission also referred to the financial reports and notices required under the CFTC Financial Reporting Rules, noting that the reports and notices provide the Commission and NFA with information necessary to

ensure the nonbank SD's compliance with minimum capital requirements; assess the firm's overall safety and soundness and ability to meet its financial obligations to customers, counterparties, creditors, and general market participants; and identify potential issues at a nonbank SD that may impact the firm's ability to maintain compliance with the CEA and Commission regulations.<sup>313</sup> As discussed in the 2022 Proposal, the Commission and NFA also have the authority to require a nonbank SD to provide any additional financial and/or operational information as they may specify to monitor the safety and soundness of the firm.<sup>314</sup>

The Commission further noted that it has authority to take disciplinary actions against a nonbank SD for failing to comply with the CEA and Commission regulations. In this regard, Section 4b-1(a) of the CEA provides the Commission with exclusive authority to enforce the capital requirements imposed on nonbank SDs adopted under Section 4s(e) of the CEA.<sup>315</sup> NFA also may take disciplinary actions against nonbank SDs for failure to comply with NFA rules.<sup>316</sup>

With respect to the FSA's authority to supervise Japanese nonbank SDs and carry out enforcement actions, the Commission stated that the FSA has supervision, audit, and investigation authority with respect to Japanese nonbank SDs, including the authority to require such firms to provide all necessary information for the FSA to carry out its supervisory responsibilities.<sup>317</sup> Specifically, as discussed in the 2022 Proposal, the FSA has the authority to require Japanese nonbank SDs to submit documents to the FSA and to conduct onsite inspections at the business offices of the Japanese nonbank SDs.<sup>318</sup>

The Commission noted that the FSA also monitors the capital adequacy

ratios of Japanese nonbank SDs through supervisory measures on an ongoing basis, referring to the system of notice requirements, discussed in Section E.1. above, that obligate Japanese nonbank SDs to provide notice to the FSA if certain triggering conditions are met. The Commission also discussed the FSA's authority to address actual cases of a Japanese nonbank SD's failure to maintain its required capital adequacy ratio. Specifically, as discussed, a Japanese nonbank SD is required to submit a notification and an action plan to the FSA if the Japanese nonbank SD's capital adequacy ratio falls below 120 percent.<sup>319</sup> The FSA will review the plan and, when necessary, identify the specific method by which the Japanese nonbank SD is required to bring its capital adequacy ratio back above the prescribed minimum level. The FSA also may order a Japanese nonbank SD to change its business methods, order assets to be deposited, or issue orders with respect to matters that are otherwise necessary from a supervisory perspective, if the FSA finds it in the public interest or for the protection of customers to take such actions.<sup>320</sup> Furthermore, a Japanese nonbank SD may have all or parts of its business suspended for a period of up to six months or have its registration revoked if the firm violates certain laws or regulations in connection with the financial instruments business or services,<sup>321</sup> or if the firm is likely to become insolvent.<sup>322</sup> Finally, a Japanese nonbank SD is subject to fines and other possible actions if it fails to submit documents that are required by law to be filed with the FSA.<sup>323</sup> Based on its analysis of the FSA's supervisory regime, the Commission preliminarily found that the FSA has the necessary powers and ability to supervise and enforce Japanese nonbank SDs' compliance with Japanese capital adequacy and financial reporting requirements.

The Commission also cited its long history of regulatory cooperation with the FSA, noting that the Commission and the FSA have entered into a Memorandum of Cooperation ("MOC") with regard to the cooperation and the exchange of information in the supervision and oversight of regulated entities that operate on a cross-border basis in both the U.S. and Japan ("Cross-Border Covered Entities"), including

<sup>311</sup> See 2022 Proposal at 48112.

<sup>312</sup> See *id.* Section 17(p)(2) of the CEA requires NFA as a registered futures association to establish minimum capital and financial requirements for nonbank 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.

<sup>313</sup> See 2022 Proposal at 48112-48113.

<sup>314</sup> 17 CFR 23.105(h). See also 2022 Proposal at 48112-48113.

<sup>315</sup> *Id.* at 48113.

<sup>316</sup> NFA is required by the CEA to maintain rules providing that its member and persons associated with its members, including nonbank SDs, shall be appropriately disciplined by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules. 7 U.S.C. 21(b)(8); see also Commission Regulation 170.6 (17 CFR 170.6), which requires, among other things, a registered futures association to take vigorous action against members that engage in activities in violation of the association's rules and to impose discipline that is fair and has a reasonable basis in fact.

<sup>317</sup> FSA Application, p. 16.

<sup>318</sup> Article 56-2 of the FIEA. See 2022 Proposal at 48113.

<sup>319</sup> Article 53(2) of the FIEA.

<sup>320</sup> *Id.*

<sup>321</sup> Article 52(1)(vii) of the FIEA.

<sup>322</sup> Article 52(1)(viii) of the FIEA.

<sup>323</sup> Article 198-6 of the FIEA. See 2022 Proposal at 48113.

nonbank SDs registered with the Commission and FIBOs registered with the FSA.<sup>324</sup> As discussed in the 2022 Proposal, pursuant to the MOC, the Commission and FSA have expressed an intent to consult regularly, as appropriate, regarding: (i) general supervisory issues, including regulatory, oversight, or other related developments; (ii) issues relevant to the operations, activities, and regulation of Cross-Border Covered Entities; and (iii) any other areas of mutual supervisory interest, and to meet periodically to discuss their respective functions and regulatory oversight programs.<sup>325</sup> The MOC further provides for the Commission and FSA to inform each other of certain events, including any material events that could adversely impact the financial or operational stability of a Cross-Border Covered Entity, and provides a procedure for the Commission or FSA to conduct on-site examinations in, respectively, Japan or the U.S.<sup>326</sup> The Commission stated that, pursuant to the terms of the MOC, it intends to communicate and consult with the FSA regarding the supervision of the financial and operational condition of Japanese nonbank SDs.<sup>327</sup>

Finally, in addition to preliminary finding that the FSA has the necessary powers and authorities to conduct supervisory programs, the Commission also noted that it retains examination authority and enforcement authority over Japanese nonbank SDs.<sup>328</sup> The ability of the Commission to exercise its

enforcement authority over Japanese nonbank SD is not conditioned upon a finding by the FSA of a violation of the Japanese Capital Rules or Japanese Financial Reporting Rules. In addition, as each Japanese nonbank SD is a member of NFA, the firm is subject to NFA membership rules, examination authority, and disciplinary process.<sup>329</sup>

## 2. Comment Analysis and Final Determination

In response to the Commission's request for comment, Better Markets stated that to ensure that the Commission fulfills its obligation to protect the U.S. financial system, it must ensure, on an ongoing basis, that each grant of substituted compliance remains appropriate over time by, at least, requiring that each order granting substituted compliance, and each memorandum of understanding with a foreign regulatory authority, impose an obligation that the applicant, as appropriate: (1) periodically apprise the Commission of the activities and results of its supervision and enforcement programs, to ensure that they remain sufficiently robust to deter and address violations of the law; and (2) immediately apprise the Commission of any material changes to the regulatory regime, whether explicit (*i.e.*, rules changes) or implicit (*i.e.*, changes in how a rule is interpreted, applied, or enforced).<sup>330</sup>

As discussed above, the Commission has entered into an MOC with the FSA, which sets forth a comprehensive framework for cooperation, timely communications, and exchange of information between the agencies. In addition, the 2022 Proposal includes a proposed condition requiring the FSA to notify the Commission of any material changes to the information submitted in the FSA Application, including, but not limited to, proposed and final material changes to the Japanese Capital Rules or Japanese Financial Reporting Rules and proposed and final material changes to the FSA's supervisory authority or supervisory regime over Japanese nonbank SDs. The Commission has included this condition in its final Comparability Order and further expanded it to require that a Japanese nonbank SD relying on the Comparability Order provide such notice.<sup>331</sup> As such, the Commission

believes that the comment concerning the nature and extent of cooperation and communication between the CFTC and the FSA with respect to the supervision and oversight of Japanese nonbank SDs is adequately addressed.

Furthermore, in issuing a Comparability Order, the Commission is not ceding its supervisory and enforcement authority. Japanese nonbank SDs that are subject to a Comparability Order are registered with the Commission as SDs and are members of NFA, and, as such, are subject to the CEA, Commission regulations, and NFA membership rules and requirements. Japanese nonbank SDs covered by the Comparability Order also remain subject to the Commission's examination authority with respect to all elements of the CEA and Commission regulations, including capital and financial reporting.<sup>332</sup> Therefore, the Commission and NFA have an ongoing obligation to conduct oversight, including potential examination, of Japanese nonbank SDs. In this regard, Japanese nonbank SDs covered by a Comparability Order are not only required to provide the Commission and NFA with information pursuant to the conditions in the order, they are also required to directly provide the Commission and NFA with additional information upon the Commission's and/or NFA's request in order to facilitate the ongoing supervision of such firms.<sup>333</sup> Further, Section 17 of NFA's SD Financial Requirements rule provides that each SD member of NFA must file the financial, operational, risk management and other information required by NFA in the form and manner prescribed by NFA.<sup>334</sup> The ability to obtain information directly from Japanese nonbank SDs ensures that the Commission and NFA have access to the information necessary to monitor the financial condition of such firms and to assess the firms' compliance with applicable capital and financial reporting requirements.

In addition, as detailed in Section I.E. above, the conditions set forth in the Comparability Order reflect that the

nonbank SDs who rely on the Comparability Order and are responsible for complying with the terms of the Order must also have an obligation to inform the Commission and NFA of material changes to the information submitted in the FSA Application. Japanese nonbank SDs may act individually or in coordination with the FSA to ensure that the Commission and NFA receive a timely notice.

<sup>332</sup> 17 CFR 23.106(a)(4)(ii).

<sup>333</sup> 17 CFR 23.105(h).

<sup>334</sup> *NFA Financial Requirements, Section 17. Swap Dealer and Major Swap Participant Reporting Requirements*, available at NFA's website: <https://www.nfa.futures.org/rulebooksqll/index.aspx>.

<sup>324</sup> *Memorandum of Cooperation Related to the Supervision of Cross-Border Covered Entities* (Mar. 10, 2014), available here: <https://www.cftc.gov/idc/groups/public/%40internationalaffairs/documents/file/cftc-ifsamoc031014.pdf>. In addition, both the Commission and the FSA 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. See 2022 Proposal at 48111–48112.

<sup>325</sup> MOC, paragraphs 19 and 26.

<sup>326</sup> MOC, paragraph 22 and 29. Event-triggered notification in paragraph 22 of the MOC includes any known adverse material change in the ownership, operating environment, operations, financial resources, management, or systems and controls of a Cross-Border Covered Entity, and the failure of a Cross-Border Covered Entity to satisfy any of its requirements for continued authorization or registration where that failure could have a material adverse effect in the jurisdiction of the Commission or FSA.

<sup>327</sup> See 2022 Proposal at 48113.

<sup>328</sup> 2022 Proposal at 48094–48095. In discussing the comparability framework, the Commission noted that a non-U.S. nonbank SD that has received confirmation of its ability to operate under a Comparability Order remains subject to the Commission's examination authority and may be subject to a Commission enforcement action if the firm fails to comply with a foreign jurisdiction's capital adequacy or financial reporting requirements.

<sup>329</sup> 7 U.S.C. 21(p).

<sup>330</sup> Better Markets Letter at pp. 6–7.

<sup>331</sup> Condition 22 of the final Comparability Order. Final Condition 22 requires that the “Japanese nonbank SD or the [FSA]” provide a notice of material changes to the information submitted in the FSA Application. Although the FSA is the applicant, the Commission believes that Japanese

Commission and NFA have a continuing obligation to conduct ongoing oversight, including potential examination, of Japanese nonbank SDs to ensure compliance with the Comparability Order. Specifically, as part of this oversight, the conditions require Japanese nonbank SDs to file directly with the Commission and NFA financial reports and notices that are comparable to the financial reports and notices filed by nonbank SDs domiciled in the U.S. In addition to requiring Japanese nonbank SDs to maintain current books and records reflecting all transactions,<sup>335</sup> the conditions further require each Japanese nonbank SD covered by the Comparability Order to file directly with the Commission and NFA: (i) notice that the firm was informed by the FSA that it is not in compliance with any component of the Japanese Capital Rules or Japanese Financial Reporting Rules;<sup>336</sup> (ii) monthly and annual financial reports;<sup>337</sup> (iii) notice that the firm's capital adequacy ratio has fallen below 140 percent or 120 percent;<sup>338</sup> (iv) notice that the firm has failed to maintain regulatory capital in the form of Basic Items in amount equal to or in excess of the equivalent of \$20 million;<sup>339</sup> and (v) notice that the firm has failed to make or keep current financial books and records required by the FSA.<sup>340</sup> The Comparability Order further requires a Japanese nonbank SD or the FSA to provide notice to the Commission of any material changes to the information submitted in the application, including, but not limited to, proposed and final material changes to the Japanese Capital Rules or Japanese Financial Reporting Rules and proposed and final material changes to the FSA's supervisory authority or supervisory regime over Japanese nonbank SDs.<sup>341</sup> The financial information and notices required to be filed directly with the Commission and NFA under the Comparability Order, and through the Commission's and NFA's direct authority to obtain additional information from Japanese nonbank SDs, will allow the Commission and NFA to conduct ongoing oversight of such firms to assess their overall safety and soundness.

In conclusion, the Commission finds that the FSA maintains a supervisory

program over Japanese nonbank SDs that is comparable to the Commission's supervisory program over nonbank SDs. The FSA's supervisory program is comparable in purpose and effect to the Commission's supervisory program in that both programs are designed to monitor the safety and soundness of nonbank SDs through a combination of periodic financial reporting, notice reporting, and examination. Also, as noted above, the Commission and NFA will continue to conduct oversight of Japanese nonbank SDs through conditions in the Comparability Order imposing obligations on the firms to provide financial reporting and notices directly to the Commission and NFA.

In addition, the Commission finds that the FSA and Commission have comparable and sufficient enforcement authority over nonbank SDs. As discussed in Section II.F.1. above, the FSA and the Commission may sanction nonbank SDs for noncompliance with capital and financial reporting requirements by imposing fines or, if necessary, revoking the firms' registration. Furthermore, as discussed above, NFA may also take disciplinary action against a nonbank SD for failure to comply with its rules, including nonbank SD capital and financial reporting requirements. Accordingly, the Commission is adopting the Comparability Order as proposed with respect to the Commission's analysis concerning the comparability of the supervisory programs and enforcement authorities of the Commission, NFA, and FSA with respect to nonbank SD capital and financial reporting.

### III. Final Capital Comparability Determination and Comparability Order

#### A. Commission's Final Comparability Determination

Based on the FSA's Application and the Commission's review of applicable Japanese laws and regulations, as well as the review of comments submitted in response to the Commission's request for comment on the FSA Application and the proposed Comparability Determination and Comparability Order, the Commission finds that the Japanese Capital Rules and the Japanese Financial Reporting Rules, subject to the conditions set forth in the Comparability 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 conclusion, the Commission recognizes that there are certain differences between the Japanese Capital Rules and

CFTC Capital Rules and certain differences between the Japanese Financial Reporting Rules and the CFTC Financial Reporting Rules. The Comparability Order below is subject to conditions that are 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 view, the differences between the two rule sets are not inconsistent with providing a substituted compliance framework for Japanese nonbank SDs subject to the conditions specified in the Order below.

Furthermore, the Comparability Determination and Comparability Order are limited to the comparison of the Japanese Capital Rules to the Bank-Based Approach under the CFTC Capital Rules. As noted previously, the FSA has not requested, and the Commission has not performed, a comparison of the Japanese Capital Rules to the Commission's NLA Approach or TNW Approach.

#### B. Order Providing Conditional Capital Comparability Determination for Japanese 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 Japan 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 Japanese 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 Japan and is domiciled in Japan (a "Japanese nonbank SD");

(3) The Japanese nonbank SD is registered as a Type I Financial Instruments Business Operator ("FIBO") with the Japan Financial Services Agency;

<sup>335</sup> Condition 7 of the final Comparability Order.

<sup>336</sup> Condition 15 of the final Comparability Order.

<sup>337</sup> Conditions 8, 9 and 10 of the final Comparability Order.

<sup>338</sup> Conditions 17 and 18 of the final Comparability Order.

<sup>339</sup> Condition 16 of the final Comparability Order.

<sup>340</sup> Condition 19 of the final Comparability Order.

<sup>341</sup> Condition 22 of the final Comparability Order.

(4) The Japanese nonbank SD is subject to and complies with: Articles 28(1), 29, 46–3, 46–6(2), 47, 52(1), 53(1) through (3), 56–2, and 198–6 of the Financial Instruments and Exchange Act (Act No. 25 of 1948); Section II–1–4 (General Supervisory Processes), Section IV–2–1 (Preciseness of Capital Adequacy Ratio), and Section IV–2–2 (Supervisory Response to Cases of Financial Instruments Business Operators' Capital Adequacy Ratio Falling Below Prescribed Level) of the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators; Articles 172, 176, 177(8), 178(1), 179(3), and Appended Forms No. 12 of the Cabinet Office Order on Financial Instruments Business (Cabinet Office Order No. 52 of 2007); Articles 1 through 17 of the Financial Services Agency Notice No. 59 of 2007; Articles 2(vi), 328(1) and (2), 435(2), and 436(2)(i) of the Japanese Companies Act (Act No. 86 of 2005); and Articles 59 and 76 of the Rules of Corporate Accounting (Ordinance of the Ministry of Justice No. 13 of 2006) (collectively, the "Japanese Capital Rules and Japanese Financial Reporting Rules");

(5) The Japanese nonbank SD maintains at all times an amount of regulatory capital in the form of Basic Items, as defined in Article 176 of the Cabinet Office Order No. 52 of 2007, equal to or in excess of the equivalent of \$20 million in United States dollars ("U.S. dollars"). The Japanese nonbank SD shall use a commercially reasonable and observed yen/U.S. dollar exchange rate to convert the value of the yen-denominated Basic Items to U.S. dollars;

(6) The Japanese nonbank SD has filed with the Commission a notice stating its intention to comply with the Japanese Capital Rules and Japanese Financial Reporting Rules in lieu of the CFTC Capital Rules and the CFTC Financial Reporting Rules. The notice of intent must include the Japanese nonbank SD's representation that the firm is organized and domiciled in Japan; is a registered FIBO; and is subject to, and complies with, the Japanese Capital Rules and Japanese Financial Reporting Rules. The Japanese nonbank SD may not rely on this Comparability Order until it receives confirmation from Commission staff, acting pursuant to authority delegated by the Commission under Commission Regulation 140.91(a)(11) (17 CFR 140.91(a)(11)), that the Japanese nonbank SD may comply with the Japanese Capital Rules and Japanese Financial Reporting Rules in lieu of the CFTC Capital Rules and CFTC Financial 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*;

(7) The Japanese nonbank SD prepares and keeps current ledgers and other similar records in accordance with accounting principles permitted by the Financial Services Agency;

(8) The Japanese nonbank SD files with the Commission and with the National Futures Association ("NFA") a copy of Forms 1–1 Capital Ratio Summary, 1–2 Capital Ratio: Deductible Assets, 1–3 Market Risk, 1–4 Counterparty Risk, 2–1 Monthly Financial Statement (1), and 2–2 Monthly Financial Statement (2) of its Monthly Monitoring Report that is required to be filed with the Financial Services Agency pursuant to Article 56–2(1) of the Financial Instruments and Exchange Act. The selected forms of the Monthly Monitoring Report must be translated into the English language and balances must be converted to U.S. dollars, using a commercially reasonable and observable yen/U.S. dollar spot rate as of the date of the reports. The selected forms of the Monthly Monitoring Report must be filed with the Commission and NFA within 35 calendar days after the end of each month;

(9) The Japanese nonbank SD files with the Commission and with NFA a copy of its Annual Business Report that is required to be filed with the Financial Services Agency in accordance with Article 46–3(1) of the Financial Instruments and Exchange Act and Article 172 of the Cabinet Office Order on Financial Instruments Business. The Annual Business Report must be translated into the English language and balances must be converted to U.S. dollars, using a commercially reasonable and observable yen/U.S. dollar spot rate as of the date of the report. The Annual Business Report must be filed with the Commission and NFA within 15 business days of the earlier of the date the Annual Business Report is filed with the Financial Services Agency or the date that the Annual Business Report is required to be filed with the Financial Services Agency;

(10) The Japanese nonbank SD files with the Commission and with NFA a copy of its Annual Audited Financial Report that is required to be prepared pursuant to Article 435(2) of the Japanese Companies Act (Act No. 86 of 2005). The Annual Audited Financial Report must be translated into the English language and balances may be reported in yen. The Annual Audited Financial Report must be filed with the

Commission and NFA within 15 business days of approval of the report at the shareholders' meeting of the Japanese nonbank SD;

(11) The Japanese nonbank SD files Schedule 1 of appendix B to Subpart E of Part 23 of the Commission'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, using a commercially reasonable and observable yen/U.S. dollar spot rate as of the date of the report, and must be filed with the Commission and NFA with the selected forms of the Japanese nonbank SD's Monthly Monitoring Report required under Condition (8) of this Comparability Order;

(12) A Japanese nonbank SD that is a registered securities-based swap dealer with the U.S. Securities and Exchange Commission ("SEC") and is required to file a monthly Form X–17A–5 ("FOCUS Report") with the SEC, or its designee, must file a copy of the FOCUS Report with the Commission and NFA within 35 calendar days after the end of each month. A Japanese nonbank SD that files a FOCUS Report with the Commission and NFA pursuant to this Condition is not required to file the financial reports and schedules specified in Conditions 8 and 11 of this Comparability Order;

(13) The Japanese 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 on a monthly basis ("Margin Report"). The Margin Report must be prepared in the English language with balances reported in U.S. dollars, using a commercially reasonable and observable yen/U.S. dollar spot rate as of the date of the report, and must be filed with the Commission and NFA with the selected forms of the Japanese nonbank SD's Monthly Monitoring Report;

(14) The Japanese nonbank SD submits with the specified forms of the Monthly Monitoring Report set forth in Condition 8, Schedule 1 of appendix B to Subpart E of Part 23 specified in Condition 11, the Margin Report specified in Condition 13, the Annual Business Report specified in Condition 9, and the Annual Audited Financial Report specified in Condition 10, a statement by an authorized representative or representatives of the Japanese nonbank SD that to the best knowledge and belief of the representative or representatives the information contained in the applicable



forms, schedules, and reports, including as applicable the translation of the forms, schedules, and reports into the English language and conversion of balances to U.S. dollars, is true and correct. The statement must be prepared in the English language;

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

(16) The Japanese nonbank SD files a notice with the Commission and NFA within 24 hours if it fails to maintain regulatory capital in the form of Basic Items, as defined in Article 176 of the Cabinet Office Order No. 52 of 2007, equal to or in excess of the U.S. dollar equivalent of \$20 million using a commercially reasonable and observed yen/U.S. dollar exchange rate. The notice must be prepared in the English language;

(17) The Japanese nonbank SD provides the Commission and NFA with notice within 24 hours of filing a notice with the Financial Services Agency pursuant to Article 179 of the Cabinet Office Order on Financial Instruments Business that the firm's capital adequacy ratio has fallen below the early warning level of 140 percent. The notice filed with the Commission and NFA must be prepared in the English language;

(18) A Japanese nonbank SD provides the Commission and NFA with notice within 24 hours of filing a notice with the Financial Services Agency pursuant to Article 179 of the Cabinet Office Order on Financial Instruments Business that the firm's capital adequacy ratio has fallen below 120 percent. The notice filed with the Commission and NFA must be prepared in the English language;

(19) The Japanese 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 required by the Financial Services Agency. The notice must be prepared in the English language;

(20) The Japanese 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 to the Japanese nonbank SD on uncleared swap and non-cleared security-based swap positions that, in the aggregate,

exceeds 25 percent of the Japanese nonbank SD's risk equivalent amount; (ii) counterparties fail to post required initial margin or pay required variation margin to the Japanese nonbank SD for uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 50 percent of the Japanese nonbank SD's risk equivalent amount; (iii) the Japanese 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 Japanese nonbank SD's risk equivalent amount; or (iv) the Japanese 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 Japanese nonbank SD's risk equivalent amount. The notice must be prepared in the English language;

(21) The Japanese 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 Financial Services Agency. 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 Japanese nonbank SD's change in fiscal year-end;

(22) The Japanese nonbank SD or the Financial Services Agency notifies the Commission of any material changes to the information submitted in the application, including, but not limited to, proposed and final material changes to the Japanese Capital Rules or Japanese Financial Reporting Rules and proposed and final material changes to the Financial Services Agency's supervisory authority or supervisory regime over Japanese nonbank SDs. The notice must be prepared in the English language; and

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

*It is also hereby determined and ordered* that this Comparability Order becomes effective upon its publication in the **Federal Register**, with the exception of Conditions 11, 13, and 20, which will become effective 180 calendar days after publication of the Comparability Order in the **Federal Register**.

Issued in Washington, DC, on July 3, 2024, 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 Order Granting Conditional Substituted Compliance in Connection with Certain Capital and Financial Reporting Requirements Applicable to Nonbank Swap Dealers Subject to Regulation by the Financial Services Agency of Japan—Voting Summary and Chairman's and Commissioners' Statements**

#### **Appendix 1—Voting Summary**

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

#### **Appendix 2—Supporting Statement of Chairman Rostin Behnam**

I support the Commission's approval of four comparability determinations and related orders finding that the capital and financial reporting requirements in Japan, Mexico, the European Union (France and Germany), and the United Kingdom (for swap dealers (SDs) designated for prudential supervision by the UK Prudential Regulation Authority (PRA)) are comparable to the Commission's capital and financial reporting requirements applicable to nonbank SDs. These are the first comparability determinations that the Commission has finalized for applications filed following the July 2020 adoption of its regulatory framework for substituted compliance for non-U.S. domiciled nonbank SDs.<sup>1</sup> There are currently 15 non-U.S. nonbank SDs that are eligible to comply with these conditional orders: three in Japan; three in Mexico; two in Germany and one in France for the EU; and six in the UK that are PRA-designated.

As part of the process leading to the Commission's final comparability determinations and orders, Commission staff engaged in a thorough analysis of each foreign jurisdictions' capital and financial reporting frameworks and considered the public comments received on the proposed determinations and orders. Based on those reviews, the Commission has determined that

<sup>1</sup> *Capital Requirements of Swap Dealers and Major Swap Participants*, 85 FR 57462 (Sept. 15, 2020). The Commission issued the final rule on July 24, 2020.

the respective foreign jurisdictions' rules are comparable in purpose and effect, and achieve comparable outcomes, to the CFTC's capital and financial reporting rules. Specifically, the Commission considered the scope and objectives of the foreign regulators' capital adequacy and financial reporting requirements; the ability of those regulators to supervise and enforce compliance with their respective capital and financial reporting requirements; and other facts or circumstances the Commission deemed relevant for each of the applications.

In certain instances, the Commission found that a foreign jurisdiction's rules impose stricter standards. In limited circumstances, where the Commission concluded that a foreign jurisdiction lacks comparable and comprehensive requirements on a specific issue, the Commission included a targeted condition designed to impose an equally stringent standard. The Commission has issued the final orders consistent with its authority to issue a comparability determination with the conditions it deems appropriate. These conditions aim to ensure that the orders only apply to nonbank SDs that are eligible for substituted compliance in these respective jurisdictions and that those non-U.S. nonbank SDs comply with the foreign country's capital and financial reporting requirements as well as certain additional capital, financial reporting, recordkeeping, and regulatory notice requirements. This approach acknowledges that jurisdictions may adopt unique approaches to achieving comparable outcomes. As a result, the Commission has focused on whether the applicable foreign jurisdiction's capital and financial reporting requirements achieve comparable outcomes to the corresponding Commission requirements for nonbank SDs, not whether they are comparable in every aspect or contain identical elements.

With these comparability determinations, the Commission fully retains its enforcement and examination authority as well as its ability to obtain financial and event specific reporting to maintain direct oversight of nonbank SDs located in these four jurisdictions. The avoidance of duplicative requirements without a commensurate benefit to the Commission's oversight function reflects the Commission's approach to recognizing the global nature of the swap markets with dually-registered SDs that operate in multiple jurisdictions, which mandate prudent capital and financial reporting requirements. This is, however, an added benefit and not the Commission's sole justification for issuing these comparability determinations.

The comparability orders will become effective upon their publication in the **Federal Register**. For several order conditions, the Commission is granting an additional compliance period of 180 calendar days. To rely on a comparability order, an eligible non-U.S. nonbank SD must notify the Commission of its intention to satisfy the Commission's capital and financial requirements by substituted compliance and receive a Commission confirmation before relying on a determination.

I appreciate the hard work and dedication of the staff in the Market Participants

Division over the past several years to propose and finalize these four determinations. I also thank the staff in the Office of the General Counsel and the Office of International Affairs for their support on these matters.

### Appendix 3—Statement of Commissioner Kristin N. Johnson

I support the Commodity Futures Trading Commission's (Commission or CFTC) issuance of four final capital and financial reporting comparability determinations and related orders (together, Final Comparability Determinations) for non-U.S. nonbank swap dealers (foreign nonbank SDs) and non-U.S. nonbank major swap participants (foreign nonbank MSPs) organized and domiciled in the United Kingdom (UK), the European Union (specifically, France and Germany), Mexico, and Japan.<sup>1</sup>

The Final Comparability Determinations allow eligible foreign nonbank SDs to satisfy certain capital and financial reporting requirements under the Commodity Exchange Act (CEA) and Commission regulations if they: (1) are subject to, and comply with, comparable capital and financial reporting requirements under the laws and regulations applicable in their home countries and (2) comply with the conditions enumerated in the applicable Final Comparability Determination. Under this conditional substituted compliance framework, foreign nonbank SDs in the relevant jurisdictions that comply with these conditions are deemed to be in compliance with the Commission's capital and financial reporting requirements.

Well-calibrated capital requirements create a cushion to absorb unexpected losses in times of market stress, and well-calibrated financial reporting requirements provide the Commission with information to monitor the business operations and financial condition of registered SDs. These tools are critical to managing systemic risk and fostering the stability of U.S. derivatives markets and the U.S. financial system. The Commission's substituted compliance framework addresses the need to promote sound global derivatives regulation while mitigating potentially duplicative cross-border regulatory requirements for non-U.S. market participants operating in our markets. Where the Commission permits substituted compliance, it must retain sufficient oversight, examination, and enforcement authority to ensure compliance with the foreign jurisdiction's laws and the conditions to substituted compliance.

Crucially, while these Final Comparability Determinations permit foreign nonbank SDs to comply with home country regulations in lieu of compliance with Commission regulations, the Commission is also imposing important guardrails to ensure continuous supervision of the operations and financial condition of the foreign SD.

<sup>1</sup> Though the Final Comparability Determinations will apply to foreign nonbank MSPs in the relevant jurisdictions, there are no such MSPs currently registered with the Commission at this time. I will refer only to SDs herein.

### Background

For an example of the detrimental consequences of failing to adequately capitalize nonbank swap market participants, one need look no further than the 2008 global financial crisis. According to the U.S. Government Accountability Office, the crisis, which threatened the stability of the U.S. financial system and the health of the U.S. economy, may have led to \$10 trillion in losses, including large declines in employment and household wealth, reduced tax revenues from lower economic activity, and lost economic output.<sup>2</sup> In response to the crisis, in 2010, the U.S. Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which amended the CEA to create a new regulatory framework for swaps.

As amended, Section 4s(e) of the CEA directs the Commission and prudential regulators to impose minimum capital requirements on SDs registered with the Commission. Section 4s(e) adopts separate approaches for the imposition of minimum capital requirements on bank and nonbank SDs. For bank SDs, prudential regulators are authorized to set the minimum capital requirements. For nonbank SDs, the Commission is authorized to set those requirements. The amended CEA also sets out financial reporting requirements for SDs. Under Section 4s(f) of the CEA, registered SDs are required to make financial condition reports and other reports regarding transactions and positions as mandated by Commission regulations.

In 2020, the Commission adopted regulations implementing both the capital and financial reporting requirements for SDs, which were amended in 2024 (the Capital and Financial Reporting Rules).<sup>3</sup> The Capital and Financial Reporting Rules set minimum capital levels that nonbank SDs must maintain and financial reporting requirements that nonbank SDs must comply with, including filing periodic unaudited financial statements and an annual audited financial report.<sup>4</sup>

Like the U.S., many other nations adopted their own regulatory regimes to govern swaps markets in the aftermath of the financial crisis. Since then, regulators from around the world have endeavored to improve the resilience of swaps markets and establish a global set of standards on critical risk

<sup>2</sup> United States Government Accountability Office, Financial Regulatory Reform: Financial Crisis Losses and Potential Impacts of the Dodd-Frank Act (Jan. 2013), <https://fraser.stlouisfed.org/title/gao-reports-testimonies-6136/financial-regulatory-reform-622249>.

<sup>3</sup> Capital Requirements of Swap Dealers and Major Swap Participants, 85 FR 57462 (Sept. 15, 2020).

<sup>4</sup> The reporting requirements imposed on bank SD and bank MSPs were "more limited" "as the financial condition of these entities will be predominantly supervised by the applicable prudential regulator and subject to its capital and financial reporting requirements." *Id.* at 57513. In May 2024, the Commission adopted amendments to the Capital and Financial Reporting Rules that codified two previously-issued staff letters providing interpretive guidance and no-action relief and made other technical amendments. 89 FR 45569 (May 23, 2024).

management issues, such as capital and financial reporting requirements. These efforts led to the development of the Principles for Financial Market Infrastructures, to which many jurisdictions, including our own, look for guidance.<sup>5</sup>

The Dodd-Frank Act amendments specifically address the cross-border application of the CFTC's swaps regime. Section 2(i) of the CEA establishes that the CEA's swaps provisions apply to foreign swaps activities that have a "direct and significant" connection to, or effect on, U.S. markets. In line with Section 2(i) of the CEA, the Capital and Financial Reporting Rules set out a substituted compliance framework in Commission Regulation 23.106 for foreign nonbank SDs seeking to comply with the Commission's capital and financial reporting requirements.

The substituted compliance framework consists of comparability determinations that afford "due consideration [to] international comity principles" while being "consistent with . . . the Commission's interest in focusing its authority on potential significant risks to the U.S. financial system."<sup>6</sup> The determinations involve an assessment of the home-country requirements that is a principles-based, holistic approach, focusing on whether the applicable home-country requirements have comparable objectives and achieve comparable outcomes to the Commission's Capital and Financial Reporting Rules.

#### Today's Final Comparability Determinations

The Final Comparability Determinations will apply to 15 foreign nonbank SDs currently registered with the Commission and subject to oversight by the UK Prudential Regulation Authority, the European Central Bank, the Mexican Comisión Nacional Bancaria y de Valores, and the Financial Services Agency of Japan. I commend staff for their hard work on the Final Comparability Determinations, including their work to thoroughly and thoughtfully analyze and address comments.

Importantly, while the Final Comparability Determinations permit foreign nonbank SDs in the relevant jurisdictions to comply with home country regulations in lieu of compliance with Commission regulations, there are numerous protections in place to ensure the Commission's ability to supervise on an ongoing basis the adequacy of the foreign nonbank SDs' compliance. The Final Comparability Determinations all include key conditions with which the foreign nonbank SDs must comply. For example, each of the Final Comparability Determinations requires that the foreign nonbank SDs provide monthly and annual financial reports to the Commission—and the Commission can request additional information as required to facilitate ongoing supervision. Each Final Comparability Determination also requires

<sup>5</sup> Principles for Financial Market Infrastructures, Bank for International Settlements and International Organization of Securities Commissions (Apr. 2012), <https://www.bis.org/cpmi/publ/d101a.pdf>.

<sup>6</sup> Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 FR 56924, 56924 (Sept. 14, 2020).

the foreign nonbank SDs to notify the Commission if adverse events occur, such as a significant decrease in excess regulatory capital, a significant failure of a counterparty to post required margin, or non-compliance with certain capital or financial reporting requirements. Finally, in recognition of the fact that a country's capital standards and financial reporting requirements may change over time, the Final Comparability Determinations require the foreign nonbank SDs to provide notice of material changes to the home country capital or financial reporting frameworks.

Moreover, the foreign nonbank SDs subject to these determinations are registered with the Commission and are members of the National Futures Association (NFA). Therefore, these entities are subject to the CEA, Commission regulations, and NFA membership rules, and each entity remains subject to Commission supervisory, examination and enforcement authority. As noted in the Final Comparability Determinations, if a foreign SD fails to comply with its home country's capital and financial reporting requirements, the Commission may initiate an action for a violation of the Commission's Capital and Financial Reporting Rules.

As I have previously noted,<sup>7</sup> it is important to recognize foreign market participants' compliance with the laws and regulations of their regulators when the requirements lead to an outcome that is comparable to the outcome of complying with the CFTC's corresponding requirements. Respect for partner regulators in foreign jurisdictions advances the Commission as a global standard setter for sound derivatives regulation and enhances market stability.

I thank the staff in the Market Participants Division for their hard work on these matters, particularly Amanda Olear, Tom Smith, and Lily Bozhanova.

#### Appendix 4—Concurring Statement of Commissioner Caroline D. Pham

I respectfully concur with the order granting conditional substituted compliance in connection with certain capital and financial reporting requirements applicable to nonbank swap dealers subject to regulation by the Financial Services Agency of Japan (JFSA) (Japan Final Order) because I believe the order imposes a condition relating to

<sup>7</sup> Kristin N. Johnson, Commissioner, CFTC, Combatting Systemic Risk and Fostering Integrity of the Global Financial System Through Rigorous Standards and International Comity (Jan. 24, 2024), <https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement012424>; Kristin N. Johnson, Commissioner, CFTC, Statement in Support of Notice and Order on EU Capital Comparability Determination (June 7, 2023), <https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement060723c>; Kristin N. Johnson, Commissioner, CFTC, Statement in Support of Proposed Order and Request for Comment on Mexican Capital Comparability Determination (Nov. 10, 2022), <https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement111022c>; Kristin N. Johnson, Commissioner, CFTC, Statement in Support of Proposed Order on Japanese Capital Comparability Determination (July 27, 2022), <https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement072722c>.

financial reporting that exceeds the scope of CFTC Regulation 23.105.

I would like to thank Amanda Olear, Thomas Smith, Rafael Martinez, Warren Gorlick, Liliya Bozhanova, Joo Hong, and Justin McPhee from the CFTC's Market Participants Division for their truly hard work on the Japan Final Order and for addressing some of my concerns. I commend the staff for their tireless efforts for over a decade to finalize the CFTC's capital comparability determinations. I would also like to thank the JFSA for their assistance and support.

I have repeatedly stated the need for a pragmatic, outcomes-based approach to the CFTC's capital comparability determinations, based on recognition of the Basel Committee for Banking Supervision (BCBS) Framework for International Bank Based Capital Standards,<sup>1</sup> that mitigates market fragmentation while promoting financial stability. However, the Japan Final Order overreaches on its conditions relating to financial reporting requirements.

The International Bankers Association of Japan (IBAJ) requested that the CFTC limit the financial information required to be filed by Japanese nonbank swap dealers with the CFTC and National Futures Association (NFA) to the types of financial information required of U.S. nonbank swap dealers under CFTC Regulation 23.105.<sup>2</sup> By requiring the filing of the full home regulator report, the CFTC and NFA will receive information from Japanese nonbank swap dealers that exceeds the scope of Regulation 23.105. For example, IBAJ stated that the out-of-scope information the CFTC and NFA would receive includes information on client assets segregation status, mutual fund and deemed securities transaction volumes, the status of the deemed securities, and other various asset management business status reports that do not relate to swap dealing activity.<sup>3</sup> Accordingly, the CFTC is not entitled to that information. By way of another example, the CFTC does not receive information regarding the consumer banking activity of bank swap dealers.

Instead of taking the common-sense approach of requiring the *same* information in Regulation 23.105 that is applicable to U.S. entities, the CFTC is requiring *more* information from Japanese nonbank swap dealers. The CFTC's justification for exceeding the scope of Regulation 23.105 in the Japan Final Order is so that the CFTC can see the totality of the home regulator report to better determine whether there is extraneous information that is not necessary and can be eliminated.

<sup>1</sup> Concurring Statement of Commissioner Caroline D. Pham Regarding Proposed Swap Dealer Capital and Financial Reporting Comparability Determination (July 27, 2022), <https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement072722>; Bank for International Settlements Basel Committee on Banking Supervision, The Basel Framework, <https://www.bis.org/baselframework/BaselFramework.pdf>.

<sup>2</sup> International Bankers Association of Japan, Letter Re: Japan Swap Dealer Capital Comparability Determination, 87 FR 48092 (August 8, 2022), (Oct. 6, 2022), 3–4.

<sup>3</sup> *Id.*

Mere curiosity is not a sufficient justification to contravene principles of international comity and respect for other sovereign nations that is the foundation of the global financial system. Not only did the IBAJ identify the specific extraneous information that is outside the scope of the CFTC's regulations, but also, I do not understand why the CFTC would set ourselves up to have to amend the Japan Final Order to address this overreach in the future.

Regrettably, this is not the only time that the CFTC appears to take a less deferential approach to Japanese law and, therefore, a more punitive approach to Japanese entities in contrast to other jurisdictions. I question the inequity that is inherent in the CFTC's view of Japan, which has certain banking and financial services laws that are stricter than the United States. Japan is a member of the G7, and its regulators are members of the Financial Stability Board (FSB), BCBS, International Organization of Securities Commissions (IOSCO), and many other international fora dedicated to safeguarding the global financial system. The CFTC has entered into multiple Memorandum of Understanding (MOU) with the JFSA. It goes without saying that Japan protects Japanese citizens and their assets. The Commission must show the same respect for Japanese laws that it provides to other jurisdictions, particularly because Japan is a key international partner and ally to the United States.

On May 25, 2024, the G7 Finance Ministers and Central Bank Governors' Communiqué stated: "We also reiterate our strong commitment to a free, fair, and rules-based multilateral system. Building on the legacy of the Japanese G7 Presidency, we will advance our cooperation to enhance global economic resilience and economic security and protect our economies from systemic shocks and vulnerabilities."<sup>4</sup> I urge the Commission to honor this commitment by the United States. [FR Doc. 2024-15092 Filed 7-17-24; 8:45 am]

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## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Chapter I

#### Order Granting Conditional Substituted Compliance in Connection With Certain Capital and Financial Reporting Requirements Applicable to Nonbank Swap Dealer Subject to Regulation by the Mexican Comision Nacional Bancaria y de Valores and Banco de Mexico

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Order.

**SUMMARY:** On December 13, 2022, the Commodity Futures Trading

Commission ("Commission" or "CFTC") published in the **Federal Register** a notice and request for comment on an application submitted by Morgan Stanley Mexico, Casa de Bolsa, S.A. de C.V., Goldman Sachs Mexico, Casa de Bolsa, S.A. de C.V., and Casa de Bolsa Finamex, S.A. de C.V. requesting that the Commission determine that CFTC-registered nonbank swap dealers organized and domiciled in Mexico may comply with certain capital and financial reporting requirements under the Commodity Exchange Act and Commission regulations by being subject to, and complying with, corresponding capital and financial reporting requirements of Mexico. The Commission also solicited public comment on a proposed order providing for the conditional availability of substituted compliance in connection with the application. The Commission is adopting the proposed order with certain modifications and clarifications to address comments received. The final order provides that a nonbank swap dealer organized and domiciled in Mexico may satisfy the capital requirements and financial reporting rules under the applicable provisions of the Commodity Exchange Act and Commission regulations by complying with certain specified Mexican laws and regulations and conditions set forth in the order.

**DATES:** This determination was made by the Commission on June 24, 2024.

**FOR FURTHER INFORMATION CONTACT:** Amanda L. Olear, Director, 202-418-5283, [aolear@cftc.gov](mailto:aolear@cftc.gov); Thomas Smith, Deputy Director, 202-418-5495, [tsmith@cftc.gov](mailto:tsmith@cftc.gov); Rafael Martinez, Associate Director, 202-418-5462, [rmartinez@cftc.gov](mailto:rmartinez@cftc.gov); Warren Gorlick, Associate Director, 202-418-5195, [wgorlick@cftc.gov](mailto:wgorlick@cftc.gov); Liliya Bozhanova, Special Counsel, 202-418-6232, [lbozhanova@cftc.gov](mailto:lbozhanova@cftc.gov); Justin McPhee, Risk Analyst, 202-418-6223, [jmchpee@cftc.gov](mailto:jmchpee@cftc.gov), Market Participants Division; Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.

**SUPPLEMENTARY INFORMATION:** The Commodity Futures Trading Commission is issuing an order finding that registered nonbank swap dealers organized and domiciled in Mexico ("Mexican nonbank SDs") may satisfy certain capital and financial reporting requirements under the Commodity Exchange Act ("CEA")<sup>1</sup> and

Commission regulations<sup>2</sup> by being subject to, and complying with, comparable capital and financial reporting requirements under relevant Mexican laws and regulations, subject to certain conditions set forth in the order below. The order is based on the proposed comparability determination and related proposed order published by the Commission on December 13, 2022 in the **Federal Register**, as modified in certain aspects to address comments and to clarify its terms.<sup>3</sup>

## I. Introduction

### A. Regulatory Background—CFTC Capital, Margin, and Financial Reporting Requirements for Swap Dealers and Major Swap Participants

Section 4s(e) of the CEA<sup>4</sup> directs the Commission and "prudential regulators"<sup>5</sup> to impose capital requirements on swap dealers ("SDs") and major swap participants ("MSPs") registered with the Commission.<sup>6</sup> Section 4s(e) 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

<sup>2</sup> 17 CFR chapter I. Commission regulations may be accessed through the Commission's website, [www.cftc.gov](http://www.cftc.gov).

<sup>3</sup> 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) ("2022 Proposal").

<sup>4</sup> 7 U.S.C. 6s(e).

<sup>5</sup> The term "prudential regulators" 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. 7 U.S.C. 1a(39).

<sup>6</sup> 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 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. 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) is a financial entity that: (a) is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and (b) maintains a substantial position in outstanding swaps in any major swap category as determined by the Commission. 7 U.S.C. 1a(33).

<sup>4</sup> G7 Finance Ministers and Central Bank Governors' Communiqué, Stresa, 23-25 May 2024, <https://www.consilium.europa.eu/media/muhnmsh1/stresa-communication-25-may-2024.pdf>.

<sup>1</sup> 7 U.S.C. 1 et seq. The CEA may be accessed through the Commission's website, [www.cftc.gov](http://www.cftc.gov).