

## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Parts 1, 23, and 140

RIN 3038—AD54

### Capital Requirements of Swap Dealers and Major Swap Participants

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Commodity Futures Trading Commission (“Commission” or “CFTC”) is proposing to adopt new regulations and to amend existing regulations to implement sections 4s(e) and (f) of the Commodity Exchange Act (“CEA”), as added by section 731 of the Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). Section 4s(e) requires the Commission to adopt capital requirements for swap dealers (“SDs”) and major swap participants (“MSPs”) that are not subject to capital rules of a prudential regulator. Section 4s(f) requires the Commission to adopt financial reporting and recordkeeping requirements for SDs and MSPs. The Commission also is proposing to amend existing capital rules for futures commission merchants (“FCMs”), providing specific capital deductions for market risk and credit risk for swaps and security-based swaps entered into by an FCM. The Commission is further proposing several technical amendments to the regulations.

**DATES:** Comments must be received on or before March 16, 2017.

**ADDRESSES:** You may submit comments, identified by RIN 3038—AD54 and “Capital Requirements for Swap Dealers and Major Swap Participants”, by any of the following methods:

- *CFTC Web site, via its Comments Online process:* <http://comments.cftc.gov>. Follow the instructions for submitting comments through the Web site.
- *Mail:* Send to Chris Kirkpatrick, Secretary, Commodity Futures Trading Commission, 1155 21st Street, NW., Washington, DC 20581.
- *Hand delivery/Courier:* Same as Mail above.
- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments. Please submit your comments using only one of these methods.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <http://www.cftc.gov>. You should submit only

information that you wish to make available publicly. If you wish the Commission to consider information that is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures set forth in Regulation 145.9 of the Commission’s regulations.<sup>1</sup>

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

#### FOR FURTHER INFORMATION CONTACT:

Eileen T. Flaherty, Director, Division of Swap Dealer and Intermediary Oversight, 202–418–5326, [eflaherty@cftc.gov](mailto:eflaherty@cftc.gov); Thomas Smith, Deputy Director, Division of Swap Dealer and Intermediary Oversight, 202–418–5495, [tsmith@cftc.gov](mailto:tsmith@cftc.gov); Jennifer C.P. Bauer, Special Counsel, Division of Swap Dealer and Intermediary Oversight, 202–418–5472, [jbauer@cftc.gov](mailto:jbauer@cftc.gov); Joshua Beale, Special Counsel, Division of Swap Dealer and Intermediary Oversight, 202–418–5446, [jbeale@cftc.gov](mailto:jbeale@cftc.gov); Rafael Martinez, Senior Financial Risk Analyst, Division of Swap Dealer and Intermediary Oversight, 202–418–5462, [rmartinez@cftc.gov](mailto:rmartinez@cftc.gov); Paul Schlichting, Assistant General Counsel, Office of the General Counsel, 202–418–5884, [pschlichting@cftc.gov](mailto:pschlichting@cftc.gov); or Lihong McPhail, Research Economist, 202–418–5722, [lmcp@mail.cftc.gov](mailto:lmcp@mail.cftc.gov), Office of the Chief Economist; Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW., Washington, DC 20581.

#### SUPPLEMENTARY INFORMATION:

##### Table of Contents

- I. Introduction
  - A. Statutory Authority
  - B. Previous Proposed Rulemaking
  - C. Consultation With U.S. Securities and Exchange Commission and Prudential Regulators
- II. Proposed Regulations and Amendments to Regulations
  - A. Capital
    1. Introduction

<sup>1</sup> Commission regulations referred to herein are found at 17 CFR chapter 1. Commission regulations are accessible on the Commission’s Web site, <http://www.cftc.gov>.

2. Capital Requirements for Swap Dealers and Major Swap Participants
  - i. Capital Requirements for Swap Dealers Under a Bank-Based Capital Approach
    - a. Computation of Minimum Capital Requirement
    - b. Computation of Common Equity Tier 1 Capital To Meet Minimum Capital Requirement
  - ii. Capital Requirement for Swap Dealers Under a Net Liquid Assets Capital Approach
    - a. Computation of Minimum Capital Requirement
    - b. Computation of Net Capital To Meet Minimum Capital Requirement
      - (1) Swap Dealers Computation of Tentative Net Capital and Net Capital Without Approval To Use Internal Capital Models
      - (2) Swap Dealers Approved To Use Internal Capital Models
  - iii. Capital Requirement for Swap Dealers That Are “Predominantly Engaged in non-Financial Activities”
    - a. Computation of Minimum Capital Requirement
    - b. Computation of Tangible Net Worth To Meet Minimum Capital Requirement
  - iv. Capital Requirements for Major Swap Participants
3. Capital Requirements for FCMs
  - i. Introduction
  - ii. FCM Capital Charges for Swaps and Security-Based Swaps in Computing Adjusted Net Capital
    - a. Standardized Market Risk and Credit Risk Capital Charges
    - b. Model-Based Market Risk and Credit Risk Capital Charges
  - iii. Market Risk and Credit Risk Capital Models for Futures Commission Merchants That Are Not Alternative Net Capital Firms
  - iv. Liquidity Requirements
4. Model Approval Process
  - i. VaR Models
  - ii. Stressed VaR Models
  - iii. Specific Risk Models
  - iv. Incremental Risk Models
  - v. Comprehensive Risk Models
  - vi. Credit Risk Models
- B. Swap Dealer and Major Swap Participant Liquidity Requirements and Equity Withdrawal Restrictions
  1. Liquidity Requirements
    - i. Swap Dealers Subject to the Bank-Based Capital Approach
    - ii. Swap Dealers Subject to the Net Liquid Assets Capital Approach
  2. Swap Dealer Equity Withdrawal Restrictions
- C. Swap Dealer and Major Swap Participant Financial Recordkeeping, Reporting and Notification Requirements
  1. Swap Dealer and Major Swap Participant Financial Recordkeeping and Financial Statement Reporting Requirements
  2. Swap Dealer and Major Swap Participant Notice Requirements
  3. Electronic Filing Requirements for Financial Reports and Regulatory Notices
  4. Swap Dealer and Major Swap Participant Reporting of Position Information
  5. Reporting Requirements for Swap Dealers Approved To Use Internal Capital Models

6. Financial Reporting Requirements for Swap Dealers and Major Swap Participants Subject to the Capital Rules of a Prudential Regulator
7. Weekly Position and Margin Reporting
- D. Comparability Determinations for Eligible Swap Dealers and Major Swap Participants
- E. Technical Amendments
  1. Amendments to the Financial Reporting Requirements in Regulations 1.10 and 1.16
  2. Amendments to the Notice Provisions in Regulation 1.12
  3. Commission Receivables for Certain Swap Transactions in Regulation 1.17
  4. Changes to Notice and Disclosure Requirements for Bulk Transfers in Regulation 1.65
  5. Conforming Amendments to Delegated Authority Provisions in Regulation 140.91
- III. Related Matters
  - A. Regulatory Flexibility Act
  - B. Paperwork Reduction Act
    1. New Information Collection Requirements and Related Burden Estimates
      - i. Form SBS
      - ii. Notice of Failure to Maintain Minimum Financial Requirements
      - iii. Requests for Extensions of Time To File Financial Statements
      - iv. Capital Requirements Elections
      - v. Application for Use of Models
      - vi. Liquidity Requirements
      - vii. Financial Recordkeeping, Reporting and Notification Requirements for SDs and MSPs
      - viii. Capital Comparability Determinations
    2. Information Collection Comments
  - IV. Cost Benefit Considerations
    - A. Background
    - B. Regulatory Capital
    - C. General Summary of Proposal
    - D. Baseline
    - E. Overview of Approaches
      1. Bank Based Capital
      2. Net Liquid Assets
      3. Alternative Net Capital (“ANC”)
      4. Tangible Net Worth
      5. Substituted Compliance
    - F. Entities
      1. Bank Subsidiaries
      2. SD/BD (Without Models)
      3. SD/BD/OTC Derivatives Dealers (Without Models)
      4. SD/FCM (Without Models)
      5. ANC Firms (SD/BD and/or FCMs That Use Models)
      6. Stand-Alone SD (With and Without Models)
      7. Non-Financial SD (With and Without Models)
      8. MSP
      9. Substituted Compliance
    - G. Liquidity and Funding Requirements
    - H. Reporting and Recordkeeping Requirements
      1. Section 15(a) Factors
        1. Protection of Market Participants and the Public
        2. Efficiency, Competitiveness, and Financial Integrity of Swaps Markets
        3. Price Discovery
        4. Sound Risk Management Practices

## 5. Other Public Interest Considerations

### I. Introduction

#### A. Statutory Authority

Section 731 of the Dodd-Frank Act<sup>2</sup> amended the CEA<sup>3</sup> by adding section 4s(e), which requires the Commission to adopt rules establishing capital requirements for SDs and MSPs to help ensure the safety and soundness of the SDs and MSPs.<sup>4</sup> Section 4s(e) applies a bifurcated approach requiring each SD and MSP subject to the capital requirements of a prudential regulator to meet the capital requirements adopted by the applicable prudential regulator, and requiring each SD and MSP that is not subject to the capital requirements of a prudential regulator to meet the capital requirements adopted by the Commission.<sup>5</sup> Therefore, SDs and MSPs that are not banking entities, including nonbank subsidiaries of bank holding companies regulated by the Federal Reserve Board, are subject to the Commission’s capital requirements.<sup>6</sup> The Commission is also proposing in this release to require SDs to meet defined liquidity and funding requirements and is proposing certain limitations on the withdrawal of capital

<sup>2</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at <http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm>.

<sup>3</sup> 7 U.S.C. 1 *et seq.*

<sup>4</sup> See 7 U.S.C. 6s(e)(3)(A). Section 4s(e) also directs the Commission to adopt regulations for SDs and MSPs imposing initial and variation margin requirements on all swaps that are not cleared by a registered clearing organization. The Commission adopted final SD and MSP margin requirements for uncleared swap transactions on December 18, 2015. See, *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 FR 636 (Jan. 6, 2016).

<sup>5</sup> The term “prudential regulator” is defined in section 1a(39) of the CEA for purposes of the section 4s(e) capital requirements. Specifically, the term “prudential regulator” is defined to mean the Board of Governors of the Federal Reserve System (“Federal Reserve Board”); the Office of the Comptroller of the Currency (“OCC”); the Federal Deposit Insurance Corporation; the Farm Credit Administration; and the Federal Housing Finance Agency. All references to an “SD” or an “MSP” in this proposal will mean an SD or MSP that is subject to the Commission’s capital rules, unless otherwise specified.

<sup>6</sup> The prudential regulators, including the Federal Reserve Board and OCC which have capital responsibilities for SDs provisionally-registered with the Commission, have adopted capital rules that incorporate capital requirements for swap and security-based swap transactions. In this regard, the Federal Reserve Board and OCC have adopted revised capital rules to incorporate Basel III capital adequacy requirements. See, *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule*, 78 FR 62018 (Oct. 11, 2013).

from SDs as part of the SD capital requirements.

The Commission is also required to adopt regulations to implement provisions in section 4s related to financial reporting and recordkeeping by SDs and MSPs. Section 4s(f)(2) of the CEA directs the Commission to adopt rules governing financial condition reporting and recordkeeping for SDs and MSPs, and section 4s(f)(1)(A) requires each registered SD and MSP to make such reports as are required by Commission rule or regulation regarding the SD’s or MSP’s financial condition. The Commission is also proposing record retention and inspection requirements consistent with the provisions of section 4s(f)(1)(B).<sup>7</sup> Pursuant to the financial reporting provisions, the Commission is proposing that SDs and MSPs submit periodic financial information and swaps and security-based swaps position information to the Commission, and that SDs and MSPs file written notices with the Commission whenever defined reportable events are triggered.

In addition to proposing minimum capital and financial reporting requirements for SDs and MSPs, the Commission is also proposing to amend existing capital requirements for FCMs to include specific market risk capital charges and credit risk capital charges for swaps and security-based swaps transactions that are not cleared by clearing organizations.<sup>8</sup> Section 4s(a) of the CEA requires entities that engage in swap dealing activities and otherwise meet the definition of an SD to register with the Commission as SDs. The Commission expects that certain FCMs will engage in swap dealing activities that requires them to register as SDs. In addition, the Commission expects that other FCMs may engage in a level of swap dealing activity that is below the de minimis exception and, therefore, exempts the FCMs from registering as SDs.<sup>9</sup> Accordingly, the Commission is

<sup>7</sup> The Commission previously finalized certain record retention requirements for SDs and MSPs regarding their swap activities. See, *Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants*, 76 FR 20128 (Apr. 3, 2012).

<sup>8</sup> Section 4f(b) of the CEA authorizes the Commission to establish minimum financial requirements for FCMs. The Commission previously adopted minimum capital requirements for FCMs, which are set forth in Commission Regulation 1.17.

<sup>9</sup> Regulation 1.3(ggg) defines the term “swap dealer” and contains a general exception from the definition for a person that engages in a de minimis

proposing to amend Regulation 1.17 to establish specific capital requirements for FCMs that engage in swaps or security-based swaps that are not cleared by a clearing organization. These proposed capital requirements would apply to all FCMs that enter into uncleared swaps or security-based swaps. The Commission also is proposing technical amendments to several regulations as part of the proposed capital and financial recordkeeping and reporting requirements.

### B. Previous Proposed Rulemaking

The Commission previously proposed capital and financial reporting rules for SDs and MSPs in 2011.<sup>10</sup> The Commission received comments from a broad spectrum of market participants, industry representatives, and other interested parties. The commenters addressed numerous topics including the permissible use of models for computing capital and the need for harmonization of the Commission's rules with capital rules of the prudential regulators and the Securities and Exchange Commission ("SEC").<sup>11</sup>

The Commission elected to defer consideration of final capital rules until the Commission adopted final regulations governing margin requirements for SDs and MSPs engaging in uncleared swap transactions. The Commission adopted the final margin requirements for uncleared swaps in December 2015.<sup>12</sup>

The Commission has considered the comments it received from its initial capital proposal in developing this proposal. In addition, and as discussed below, the Commission also has considered capital rules adopted by the prudential regulators and capital rules proposed by the SEC for security-based

level of swap dealing activities. Regulation 1.3(ggg) generally defines the term "de minimis" to mean that the swap dealing activities of a person, or any other entity controlling, controlled by or under common control with the person, over the preceding 12 months have an aggregate gross notional amount of no more than \$3 billion (subject to a phase in level of \$8 billion) and an aggregate notional amount of no more than \$25 million with regard to swaps in which the counterparty is a "special entity" as defined in section 4s(h)(2)(C) of the CEA and Commission Regulation 23.401(c).

<sup>10</sup> See *Capital Requirements of Swap Dealers and Major Swap Participants*, 76 FR 27802 (May 12, 2011).

<sup>11</sup> Comments received on the Commission's May 12, 2011 proposed capital and financial reporting rules are available on the Commission's Web site. Commenters included financial services associations, agricultural associations, energy associations, insurance associations, banks, brokerage firms, investment managers, insurance companies, pension funds, commercial end users, law firms, public interest organizations, and other members of the public.

<sup>12</sup> See 81 FR 636 (Jan. 6, 2016).

swap dealers ("SBSDs") and major security-based swap participants ("MSBSPs") in developing this proposal. The Commission further considered the impact of the final margin rules for uncleared swaps and the final rules addressing the cross-border application of the margin requirements for uncleared swaps in developing this proposal.<sup>13</sup>

### C. Consultation With U.S. Securities and Exchange Commission and Prudential Regulators

Section 4s(e)(3)(D) of the CEA provides that the CFTC, SEC, and prudential regulators (collectively, the "Agencies") shall, to the maximum extent practicable, establish and maintain comparable minimum capital requirements for SDs and MSPs. Further, section 4s(e)(3)(D) directs staff of the Agencies to meet periodically, but no less frequently than annually, to consult on minimum capital requirements. Accordingly, staff from each of the Agencies had the opportunity to provide oral and/or written comments to the capital and financial reporting regulations for SDs and MSPs contained in this proposing release, and the proposal reflects certain elements of their comments.

## II. Proposed Regulations and Amendments to Regulations

### A. Capital

#### 1. Introduction

Broadly speaking, in developing the proposed capital requirements for SDs and MSPs, the Commission strived to advance the statutory goal of helping to protect the safety and soundness of SDs and MSPs, while also taking into account the diverse nature of entities participating in the swaps market and the existing capital regimes that apply to these entities and/or their financial group. To that end, the Commission is proposing three alternative capital approaches for SDs and MSPs, which are intended to minimize competitive advantages that might otherwise arise if the Commission were to impose a singular capital approach in light of the different corporate and operating structures of the entities. The Commission further considered the degree to which its proposed capital requirements would be consistent with an existing regulatory framework (if

<sup>13</sup> The Commission adopted final regulations addressing the cross-border application of the uncleared swaps margin rules. See, *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements*, 81 FR 34818 (May 31, 2016).

any) to which these entities are already subject and the statutory objective of the capital requirements, to help ensure the safety and soundness of SD and MSP registrants.

The Commission has, to a great extent, drawn on existing CFTC, prudential regulator, and SEC capital rules in developing the proposed capital requirements for SDs and MSPs. Also, as discussed in this release, the Commission's proposed capital requirements for SDs and MSPs are consistent in many respects with the SEC's proposed capital requirements for SBSDs and MSBSPs, and the prudential regulators' capital requirements for banks and bank holding companies.<sup>14</sup> Specifically, the proposal, depending on the characteristics of the registered entity, would: (i) Permit SDs to elect a capital requirement that is based on existing bank holding company capital rules adopted by the Federal Reserve Board (the "bank-based capital approach"); (ii) permit SDs to elect a capital requirement that is based on the existing CFTC FCM capital rule, the existing SEC broker-dealer ("BD") capital rule, and the SEC's proposed capital requirements for SBSDs, (the "net liquid assets capital approach"); or (iii) permit SDs that meet defined conditions designed to ensure that they are "predominantly engaged in non-financial activities" to compute their minimum regulatory capital based upon the firms' tangible net worth (the "tangible net worth capital approach").

With respect to MSPs, the Commission is proposing a minimum regulatory capital requirement based upon the tangible net worth of the MSP. This tangible net worth approach is consistent with the SEC's proposed capital rule for MSBSPs as discussed in section II.A.2.iii of this release.

The Commission's proposed SD and MSP capital requirements are set forth in new Regulation 23.101, and are discussed in section II.A.2 of this release. Proposed Regulation 23.101 details the minimum capital requirements for each of the three capital approaches and the eligibility criteria (as applicable), and further

<sup>14</sup> Section 15F(e) of the Exchange Act (15 U.S.C. 78o-10(e)(1)(B)) provides that the SEC shall prescribe capital and margin requirements for SBSDs and nonbank MSBSPs that do not have a prudential regulator. The SEC proposed capital requirements for SBSDs and MSBSPs in November 2012. See *Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants*, 77 FR 70214 (Nov. 23, 2012). The prudential regulators adopted amendments to the capital rules for banks and bank holding companies to incorporate certain requirements set forth in the Dodd-Frank Act. See, 78 FR 62018 (Oct. 11, 2013).

defines the capital computations for each approach, including various market risk and credit risk charges, whether using models or otherwise, to determine whether an SD satisfies the minimum capital requirements. The proposal also defines a minimum capital requirement for MSPs and defines the capital computation for MSPs.

The Commission is also proposing several amendments to Regulation 1.17, which governs the capital requirements for FCMs. The proposed amendments would establish specific market risk and credit risk capital charges for swap and security-based swap positions, and would provide a process for an FCM that is dually-registered as an SD to seek approval from the Commission or from the registered futures association ("RFA") of which the FCM is a member to use internal capital models to compute market risk and credit risk capital charges.<sup>15</sup> The discussion of the proposed FCM capital amendments is contained in section II.A.3 of this release.

## 2. Capital Requirements for Swap Dealers and Major Swap Participants

The Commission is proposing capital requirements for SDs and MSPs in order to help ensure the safety and soundness of the SDs and MSPs by requiring such firms to maintain a minimum level of financial resources that is based upon the activities of the firms. Adequate levels of capital will allow SDs and MSPs to meet their obligations to swap and security-based swap counterparties and general creditors.

The Commission's proposed SD capital requirements in Regulation 23.101 are comprised of two components. First, an SD must compute the minimum amount of capital that the SD is required to maintain under proposed Regulation 23.101. Second, the SD must compute, based upon its balance sheet and certain adjustments including market risk and credit risk charges on its swaps, security-based swaps and other proprietary positions, the actual amount of capital that the SD maintains. The SD's actual capital must be equal to or greater than the SD's minimum capital requirement. This section discusses the proposed minimum amount of capital required to

<sup>15</sup> Section 3 of the CEA states that a purpose of the CEA is to establish a system of effective self-regulation under the oversight of the Commission. Consistent with the self-regulatory concept established under section 3, section 17 of the CEA provides a process whereby an association of persons may register with the Commission as a registered futures association ("RFA"). Currently, the National Futures Association ("NFA") is the only RFA under section 17 of the CEA.

be maintained by an SD or MSP under the proposal and the proposed regulations governing the computation of the amount of capital that an SD or MSP actually maintains.

To provide SDs with flexibility given the diverse nature of their corporate structures and operations, the Commission is proposing a bank-based capital approach, a net liquid assets capital approach, and a tangible net worth capital approach for SDs. And as described below, SDs which are subject to existing capital requirements that would adequately address their swaps transactions may choose to remain under those existing requirements. The Commission believes that providing this flexibility is appropriate as both the bank-based capital approach and the net liquid assets capital approach are based on internationally-recognized and accepted approaches for establishing strong minimum capital requirements for financial institutions. Both of these approaches are designed to ensure that SD's meet their financial obligations and to help ensure that safety and soundness of the SD. Although there are differences between the bank-based and net liquid assets based capital approaches, they are structurally similar in that they evaluate the composition of the SD's balance sheet and are formulated to ensure the SD's ability to continue its operations in times of financial stress. The option to use the tangible net worth approach is appropriate because it would be available only for SDs that are predominantly engaged in non-financial activities. These SDs are primarily involved in commercial activities and engage in a relatively insignificant amount of financial transactions when compared to their entire operations, as described below. As the Commission has previously noted, financial firms generally present a higher level of systemic risk than commercial firms as the profitability and viability of financial firms is more tightly linked to the health of the financial system than commercial firms.<sup>16</sup>

In addition, as noted above, the Commission based the proposal on existing regulatory capital regimes. The Commission recognizes that certain of the current registered SDs are nonbank subsidiaries of bank holding companies that are already subject to the Federal Reserve Board's bank-based capital requirements for bank holding companies. The Commission anticipates that SDs that are nonbank subsidiaries of bank holding companies may elect the bank-based capital approach as the

<sup>16</sup> See 81 FR 636, 640 (Jan. 6, 2016).

firms consolidate into bank holding companies that are subject to the Federal Reserve Board's bank-based capital requirements. The Commission's proposed bank-based capital approach would allow an SD that consolidates into a bank holding company to maintain books and records, and perform capital computations, in a manner that is consistent with its holding company parent entity.

Furthermore, several of the current provisionally-registered SDs are also dually-registered with the Commission as FCMs or dually-registered with the SEC as BDs or "OTC derivatives dealers," and several of the current provisionally-registered SDs are anticipated to register with the SEC as SBSDs.<sup>17</sup> FCMs, BDs, and OTC derivatives dealers currently are subject to a net liquid assets capital requirement, and the SEC is proposing a net liquid assets capital requirement for SBSDs.<sup>18</sup> The Commission believes that permitting dually-registered SDs/SBSDs or SDs/OTC derivatives dealers to use a uniform CFTC-SEC net liquid assets capital approach would simplify the SDs recordkeeping obligations and allow them to use existing accounting and financial reporting systems. This approach is also consistent with the Commission's long-standing practice of maintaining a uniform capital rule for dually-registered FCM/BDs, while also imposing a strong capital requirement on the SDs to help ensure the safety and soundness of the firms.

In addition to the bank-based capital approach and the net liquid assets capital approach, the Commission is also proposing to permit SDs that are "predominantly engaged in non-financial activities," as defined below, to elect a capital approach that is based on the SD's tangible net worth.<sup>19</sup> The Commission is proposing the tangible net worth capital approach in recognition that not all SDs will be principally engaged in traditional dealing and other financial activities. The Commission anticipates that a small number of SDs will be substantially engaged in commercial operations that would make meeting a traditional bank-based capital approach or net liquid

<sup>17</sup> An OTC derivatives dealer is a limited purpose BD established by SEC regulations. An OTC derivatives dealer's securities activities are limited to engaging in eligible OTC derivative instruments that are securities and other enumerated activities. See 17 CFR 240.3b-12.

<sup>18</sup> FCM capital requirements are set forth in CFTC Regulation 1.17. SEC Rule 15c3-1 (17 CFR 240.15c3-1) governs the capital requirements for BDs. SEC proposed Rule 18a-1 would govern the capital requirements for SBSDs that are not registered as BDs. (See 77 FR 70214).

<sup>19</sup> See proposed Regulation 23.101(a)(2).

assets capital approach extremely challenging, if at all possible, without substantial corporate restructuring. The Commission's proposal to use the tangible net worth approach would be limited to SDs that are predominantly engaged in non-financial (*i.e.*, commercial) activities.

The Commission's proposed approach of recognizing existing capital requirements on firms that register as SDs and the Commission's further recognition that not all SDs will be traditional financial firms offers potential benefits to swap market participants by encouraging more firms to act as SDs and to make markets in swaps. An approach that would impose a standardized capital requirement on firms that otherwise are subject to existing capital regimes that differ substantially from the standardized capital requirement or that would require substantial corporate reorganization to satisfy the standardized capital requirement would increase costs of swap transactions for swap dealers and their counterparties, including commercial end users and other non-financial market participants. A standardized capital requirement may also impose significant disincentives for certain SDs to remain in the market as dealers in swaps, which would concentrate dealing activities in a smaller number of firms. The Commission's proposal implements strong capital requirements to help ensure the safety and soundness of the SDs, while at the same time offers an appropriate degree of flexibility, recognizing that a single, standardized capital approach is not appropriate for all SDs which could result in significant burdens on all swap market participants.

Proposed Regulation 23.101 also is consistent with the statutory requirements under section 4s(e), which effectively provides that SDs subject to the capital rule of a prudential regulator are not subject to the Commission's capital rules.<sup>20</sup> Proposed Regulation 23.101(a)(3) would provide that an SD subject to the capital rules of a prudential regulator is not subject to the Commission's capital rules.

Proposed Regulation 23.101(a)(4) also provides that certain SDs that are otherwise currently subject to the Commission's capital rules are not subject to Regulation 23.101. Specifically, proposed Regulation 23.101(a)(4) would provide that an SD that is also registered as an FCM with the Commission is subject to the Commission's FCM capital requirements

contained in Regulation 1.17.<sup>21</sup> These SDs would be subject to the FCM capital requirements, which the Commission is proposing to amend in order to better reflect the specific risks of engaging in uncleared swaps and security-based swap transactions. The Commission is requiring an SD that is dually-registered as an FCM to meet the FCM capital requirements as such requirements reflect the Commission's long experience in regulating the financial requirements of FCMs. For example, the FCM capital requirement, which requires an FCM to hold at least one dollar of liquid assets to meet each dollar of liabilities (except certain subordinated debt), is designed to ensure that an FCM has adequate liquid resources to effectively operate as a market intermediary by having resources to pay customers' requests to withdraw funds and by satisfying its customers' obligations to clearing organizations. The Commission proposed amendments for FCMs are discussed in section II.A.3 of this release.

Lastly, proposed Regulation 23.101(a)(5) would contain a provision of "substituted compliance" for capital and financial reporting requirements for SDs that are: (1) Not organized under the laws of the U.S., and (2) not domiciled in the U.S. The proposal would permit these non-U.S. organized and domiciled SDs (or a regulatory authority in the SDs' home country jurisdictions) to petition the Commission to satisfy the Commission's capital and financial reporting requirements through substituted compliance with the capital and financial reporting requirements of the SDs' respective home country jurisdiction.<sup>22</sup> The proposed substituted compliance provisions and the Commission program of conducting comparability determinations of foreign jurisdictions capital requirements are discussed in section II.D of this release.

#### i. Capital Requirement for Swap Dealers Under a Bank-Based Capital Approach

##### a. Computation of Minimum Capital Requirement

The Commission is proposing to provide SDs with an option to elect the bank-based capital approach based on the capital requirements adopted by the Federal Reserve Board for bank holding companies. The Federal Reserve Board's

bank holding company capital requirements are consistent with the bank capital framework adopted by the Basel Committee on Banking Supervision ("BCBS").<sup>23</sup> The BCBS framework is an internationally-recognized framework for setting capital requirements for banks and bank holding companies. The Commission believes that proposing capital requirements using the Federal Reserve Board's capital framework is appropriate as the framework specifically reflects swaps and security-based swaps in the capital requirements, and the framework was developed to provide prudential standards to help ensure the safety and soundness of bank and bank holding companies. In addition, as noted above, the proposal to allow SDs an option to elect this approach would provide efficiencies for several of the provisionally registered SDs that are part of a bank holding company structure, and have developed recordkeeping, accounting, and financial reporting systems that are designed to comply with existing prudential requirements.

The Commission's bank-based capital approach is set forth in proposed Regulation 23.101(a)(1)(i), and would require an SD to maintain a minimum level of regulatory capital that is equal to or in excess of the greater of the following four criteria:

(1) \$20 million of common equity tier 1 capital, as defined under the bank holding company regulations in 12 CFR 217.20, as if the SD itself were a bank holding company subject to 12 CFR part 217;<sup>24</sup>

(2) common equity tier 1 capital, as defined under the bank holding company regulations in 12 CFR part 217.20, equal to or greater than eight percent of the SD's risk-weighted assets computed under the bank holding company regulations in 12 CFR part 217 as if the SD were a bank holding company subject to 12 CFR part 217;

(3) common equity tier 1 capital, as defined under 12 CFR 217.20, equal to or greater than 8 percent of the sum of:

(a) The amount of "uncleared swaps margin" (as that term is defined in

<sup>23</sup> 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 France, Bank of England, Bank of Japan, and Bank of Canada.

<sup>24</sup> Common equity tier 1 capital is defined in 12 CFR 217.20 of the Federal Reserve Board's rules. Common equity tier 1 capital generally represents the sum of a bank holding company's common stock instruments and any related surpluses, retained earnings, and accumulated other comprehensive income.

<sup>21</sup> The Commission, as discussed in section II.A.3 of this release, also is proposing to amend Regulation 1.17 to specifically address capital requirements for FCMs that carry swaps and/or security-based swaps positions.

<sup>22</sup> Proposed Regulations 23.101(a)(5) and 23.106.

<sup>20</sup> See section 4s(e)(1) and (2).

proposed Regulation 23.100) for each uncleared swap position open on the books of the SD, computed on a counterparty by counterparty basis pursuant to Regulation 23.154;<sup>25</sup>

(b) the amount of initial margin that would be required for each uncleared security-based swap position open on the books of the SD, computed on a counterparty-by-counterparty basis pursuant to proposed SEC Rule 18a-3(c)(1)(i)(B), without regard to any initial margin exemptions or exclusions that the rules of the SEC may provide to such security-based swap positions; and

(c) the amount of initial margin required by a clearing organization for cleared proprietary futures, foreign futures, swaps, and security-based swap positions open on the books of the SD; or

(4) the capital required by an RFA of which each SD is a member.

Each of the proposed minimum capital criteria is discussed below.

The first criterion under the Commission's proposal is that all SDs that elect the bank-based capital approach must maintain a minimum of \$20 million of common equity tier 1 capital. The Commission believes that given the role that SDs play in the financial markets by engaging in swap dealing activities that it is appropriate to require that all SDs maintain a minimum level of capital, stated as an absolute dollar amount that does not fluctuate with the level of the firms' dealing activities to help ensure the safety and soundness of SDs.

The proposed \$20 million of minimum capital is consistent with the minimum regulatory capital requirements proposed by the Commission in this release for SDs that elect the net liquid assets capital approach or the tangible net worth capital approach discussed in sections II.A.2.ii and II.A.2.iii, respectively, of this release. The \$20 million minimum capital requirement is also consistent with the net capital requirement proposed by the SEC for SBSBs, and is consistent with the current minimum

<sup>25</sup> The term "uncleared swap margin" is defined in Regulation 23.100 to mean the amount of initial margin that a swap dealer would be required to collect from each swap counterparty pursuant to the margin rules for uncleared swap transactions (Regulation 23.154). The term "uncleared swap margin" includes all uncleared swaps that an SD is required to collect margin for under the margin regulations, and also includes all uncleared swaps that are exempt or excluded from the margin requirements including swaps with commercial end users, swaps entered into prior to the respective compliance dates of the Commission's margin requirements set forth in Regulation 23.161 (*i.e.*, legacy swaps), and excluded swaps with an affiliated entity.

net capital requirements for OTC derivatives dealers registered with the SEC.<sup>26</sup>

The second criterion of the minimum capital requirement for SDs that elect the bank-based capital approach is that the SD must maintain common equity tier 1 capital equal to or greater than eight percent of the SD's risk-weighted assets computed under the bank holding company regulations in 12 CFR part 217 as if the SD were a bank holding company. In effect, this provision of Regulation 23.101(a)(1)(i) imposes a capital approach on a SD that is generally consistent with the approach that the Federal Reserve Board imposes on bank holding companies.<sup>27</sup> The Commission believes it is important to include this criterion so that an SD would maintain a level of common equity tier 1 capital that is comparable to the level it would have to maintain if it were subject to the capital rules of the Federal Reserve Board.

The Commission is also proposing to measure the required minimum amount of regulatory capital in terms of a minimum ratio of total qualifying capital to risk-weighted assets of eight percent, in a manner that is comparable to the Federal Reserve Board's capital rules for bank holding companies.<sup>28</sup> For purposes of the Commission's proposal, as is also the case for the Federal Reserve Board's minimum ratio requirement, the assets and off-balance sheet transactions or exposures of the bank holding company are weighted relative to their risk.<sup>29</sup> Thus, under the Commission's proposal, the greater the perceived risk of the assets and the off-balance sheet items, the greater the weighting for the risk and the greater the amount of capital necessary to cover eight percent of the risk-weighted assets.<sup>30</sup>

<sup>26</sup> The SEC proposed capital requirements for SBSBs would impose a minimum net capital requirement of \$20 million for SBSBs that are not approved to use internal capital models and a \$100 million dollar tentative net capital and \$20 million net capital requirement for SBSBs that are approved to use internal capital models. *See* 77 FR 70214 (Nov. 23, 2012). SEC Rule 15c3-1(a)(5) (17 CFR 240.15c3-1(a)(5)) currently requires an OTC derivatives dealer that has obtained approval to use capital models to maintain a minimum of \$100 million of tentative net capital and \$20 million of net capital.

<sup>27</sup> As discussed further below, the Commission's proposal differs from the rules of the Federal Reserve Board in that the Commission's proposal would require an SD to add to its risk weighted assets the market risk capital charges computed in accordance with Regulation 1.17 if the SD has not obtained approval from the Commission or from an RFA to use internal market risk and credit risk models.

<sup>28</sup> *See* 12 CFR 217.10.

<sup>29</sup> *See* 12 CFR 217 subparts D, E, and F.

<sup>30</sup> Large, complex banks also must make further adjustments to these risk-weighted assets for the

Proposed Regulation 23.101(a)(1)(i) would require an SD that elects a bank-based capital approach to compute its risk-weighted assets in accordance with the Federal Reserve Board's capital requirements contained in 12 CFR part 217. The proposal includes the two general approaches to computing risk-weighted assets under 12 CFR part 217. The first approach is for SDs that have not obtained Commission or RFA approval to calculate their risk-weighted assets using internal credit risk and market risk models. Proposed Regulation 23.103 would require these SDs to use a standardized, or rules-based, approach to computing their risk-weighted assets. Under this approach, these SDs would use the credit risk charges from the Federal Reserve Board's standardized approach under subpart D of 12 CFR 217 and the market risk charges that are set forth in Regulation 1.17.<sup>31</sup> Regulation 1.17 contains the standard market risk capital charges that have been imposed on FCMs for many years. Generally, market risk charges are determined by multiplying the notional value or market value of an asset by a fixed percentage set forth in the regulations.<sup>32</sup> The market risk charges are then multiplied by a factor of 12.5 and added to the total risk-weighted assets of the SD.<sup>33</sup>

additional capital they must hold to reflect the market risk of their trading assets *See* 12 CFR 217 subpart F. The market risk requirements generally apply to Federal Reserve Board-regulated institutions with aggregate trading assets and trading liabilities equal to 10 percent or more of total assets or one billion dollars or more.

<sup>31</sup> The Federal Reserve Board's standardized approach under subpart D of 12 CFR 217 applies only to credit risk charges; the Federal Reserve Board has not adopted standardized market risk charges. Bank and bank holding companies that are subject to market risk charges are required to use internal models and, accordingly, subpart D of 12 CFR 217 does not include a standardized approach for computing market risk charges. To address this issue, the Commission is proposing that an SD that has not obtained Commission or RFA approval to use internal market risk models must apply the rules-based market risk capital charges contained in Regulation 1.17 in computing its total risk-weighted assets.

<sup>32</sup> For example, U.S. Treasuries are subject to capital charges of between zero and six percent depending on the time to maturity of each treasury instrument, and readily marketable equity securities are subject to a 15 percent capital charge. *See* Regulation 1.17(c)(5)(v), which references SEC Rule 15c3-1(c)(2)(vi) (17 CFR 240.15c3-1(c)(2)(vi)). SEC Rule 15c3-1(c)(2)(vi)(A)(1) provides that a BD shall take a capital charge on U.S. Treasuries of between zero and six percent of the fair market value of the instrument depending upon the time to maturity. Rule 15c3-1(c)(2)(vi)(j) provides a capital charge for equities equal to 15 percent of the fair market value of the securities.

<sup>33</sup> The 12.5 multiplication factor is necessary to ensure that the SD maintains common equity tier 1 capital at level to cover the full amount of the

The second approach to computing risk-weighted assets allows SDs that have obtained Commission or RFA approval of internal credit risk and market risk models to use those models to calculate their risk-weighted assets. For SDs that have been approved to use internal models to compute market risk and credit risk, the models would have to meet the qualitative and quantitative requirements set forth in proposed Regulation 23.102 and Appendix A to Regulation 23.102, which are based upon the Federal Reserve Board's qualitative and quantitative requirements in 12 CFR 217.<sup>34</sup> The proposed qualitative and quantitative requirements for the models, and the proposed model submission process, are discussed in section II.4 of this release.

The third criterion that comprises the SD minimum capital requirement under the proposed bank-based capital approach would require an SD to maintain common equity tier 1 capital equal to or in excess of eight percent of the sum of: (1) The SD's uncleared swaps margin requirements for uncleared swaps transactions, (2) the initial margin that would be required for each uncleared security-based swap transactions pursuant to SEC's proposed Rule 18a-3(c)(1)(i)(B), without regard for any amounts or security-based swaps that may be exempted or excluded under the SEC's proposal, (3) the risk margin required on the SD's cleared futures, foreign futures, and swaps positions, and (4) the amount of initial margin required by a clearing organization that clears the SD's proprietary security-based swaps. Each of these elements is discussed below.

This criterion is intended to ensure that an SD maintains a minimum level of capital that is correlated to the risk associated with the SD's trading activities. The Commission believes that this approach would be appropriate for SDs as the minimum capital requirement would be correlated with the "risk" of the SD's futures, foreign futures, swaps, and security-based swaps positions as measured by the margin required on the positions. Specifically, the SD's minimum capital requirement would increase or decrease as the amount of margin necessary to

market risk charge. Since the SD is required to maintain common equity tier 1 capital equal to or in excess of eight percent of the risk-weighted assets, the market risk charge is multiplied by 12.5, which effectively requires the SD to hold common equity tier 1 capital in an amount equal to the full amount of the market risk charge. This approach is consistent with the Federal Reserve Board's approach to bank holding companies.

<sup>34</sup> Federal Reserve Board model-based capital charges for credit risk and market risk are set forth in 12 CFR part 217 subparts E and F, respectively.

support the SD's futures, foreign futures, swaps and security-based swaps positions increased or decreased. This approach is consistent with the Commission's current approach to establishing a minimum capital requirement for FCMs.<sup>35</sup>

As noted above, the term "uncleared swaps margin" is defined in proposed Regulation 23.100 and would mean the amount of initial margin that the SD would be required to collect from a swap counterparty pursuant to the Commission's margin rules for uncleared swap transactions in Commission Regulations 23.150 through 23.161, subject to certain adjustments to incorporate an amount for the initial margin for swaps that are otherwise exempt or excluded from the Commission's margin requirements. The SD would compute the uncleared margin amount on a portfolio basis for each of its counterparties. Similarly, the Commission would also require the SD to compute, again on a portfolio basis, the amount of initial margin that would be required for each uncleared security-based swap pursuant to SEC's proposed Rule 18a-3(c)(1)(i)(B) without regard for any exemptions or exclusions that may be provided by the SEC's proposal. The term "risk margin" is defined in Regulation 1.17(b)(8), and generally refers to the amount of margin required by clearing organizations that clear futures, foreign futures, and swaps transactions. Similarly, the proposed rules would also include the amount of initial margin required by clearing organizations for an SD's cleared security-based swaps.

The proposal would require an SD to include all swaps and security-based swaps in the computation, including swaps that are excluded from the Commission's margin rules for uncleared swaps and any security-based swaps that the SEC may exclude from its margin rules when adopted as final. Specifically, the proposal would provide that an SD must include in its computation of the uncleared swaps margin each outstanding swap, including swaps exempt from the scope of the Commission's swaps margin rules by Regulation 23.150 ("TRIPRA Exemption"),<sup>36</sup> foreign exchange swap

<sup>35</sup> FCMs are required to maintain a minimum level of adjusted net capital that is equal to or greater than eight percent of the margin required on futures, foreign futures, and cleared swaps positions carried by the FCM in customer and noncustomer accounts. See Regulation 1.17(a)(1)(i)(B).

<sup>36</sup> Title III of the Terrorism Risk Insurance Program Reauthorization Act of 2015 amended sections 731 and 764 of the Dodd-Frank Act to provide that the Commission's margin requirements shall not apply to a swap in which a counterparty: (1) Qualifies for an exception under section

as the term is defined in Regulation 23.151, or netting set of swaps or foreign exchange swaps, for each counterparty, as if that counterparty were an unaffiliated SD.

The Commission's proposal also would require an SD to include the initial margin for all swaps that would otherwise fall below the \$50 million initial margin threshold amount or the \$500,000 minimum transfer amount, as defined in Regulation 23.151, for purposes of computing the uncleared swap margin amount. As such, the uncleared swap margin amount would be the amount that an SD would have to collect from a counterparty, assuming that the exclusions and exemptions for collecting initial margin for uncleared swaps set forth in Regulations 23.150-161 would not apply, and also assuming that the thresholds under which initial margin and/or variation margin would not need to be exchanged would not apply. Accordingly, uncleared swaps that are not subject to the margin requirement such as those executed prior to the compliance date for margin requirements ("legacy swaps"), inter-affiliate swaps, and TRIPRA Exemption swaps would have to be taken into account in determining the capital requirement.

The Commission is proposing to include these swaps and comparable security-based swaps in the computation as it believes that it would be appropriate to require an SD to maintain capital for unmargin swap and security-based swap exposures to counterparties, so that capital would be available to cover the "residual" risk of a counterparty's uncleared swaps and security-based swap positions. The Commission believes that its approach is consistent with its statutory mandate—helping to ensure the safety and soundness of the SDs subject to its jurisdiction—to require an SD to reserve capital for all of its uncollateralized exposures, including the exposures that have been excluded or exempted from the Commission's margin requirements. This includes swaps where the counterparty is a commercial end user or an affiliate of the SD, as the uncollateralized exposures from these counterparties present risk to the financial condition of the SD.

The Commission's proposal to require an SD to reserve capital for uncollateralized exposures to swap and security-based swap counterparties is not inconsistent with the Commission's

2(h)(7)(A) of the CEA; (2) qualifies for an exemption issued under section 4(c)(1) of the CEA for cooperative entities as defined in such exemption; or (3) satisfies the criteria in section 2(h)(7)(D) of the CEA. See Public Law 114-1, 129 Stat. 3.



regulations exempting or excluding uncleared swaps with certain counterparties from margin requirements.<sup>37</sup> Initial margin is a transaction-based financial resource. Initial margin protects counterparties to a swap transaction as well as the overall financial system. Initial margin serves both as a check on risk-taking that might exceed a counterparty's financial capacity and as a resource that can limit losses when there is a failure by a counterparty to meet its obligations. If a swap counterparty defaults, the other party may use initial margin to cover some or all of the loss.

In developing its proposed margin requirements for uncleared swap transactions, the Commission recognized that different categories of counterparties present different levels of risk.<sup>38</sup> The Commission stated its belief that financial firms generally present a higher level of risk than non-financial firms due to the profitability and viability of financial firms being more tightly linked to the health of the financial system than non-financial firms.<sup>39</sup> Non-financial end users, however, generally use swaps to hedge commercial risk and were deemed to pose less risk to SDs.<sup>40</sup> Due to the differences in perceived risk and potential systemic effects, and consistent with Congressional intent, the Commission excluded non-financial end users from the margin requirements.

Capital, however, serves as an overall financial resource for the SD and is intended to cover potential risks that are not adequately covered by other risk management programs (*i.e.*, "residual risk") including margin on uncleared swaps. Capital is intended to help ensure the safety and soundness of the SD by providing financial resources to allow an SD to absorb unanticipated losses and declines in asset values from all aspects of its business operations, including swap dealing activities, while also continuing to meet its financial obligations. The Commission is proposing to require that an SD reserve capital against all uncollateralized swaps exposures, as such exposures pose residual risk not covered by other assets of the SD. Accordingly, capital is necessary to provide a financial cushion to protect an SD from financial exposures, including uncollateralized exposures to swap counterparties.

The Commission's proposal would not require an SD to reserve capital equal to the full amount of its uncollateralized swap exposures. The Commission's proposal would require an SD to reserve capital equal to a percentage of its uncollateralized exposures. In this respect, the Commission's capital requirement would not have the same impact on the SD with respect to such uncollateralized swaps (*e.g.*, an SD's funding or pricing of swaps) as would the application of the Commission's margin requirements to such swaps. The Commission's proposal should also not have the same impact on the cost to commercial end users who are counterparties to such uncollateralized swaps as would imposition of margin requirements on such swaps, because of the different impact on an SD's funding or pricing of swaps and because margin requirements impose specific transactional costs on counterparties (*e.g.*, establishment of custodial arrangements, documentation requirements) that are not generated by SD capital requirements. The Commission's proposed approach regarding the inclusion of uncollateralized swap exposures in the SD's capital requirements is also consistent with the approach adopted by the prudential regulators in setting capital requirements for SDs subject to their jurisdiction and is consistent with the approach proposed by the SEC for SBSDs.

The proposed capital requirement would require an SD to include in the eight percent calculation the amount of margin required by a clearing organization for the SD's proprietary cleared swaps, security-based swaps, futures, and foreign futures positions. The Commission notes that while the proposed minimum capital requirement based on eight percent of margin on cleared and uncleared swaps is consistent with the SEC's proposal for SBSDs, the SEC approach would require an SBSD to maintain a minimum level of net capital equal to or greater than eight percent of the risk margin required on cleared and uncleared security-based swaps only. The Commission's proposal would expand the products included in the SD's minimum capital requirement to include swaps, security-based swaps, futures and foreign futures positions. The Commission is expanding the products beyond the SEC proposal as it believes that it is appropriate for SDs to maintain a minimum level of capital that reflects the extent of the risks posed by the full, broad range of the SDs' proprietary positions.

The fourth criterion of the proposed minimum capital requirements would

require an SD to maintain the minimum level of capital required by an RFA of which the SD is a member. The proposed minimum capital requirement based on membership requirements of an RFA is consistent with current FCM capital requirements under Regulation 1.17, and reflects Commission regulations that require each SD to be a member of an RFA.<sup>41</sup> The proposal also is consistent with section 17(p)(2) of the CEA, which provides, in relevant part, that an RFA must adopt rules establishing minimum capital and other financial requirements applicable to the RFA's members for which such requirements are imposed by the Commission.<sup>42</sup> As noted above, the NFA currently is the only RFA. The proposal recognizes that the NFA would be required by section 17 of the CEA to adopt SD capital rules once the Commission imposes capital requirements on SDs, and would incorporate the NFA minimum capital requirements into the Commission's regulation.

#### b. Computation of Common Equity Tier 1 Capital To Meet Minimum Capital Requirement

Each SD subject to the bank-based capital approach is required to maintain a level of common equity tier 1 capital that is equal to or in excess of the highest of the three criteria listed in section II.A.2.i above. The Commission is proposing to limit the SD's capital that qualifies to satisfy the SD's minimum capital requirement to common equity tier 1 capital. This limitation would be different from the Federal Reserve Board's requirements, which allow a bank holding company to meet its minimum capital requirements with a combination of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital.<sup>43</sup>

The Commission is proposing the stricter standard as common equity tier 1 capital is a more conservative form of capital than additional tier 1 or tier 2 capital, particularly as it relates to the

<sup>41</sup> See Regulations 1.17(a)(1)(i)(C) and 170.16.

<sup>42</sup> See section 17(p)(2) of the CEA, which requires RFAs to adopt rules establishing minimum capital and other financial requirements applicable to its members for which such requirements are imposed by the Commission, provided that such requirements may not be less stringent than the requirements imposed by the CEA or by Commission regulations.

<sup>43</sup> Under the Federal Reserve Board's rules, a bank holding company's total capital must equal or exceed at least eight percent of its risk-weighted assets. In addition, at least six percent of the bank holding company's capital must be in the form of tier 1 capital, and at least 4.5 percent of the tier 1 capital must qualify as common equity tier 1 capital. The remaining two percent of capital may be comprised of tier 2 capital.

<sup>37</sup> See Regulation 23.150.

<sup>38</sup> See *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*; Proposed Rule 79 FR 59898 (Oct. 3, 2014).

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*



permanence of the capital and its availability to absorb unexpected losses. As noted above, common equity tier 1 capital is defined in 12 CFR 217.20 to generally comprise the sum of a bank holding company's common stock instruments and any related surpluses, retained earnings, and accumulated other comprehensive income. Tier 1 capital includes common equity tier 1 capital and further includes such instruments as preferred stock. Tier 2 capital includes certain types of instruments that include both debt and equity characteristics (e.g., certain perpetual preferred stock instruments and subordinated term debt instruments).<sup>44</sup> The Commission also is proposing the stricter common equity tier 1 requirement as it is not proposing to include in the SD's minimum capital requirement certain of the prudential regulators' capital add-ons, including the capital conservation buffer and the countercyclical capital buffer.<sup>45</sup> In order for the SD to meet its minimum requirements, it must demonstrate that its common equity tier 1 capital equals or exceeds the highest of the minimum requirements set forth in proposed Regulation 23.101(a)(1)(i) and discussed in section II.A.2.i.a above.

#### Request for Comment

The Commission requests comment on all aspects of the proposed bank-based capital approach. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is the proposed \$20 million fixed amount of minimum tier 1 capital appropriate? If not, explain why not. If the minimum fixed-dollar amount should be set at a level greater or lesser than \$20 million, explain what that greater or less amount should be and explain why that is a more appropriate amount.

2. Is the proposed minimum capital requirement based upon an SD's common equity tier 1 capital appropriate? If not, explain why, and suggest what modifications the Commission should make to the regulation. For example, should the proposal include tier 1 capital other than common equity tier 1 capital? Are there specific elements of tier 1 capital that the Commission should include in

addition to common equity tier 1 capital? Are there specific elements of tier 2 capital that the Commission should include in the regulation?

3. Is the proposed minimum capital requirement based upon eight percent of the SD's risk weighted assets appropriate? If not, explain why not. Is the proposed requirement that the SD add to its risk-weighted assets market risk capital charges computed in accordance with Regulation 1.17 if the SD has not obtained the approval of the Commission or of an RFA to use internal models appropriate? Are there other options to compute market risk charges when models are not approved? Should the 8 percent be set at a higher or lower level? If so, what percent should the Commission consider?

4. Is the proposed minimum capital requirement based upon eight percent of the margin required on the SD's cleared and uncleared swaps and security-based swaps, and the margin required on the SD's futures and foreign futures appropriate? If not, explain why not. Should the percentage be set at a higher or lower level? Please explain your response. Is including in the computation margin for swaps and security-based swaps that are exempt or excluded from the uncleared margin requirements (e.g., legacy swaps and security-based swaps, and swaps with commercial end users) appropriate? If not, explain why these uncollateralized exposures do not result in risk to the SD without capital to address that risk.

5. Commodity Exchange Act section 4s(e)(3)(A) only cites the risk of uncleared swaps in setting standards for capital. Additionally, in the Commission's final swap dealer definition rule, it said it will "in connection with promulgation of final rules relating to capital requirements for swap dealers and major swap participants, consider institution of reduced capital requirements for entities or individuals that fall within the swap dealer definition and that execute swaps only on exchanges, using only proprietary funds."<sup>46</sup> Given these pronouncements, should the Commission exclude cleared swaps from the capital calculation requirements?

6. In addition to swaps, the proposal includes security-based swaps, futures, and foreign futures in the capital calculation requirements. The SEC's capital proposal only included security-based swaps. Given the statements above in question 5 and the narrower scope of the SEC's proposal, should the

Commission limit its capital calculation requirements to uncleared swaps only?

7. If the swap dealer *de minimis* level falls to \$3 billion, what impact would the proposed capital rule have on any new potential registrants? Please provide any quantitative estimates.

#### ii. Capital Requirement for Swap Dealers Under a Net Liquid Assets Capital Approach

##### a. Computation of Minimum Capital Requirement

Proposed Regulation 23.101(a)(ii) would permit an SD to elect to be subject to a net liquid assets capital approach. The net liquid assets capital approach is consistent with the Commission's current capital approach for FCMs, and is consistent with the SEC's proposed capital rule for SBSDs and the SEC's current capital requirements for BDs and OTC derivatives dealers.<sup>47</sup> Harmonization of the CFTC and SEC capital requirements benefit firms that are dually-registered (including dually-registered SDs and SBSDs) as such firms should be able to meet the regulatory requirements of both the CFTC and SEC with a uniform set of books and records, and one capital computation. This concept of a harmonized capital approach is consistent with the Commission's and SEC's long standing uniform capital rule for FCMs and BDs. An SD that elects the proposed net liquid assets capital rule contained in Regulation 23.101(a)(1)(ii) would be required to comply with proposed SEC Rule 18a-1 as if the SD were a SBSD registered with the SEC, subject to several modifications discussed below.<sup>48</sup>

SDs that elect to comply with the proposed net liquid assets capital approach would be required to maintain a minimum level of net capital<sup>49</sup> equal to or greater than the highest of the following criteria:

- (1) \$20 million;
- (2) net capital equal to or greater than eight percent of the sum of:
  - (a) The amount of "uncleared swaps margin" (as that term is defined in proposed Regulation 23.100) for each uncleared swap position open on the books of the SD, computed on a counterparty by counterparty basis pursuant to Regulation 23.154;

<sup>47</sup> The SEC has proposed a net liquid assets capital requirement for SBSDs that is set forth in proposed SEC Rule 18a-1. See 77 FR 70214 (Nov. 23, 2012).

<sup>48</sup> See SEC proposed Rule 18a-1(a)(1) (77 FR 70214).

<sup>49</sup> Net capital is generally defined to mean the SD's liquid assets (less deductions for potential decreases in value of the assets) less all of the SD's liabilities (excluding qualifying subordinated debt).

<sup>44</sup> See 12 CFR 217.10.

<sup>45</sup> See 12 CFR 217.11. The capital conservation buffer and the countercyclical capital buffer represent capital "add-ons" to the standard bank capital requirements and are intended to require entities subject to the rules to have certain levels of capital in order to make capital distributions and discretionary bonuses.

<sup>46</sup> 77 FR 30596, 30610 fn. 199 (May 23, 2012).

(b) the amount of initial margin that would be required for each uncleared security-based swap position open on the books of the SD, computed on a counterparty-by-counterparty basis pursuant to proposed SEC Rule 18a-3(c)(1)(i)(B), without regard for any amounts that may be excluded or exempted under the SEC's rules;

(c) the amount of "risk margin requirement" (as that term is defined in Regulation 1.17(b)(8)) for the SD's cleared futures, foreign futures, and swaps positions open on the books of the SD; and

(d) the amount of initial margin required by a clearing organization for proprietary cleared security-based swaps positions open on the books of the SD; or

(3) the capital required by the RFA of which the SD is a member.

In addition, the proposal provides that an SD that has received approval from the Commission, or from an RFA of which the SD is a member, to use internal models to compute market risk and credit risk capital charges for its swaps and/or security-based swaps and other proprietary positions when computing its capital, as described in section II.A.4 of this release, must maintain a minimum level of tentative net capital equal to \$100 million and net capital of \$20 million.<sup>50</sup> The proposal is consistent with the SEC's proposed requirement that SBSBs that have obtained approval to use internal capital models must maintain tentative net capital of \$100 million and net capital of \$20 million.<sup>51</sup>

The first criterion of proposed Regulation 23.101(a)(1)(ii) would require the SD to maintain a minimum of \$20 million of net capital. This requirement is consistent with the minimum requirements proposed for SDs under the bank-based capital approach discussed in section II.A.2.i.a of this release. As discussed in section II.A.2.i.a above, the Commission believes that given the role that SDs play in the financial markets by engaging in swap dealing activities that it is appropriate to require that all SDs maintain a minimum level of capital, stated as an absolute dollar amount that does not fluctuate with the level of the firms' dealing activities to help ensure the safety and soundness of the SDs. Furthermore, the proposed \$20 million

minimum capital requirement is consistent with the SEC's current minimum capital requirement for OTC derivatives dealers and the SEC proposed minimum capital requirement for SBSBs.

The second criterion under the net liquid assets capital approach would require an SD to maintain a minimum level of net capital equal to or greater than eight percent of the sum of: (1) The amount of "uncleared swap margin" (as that term is proposed to be defined in Regulation 23.100) for each uncleared swap position open on the books of the SD, computed on a counterparty by counterparty basis pursuant to Regulation 23.154; (2) the amount of initial margin that would be required for each uncleared security-based swap position open on the books of the SD, computed on a counterparty by counterparty basis pursuant to SEC proposed Rule 18a-3(c)(1)(i)(B) without regard to any initial margin exemptions or exclusions that the rules of the SEC may provide to such security-based swap positions; (3) the amount of "risk margin" (as defined in Regulation 1.17(b)(8)) required by a clearing organization for the SD's futures, swaps, and foreign futures positions that are open on the books of the SD; and (4) the amount of initial margin required by a clearing organization for security-based swaps that are open on the books of the SD.

Consistent with the requirements for SDs that elect the bank-based capital approach discussed in section II.A.2.a above, an SD that elects the net liquid assets approach would have to include all swaps and security-based swaps in its computation of the margin for uncleared swaps subject to the eight percent calculation, including any swaps positions that are not included in the Commission's margin requirements in Regulations 23.150 through 23.161 and any security-based swaps positions that may be exempt or excluded from the SEC's proposed margin requirements in Rule 18a-3(c)(1)(i)(B).

Consistent with the bank-based capital approach discussed in section II.A.2.a above, this minimum capital requirement is generally comparable to the SEC's proposed minimum capital requirement for SBSBs, with the exception that the SEC proposal only requires a SBSB to compute its minimum capital requirement based upon eight percent of the initial margin required on cleared and uncleared security-based swaps. The Commission is proposing to require that an SD expand the positions subject to the eight percent initial margin minimum capital requirement to include the SD's

proprietary swaps, futures, and foreign futures positions. The Commission believes that the minimum capital requirement should reflect these additional positions to more fully reflect the potential exposure from all of the SD's swaps, security-based swaps, futures and foreign futures positions. Accordingly, the Commission's proposal has adjusted the calculation to include these additional positions of the SD.

The proposed third criterion would require an SD to maintain net capital that is equal to or greater than the amount of net capital required by the RFA of which is a member. As discussed more fully in section II.A.2.i.a above, this provision recognizes that an RFA is required to adopt minimum capital requirements for SDs pursuant to Commission Regulation 170.16 and section 17(p)(2) of the CEA.

#### b. Computation of Net Capital To Meet Minimum Capital Requirement

Each SD that elects the proposed net liquid assets capital approach would be required to maintain net capital in excess of the highest of the three criteria listed above. The second component of the proposed capital requirement would require an SD to compute its net capital, including applicable charges for market and credit risk on its swaps and security-based swaps positions and other proprietary positions (including debt instruments such as U.S. treasury instruments and municipal bonds, and equity instruments), and determine if such net capital equals or exceeds the highest level required under the three criteria discussed in section II.A.2.i.a above.

Proposed Regulation 23.101(a)(1)(ii) would require each SD electing the net liquid assets capital approach to compute its tentative net capital and net capital in accordance with the SEC's proposed computation of tentative net capital and net capital for SBSBs under proposed Rule 18a-1 as if the SD were a SBSB, subject to several adjustments. Under proposed SEC Rule 18a-1, a SBSB that has not received permission to use models to compute its market risk and credit risk capital charges, as described below, must maintain net capital of not less than the greater of \$20 million or eight percent of the risk margin amount on cleared and uncleared security-based swaps positions. For a SBSB that has received permission from the SEC to use internal models to compute its market risk and credit risk capital charges, the SBSB must at all times maintain tentative net capital of not less than \$100 million and adjusted net capital of not less than the greater of \$20 million or eight percent

<sup>50</sup> SEC Rules generally define "tentative net capital" as the registrant's assets less liabilities (excluding certain qualifying subordinated debt), and "net capital" as tentative net capital less certain capital deductions such as market risk and credit risk deductions. See 17 CFR 240.15c3-1.

<sup>51</sup> See SEC proposed Rule 18a-1(a)(2), (77 FR 70214, 70333).

of the risk margin amount on cleared and uncleared security-based swaps positions. The Commission is proposing the SEC's general approach with the adjustments to include an SD's swaps, security-based swaps, futures and foreign futures positions in its calculation of the eight percent minimum capital requirement as discussed above.

#### (1) Swap Dealers Computation of Tentative Net Capital and Net Capital Without Approval To Use Internal Capital Models

The Commission is proposing that an SD electing the net liquid assets capital approach which has not obtained Commission or RFA approval to use internal models to compute its market risk and credit risk charges for positions in swaps, security-based swaps, and other proprietary positions must use the standardized capital charges set forth in proposed SEC Rule 18a-1 and the appendices thereto. The use of standardized capital charges would be consistent with the SEC's proposal for SBSBs that have not obtained SEC approval to use internal capital models to compute market risk and credit risk capital charges. The Commission anticipates that this consistency would promote parity between SDs and SBSBs, as well as efficiency for an entity that is dually-registered as both an SBSB and SD.

Under the Commission's proposal, an SD would be required to compute a market risk capital charge for swaps and security-based swaps by multiplying the notional amount or fair market value of the swap or the security-based swap by a specified percentage set forth in proposed Rule 18a-1. The resulting market risk charge would be deducted from the SD's tentative net capital to arrive at the firm's net capital.

SDs would also be required to compute standardized credit risk charges pursuant to proposed Rule 18a-1. Rule 18a-1 generally provides that a SBSB's unsecured receivables are subject to a 100 percent credit risk capital charge (*i.e.*, the SBSB would have to deduct 100 percent of any unsecured receivable balance from tentative net capital in computing its net capital). The Commission, however, is modifying the SEC approach in proposed Regulation 23.101(a)(1)(ii) by providing that an SD may recognize as a secured receivable, and not take a capital charge for, the amount of initial margin that the SD has deposited with a third party custodian for uncleared swap transactions pursuant to the Commission's margin rules at Regulations 23.150 through 23.161 or

margin deposited with a third party custodian for uncleared security-based swap transactions pursuant to the SEC's proposed margin rules.<sup>52</sup> Regulation 23.157 provides that each SD that posts margin with a third party custodian must enter into an agreement with the custodian that, in relevant part: (1) Prohibits the custodian from rehypothecating, repledging, reusing, or otherwise transferring the collateral held by the custodian; and (2) is a legally binding and enforceable agreement under the laws of all relevant jurisdictions including in the event of bankruptcy, insolvency, or similar proceeding.

#### (2) Swap Dealers Approved To Use Internal Capital Models

The Commission is proposing to permit an SD that elects a net liquid assets capital approach to seek Commission or RFA approval to use internal models to compute market risk and credit risk capital charges on its swaps, security-based swaps and other proprietary positions in lieu of the standardized deductions contained in the SEC's proposed Rule 18a-1. In order to be considered for approval, the SD's models would have to meet the qualitative and quantitative requirements set forth in proposed Regulation 23.102 and Appendix A to Regulation 23.102.

The Federal Reserve Board has adopted quantitative and qualitative requirements for internal models used by bank holding companies to compute market risk and credit risk capital charges.<sup>53</sup> In developing the proposed market risk and credit risk requirements for SDs, including the proposed quantitative and qualitative requirements, the Commission has incorporated the market risk and credit risk model requirements adopted by the Federal Reserve Board. The Commission's proposed model requirements are also comparable to the SEC's model requirements. The model requirements and the process for obtaining Commission or RFA review is set forth in section II.4 of this release.

#### Request for Comment

The Commission requests comment on all aspects of the proposed net liquid assets capital approach. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

<sup>52</sup> Under the SEC's proposed Rule 18a-1, a SBSB would not be permitted to include margin funds deposited with a third party custodian as a current asset in computing the SBSB's net capital.

<sup>53</sup> See, 12 CFR 217, subparts E and F.

1. Is the proposed minimum \$20 million fixed-dollar amount of net capital appropriate for SDs that elect a net liquid assets capital approach? If not, explain why not. If the minimum fixed-dollar amount should be set at a level greater or lesser than \$20 million, explain what that amount should be and why that is a more appropriate amount.

2. Is the proposed minimum \$100 million fixed dollar amount of tentative net capital appropriate for SDs that use market risk and credit risk models approved by the Commission or by an RFA? If not, explain why not. If the minimum fixed-dollar amount should be set at a level greater or lesser than \$100 million, explain what that amount should be and explain why that is more appropriate.

3. Is the proposed minimum capital requirement based upon eight percent of the margin required on the SD's cleared and uncleared swaps and security-based swaps, and the margin required on the SD's futures and foreign futures appropriate? If not, explain why not. Should the percentage be set at a higher or lower level? If so, what percent should the Commission consider? Please explain your response. Is including in the computation margin for swaps and security-based swaps that are exempt or excluded from the uncleared margin requirements (*e.g.*, legacy swaps and security-based swaps, and swaps with commercial end users) appropriate? If not, explain why these uncollateralized exposures would not result in an SD that is not adequately capitalized.

4. Is the proposed requirement for an SD to compute its capital in accordance with the SEC proposed capital rules for stand-alone SBSBs (*i.e.*, SEC proposed Rule 18a-1) appropriate? If not, explain why not. What other alternatives approaches should the Commission consider?

5. Is the proposal to allow SDs to recognize as current assets margin funds deposited with third-party custodians as margin for uncleared swaps or security-based swaps in accordance with the Commission's margin rules or the SEC's proposed margin rules appropriate? If not, explain why not.

6. Are there other adjustments to the SEC's proposed capital rules for SBSBs that the Commission should consider in adopting such requirements for SDs that elect the net liquid asset capital approach? If so, explain such adjustments and why the Commission should consider such adjustments.

7. If the swap dealer de minimis level falls to \$3 billion, what impact would the capital rule have on any new

potential registrants? Please provide any quantitative estimates.

### iii. Capital Requirement for Swap Dealers That Are “Predominantly Engaged in non-Financial Activities”

#### a. Computation of the Minimum Capital Requirement

The Commission is proposing that SDs that are “predominantly engaged in non-financial activities”, as defined below, would be permitted to elect a capital requirement based upon the SD’s tangible net worth.<sup>54</sup> An SD eligible to elect the tangible net worth approach would have to maintain tangible net worth in an amount equal to or in excess of the greatest of:

(1) \$20 million plus the amount of the SD’s market risk exposure requirement and credit risk exposure requirement associated with the SD’s swap and related hedge positions that are part of the SD’s swap dealing activities;

(2) Eight percent of the sum of:

(a) The amount of uncleared swap margin (as that term is defined in Regulation 23.100) for each uncleared swap position open on the books of the SD, computed on a counterparty by counterparty basis pursuant to Regulation 23.154 without regard to any initial margin exemptions or thresholds that the Commission’s margin rules may provide;

(b) the amount of initial margin that would be required for each uncleared security-based swap position open on the books of the SD, computed on a counterparty by counterparty basis pursuant to 17 CFR 240.18a–3(c)(1)(i)(B) without regard to any initial margin exemptions or exclusions that the rules of the SEC may provide to such security-based swap positions; and

(c) the amount of initial margin required by clearing organizations for cleared proprietary futures, foreign futures, swaps and security-based swaps positions open on the books of the SD; or

(3) the amount of net capital required by the registered futures association of which the SD is a member.

The Commission is proposing that in order to be eligible to elect the tangible net worth capital approach, an SD’s overall financial activities would have to be insignificant in relation to its other overall non-financial activities. Accordingly, proposed Regulation 23.101(a)(2) would define the term “predominantly engaged in non-financial activities” by referencing the definition of the term “financial activities” under the Federal Reserve

Board’s regulations establishing criteria for determining if a nonbank financial company is predominantly engaged in financial activities.<sup>55</sup> For purposes of the proposal, an entity would be considered “primarily engaged in non-financial activities” if: (1) The consolidated annual gross financial revenues of the entity in either of its two most recently completed fiscal years represents less than 15 percent of the entity’s consolidated gross revenue in that fiscal year (“15% revenue test”), and (2) the consolidated total financial assets of an entity at the end of its two most recently completed fiscal years represents less than 15 percent of the entity’s consolidated total assets as of the end of the fiscal year (“15% asset test”). For purposes of the 15% revenue test, consolidated annual gross financial revenues means that portion of the consolidated total revenue of the entity that are related to activities that are financial in nature. For purposes of the 15% asset test, consolidated total financial assets means that portion of the consolidated total assets of the entity that are related to activities that are financial in nature.

The Commission is proposing to define the financial activities covered by the 15% revenue test and 15% asset test by reference to the listed financial activities set forth in Appendix A of 12 CFR part 242, which covers an extensive range of financial activities and services. The financial activities include, among other things: (1) Lending, exchanging, transferring, investing for others, or safeguarding money or securities; (2) insuring, guaranteeing, or indemnifying against loss or harm, damage or death in any state; (3) providing financial, investment, or economic advisory services; (4) issuing or selling interests in a pool; (5) underwriting, dealing in, or making a market in securities; and (6) engaging as principal in the investment and trading of certain financial instruments. The Commission, however, is proposing to explicitly provide that accounts receivable from non-financial activities, which may meet the definition of financial activities under 12 CFR part 242, may be excluded by the SD from the computation of its financial activities. The purpose of providing this exclusion is to prevent the SD’s non-financial activities from becoming part of the computation of the firm’s financial activities merely on the

<sup>55</sup> See, 12 CFR 242.3. The Financial Stability Oversight Council will use the criteria when it considers the potential designation of a nonbank financial company for consolidated supervision by the Federal Reserve Board.

basis that the non-financial activities result in the SD recognizing receivables.

The Commission is proposing an option to use a tangible net worth capital approach as it recognizes that certain entities that engage primarily in non-financial activities may currently or in the future meet the statutory and regulatory definition of the term “swap dealer” and, therefore, will be required to register as such with the Commission.<sup>56</sup> However, while these entities may engage in dealing activities, they are primarily commercial entities and differ from financial entities in various ways, including the composition of their balance sheet (*e.g.*, the types of assets they hold), the types of transactions they enter into, and the types of market participants and swap counterparties that they deal with. Because of these differences, the Commission believes that application of the bank-based or net liquid assets capital approaches to these SDs could result in inappropriate capital requirements that would not be proportionate to the risk associated with them, and, therefore, these SDs should have the option to apply a tangible net worth approach.<sup>57</sup>

#### b. Computation of Tangible Net Worth To Meet Minimum Capital Requirement

Proposed Regulation 23.101(a)(2) would require an SD to maintain tangible net worth in an amount equal to or in excess of the greater of the tangible net worth of the SD plus the market risk capital charges and credit risk capital charges associated with the SD’s dealing swaps and related hedging, or eight percent of the initial margin required on the SD’s proprietary swaps, security-based swaps, futures, and foreign futures. The term “tangible net worth” is proposed to be defined as the net worth of an SD as determined in accordance with generally accepted accounting principles in the United States, excluding goodwill and other intangible assets.<sup>58</sup> The proposal would further require an SD in computing its tangible net worth to include all liabilities or obligations of a subsidiary or affiliate that the SD guarantees, endorses, or assumes either directly or indirectly to ensure that the tangible net worth of the SD reflects the full extent

<sup>56</sup> The term “swap dealer” is defined by section 1a(49) of the CEA and § 1.3(ggg) of the Commission’s regulations. Section 1.3(ggg)(3) provides that an entity may apply to limit its designation as an SD to specified categories of swaps or specified activities in connection with swaps.

<sup>57</sup> Furthermore, as a SD, the firm is subject to the Commission’s final swaps margin requirements.

<sup>58</sup> See proposed Regulation 23.100.

<sup>54</sup> See proposed Regulation 23.101(a)(2)(ii).

of the SD's potential financial obligations.<sup>59</sup> The proposed definition would further provide that in determining net worth, all long and short positions in swaps, security-based swaps and related positions must be marked to their market value to ensure that the tangible net worth reflects the current market value of the SD's swaps and security-based swaps, including any accrued losses on such positions.<sup>60</sup>

In proposing this approach and as discussed above, the Commission recognizes that SDs that predominantly engage in non-financial activities may differ from financial entities. However, the Commission also recognizes that capital should account for all the activities entered into by the entity and not just its swap dealing activities in order to help ensure the safety and soundness of the SD.<sup>61</sup> By requiring the SD electing this approach to maintain tangible net worth equal to its liabilities and swaps market risk and credit risk exposures, the Commission believes that its approach would impose a sufficient level of capital (*i.e.*, unencumbered tangible assets) to help ensure the safety and soundness of an SD and that the SD can meet its swap-related obligations to its swap counterparties.

Pursuant to the proposal, the SD would have to compute its market risk charges and credit risk charges associated with its dealing swaps and related hedges. Proposed Regulation 23.101(a)(2)(i)(A) provides that the SD may use internal capital models to compute its market risk and credit risk capital charges if the SD has obtained the approval of the Commission or an RFA. If the SD has not obtained approval to use internal capital models, the SD must use the standardized deductions under Regulation 1.17.

#### Request for Comment

The Commission requests comment on all aspects of the proposed tangible net worth capital approach for SDs that are predominantly engaged in non-financial activities. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is the proposed minimum net capital requirement of \$20 million plus the amount of the SD's market risk and credit risk charges for its dealing swaps appropriate for SDs that are eligible and elect the tangible net worth net capital approach? If not, explain why not. If the minimum dollar amount should be set at a level greater or lesser than \$20 million, explain what that amount should be and explain why that is more appropriate.

2. Should the market risk and credit risk associated with the SD's security-based swap positions be added to the market risk and credit risk associated with the SD's swap positions in setting the minimum capital requirement under proposed Regulation 23.101(a)(2)(A)? Explain why or why not such security-based swap positions should or should not be included in the minimum capital requirement. Provide any empirical data to support your analysis.

3. Is the proposed minimum capital requirement based upon eight percent of the margin required on the SD's cleared and uncleared swaps and security-based swaps, and the margin required on the SD's futures and foreign futures appropriate? If not, explain why not. Should the percentage be set at a higher or lower level? Please explain your response. Is including in the computation margin for swaps and security-based swaps that are exempt or excluded from the uncleared margin requirements (*e.g.*, legacy swaps and security-based swaps, and swaps with commercial end users) appropriate? If not, explain why these uncollateralized exposures would not result in an SD that is not adequately capitalized.

4. Is the Commission's proposed 15% revenue test and 15% asset test appropriate for determining whether an SD is predominantly engaged in non-financial activities? If not, explain why not. What other alternatives should the Commission consider? If the approach is appropriate, should the Commission consider raising or lowering the percentages in the 15% revenue test and the 15% asset test?

5. Is the Commission's proposed reference to the definition of the term "financial activities" in Rule 242.3 of the Federal Reserve Board (12 CFR 242.3) to define whether an SD's activities are "financial activities" for purposes of computing the 15% revenue test and 15% asset test appropriate? If not, explain why not. Provide other alternatives that the Commission should consider.

6. Is the Commission's adjustment in the application of Rule 242.3 to permit SDs to exclude receivables resulting from non-financial activities from the

term "financial activities" in computing the 15% revenue and 15% asset tests appropriate? If not, explain why not. Are there other adjustments that the Commission should consider in the application of the 15% revenue and 15% asset tests? If yes, explain what those adjustments are and why it is appropriate for the Commission to make such adjustments.

#### iv. Capital Requirements for Major Swap Participants

Proposed new Regulation 23.101(b) would establish capital requirements for MSPs that are not subject to the capital rules of a prudential regulator.<sup>62</sup> An MSP is by definition a person that is not a swap dealer and that: (1) Maintains a substantial position in swaps, excluding positions held to hedge or mitigate commercial risk; (2) has outstanding swaps that create substantial counterparty exposures that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or (3) is a financial entity that is highly leveraged, is not subject to capital requirements of a prudential regulator, and has a substantial position in swaps, including positions used to hedge and mitigate commercial risk.<sup>63</sup>

Under proposed Regulation 23.101(b), an MSP would be required to maintain positive tangible net worth or the amount of capital required by the RFA of which the MSP is a member. A tangible net worth standard is being proposed for MSPs, rather than the net liquid assets capital approach or the bank-based capital approach, as the Commission anticipates that entities that register as MSPs may engage in a diverse range of business activities different from, and broader than, the activities engaged in by SDs. For example, MSPs may engage in commercial activities that require them to have substantial fixed assets to support manufacturing and/or result in them having significant assets comprised of non-current assets as defined in the Regulations. In addition, MSPs typically use swaps for different purposes (*e.g.*, hedging or investing) than SDs, which engage in swaps as a dealing activity. The Commission believes requiring MSPs to comply with the proposed net liquid assets capital approach or bank-based capital approach could result in MSPs having to obtain significant additional capital or engage in costly restructuring.

<sup>59</sup> See proposed definition of "tangible net worth" in Regulation 23.100.

<sup>60</sup> *Id.*

<sup>61</sup> Section 4s(e)(2)(C) of the CEA states that for SDs that are designated as SDs for one single class or category of swap or activities, the Commission shall take into account the risks associated with other types of swaps or classes of swaps or categories of swaps engaged in and the other activities conducted by that person that are not otherwise subject to regulation applicable to that person by virtue of the status of the person as an SD.

<sup>62</sup> There are currently no MSPs provisionally registered with the Commission.

<sup>63</sup> See Regulation 1.3(hhh).

The term “tangible net worth” is proposed to be defined as the net worth of an MSP as determined in accordance with generally accepted accounting principles in the United States, excluding goodwill and other intangible assets.<sup>64</sup> The proposal would further require an MSP in computing its tangible net worth to include all liabilities or obligations of a subsidiary or affiliate that the MSP guarantees, endorses, or assumes either directly or indirectly to ensure that the tangible net worth of the MSP reflects the full extent of the MSP’s potential financial obligations.<sup>65</sup> The proposed definition would further provide that in determining net worth, all long and short positions in swaps, security-based swaps and related positions must be marked to their market value to ensure that the tangible net worth reflects the current market value of the MSP’s swaps and security-based swaps, including any accrued losses on such positions.<sup>66</sup>

In developing the proposed positive tangible net worth requirement for MSPs, the Commission also considered the impact of its recent margin rules for uncleared swap transactions. Under the margin rules, MSPs are required to post and collect initial margin and variation margin with SDs, other MSPs, and financial end users (subject to certain thresholds and minimum transfer amounts). The exchanging of variation margin and the posting of initial margin by MSPs will substantially reduce their uncollateralized exposures, which will mitigate the possibility that MSPs could destabilize the financial markets or present systemic risk. Lastly, the Commission’s proposed MSP capital standard and definitions are comparable with the SEC’s proposal for MSBSPs, and are intended to require an MSP to maintain a sufficient level of assets to meet its obligations to counterparties and creditors and to help ensure the safety and soundness of the MSP.

#### Request for Comment

The Commission requests comment on the proposed capital requirements for MSPs. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is a tangible net worth test an appropriate standard for MSPs? If not, explain why not. Would the net liquid assets approach or bank-based capital approach be a more appropriate method for establishing capital requirements for

MSPs? If so, please state which approach is more appropriate and describe the rationale for such approach. What other capital approaches should the Commission consider for MSPs?

2. Should the proposed minimum capital requirement for MSPs include a minimum fixed-dollar amount of tangible net worth, for example, equal to \$20 million or some greater or lesser amount? If so, explain the merits of imposing a fixed-dollar amount and identify the recommended fixed-dollar amount.

3. Should proposed Regulation 23.101(b) require an MSP to maintain positive tangible net worth in an amount in excess of the market risk and credit risk charges on the MSP’s swaps and security-based swap positions? If so, please explain why. Should any other adjustments be made to the MSP’s minimum capital requirement? If so, please explain why.

#### 3. Capital Requirements for FCMs

##### i. Introduction

Section 4s(e)(3)(B)(i) of the CEA provides that the requirements applicable to SDs and MSPs under section 4s do not limit the Commission’s authority with respect to FCM regulatory requirements.<sup>67</sup> The Commission’s current capital requirements for FCMs are contained in Regulation 1.17, and are designed to require a minimum level of “liquid assets” in excess of the FCM’s liabilities to provide resources for the FCM to meet its financial obligations as a market intermediary in the regulated futures and cleared swaps markets. Specifically, an FCM is required to hold at all times more than one dollar of highly liquid assets for each dollar of unsubordinated liabilities (e.g., money owed to customers, counterparties and creditors). The capital requirements also are intended to ensure that an FCM maintains a sufficient level of liquid assets to wind-down its operations by transferring customer accounts to other FCMs in the event that the FCM decides, or is forced, to cease operations.

Regulation 1.17(a) specifies the minimum amount of adjusted net capital that an FCM is required to maintain as the greatest of: (1) \$1 million; (2) for an FCM that engages in off-exchange foreign currency

transactions with retail forex customers,<sup>68</sup> \$20 million, plus five percent of the FCM’s liabilities to the retail forex customers that exceed \$10 million; (3) eight percent of the sum of the risk margin of futures, options on futures, foreign futures, and swap positions cleared by a clearing organization and carried by the FCM in customer and non-customer accounts;<sup>69</sup> (4) the amount of adjusted net capital required by the RFA of which the FCM is a member; and (5) for an FCM that also is registered with the SEC as a BD, the amount of net capital required by the rules of the SEC.

Regulation 1.17(c)(5) defines the term “adjusted net capital” as an FCM’s “current assets” (i.e., current, liquid assets excluding, however, most unsecured receivables), less all of the FCM’s liabilities (except certain qualifying subordinated debt). An FCM is further required to impose certain prescribed capital deductions (“capital charges” or “haircuts”) from the current market value of the FCM’s proprietary positions (e.g., futures positions, securities, debt instruments, money market instruments, and commodities) in computing its adjusted net capital to reflect potential market risk and credit risk of the firm’s current assets.

An FCM, in computing its adjusted net capital, is required to compute a capital charge to reflect the potential market risk associated with uncleared swap and security-based swap positions. Regulation 1.17(c)(5) establishes specific capital charges for market risk for an FCM’s proprietary positions in physical inventory, forward contracts, fixed price commitments, and securities. Regulation 1.17(c)(5) does not explicitly address uncleared swap or security-based swap positions. The Commission, however, requires an FCM to use the capital charges specified in Regulation 1.17(c)(5)(ii), or the capital charges established by SEC Rule 15c3–1 for dually registered FCM–BDs, to compute its capital charges for uncleared swap and security-based swap positions.

The Commission is proposing to amend the minimum adjusted net capital requirements for FCMs that are also registered as SDs. In this regard, the Commission is proposing amendments to Regulation 1.17(a) that would require an FCM that is also an SD to maintain

<sup>68</sup> Regulation 5.1(k) defines the term “retail forex customer” as a person, other than an eligible contract participant as defined in section 1a(18) of the CEA, acting on its own behalf in any account agreement, contract or transaction described in section 2(c)(2)(B) or 2(c)(2)(C) of the CEA.

<sup>69</sup> The term “risk margin” is defined in Regulation 1.17(b)(8).

<sup>64</sup> See proposed Regulation 23.100.

<sup>65</sup> See proposed Regulation 23.100.

<sup>66</sup> *Id.*

<sup>67</sup> Section 4s(e)(3)(B)(i) states that nothing in section 4s(e) imposing capital and margin requirement on SDs and MSPs limits, or shall be construed to limit, the authority of the Commission to set financial responsibility rules for FCMs pursuant to section 4f(a).

adjusted net capital that is equal to or greater than the highest of:

- (1) \$20 million;
- (2) Eight percent of the sum of the following:
  - (a) The total risk margin (as defined in Regulation 1.17(b)(8)) for positions carried by the FCM in customer and non-customer accounts;
  - (b) the total initial margin that the FCM is required to post with a clearing agency or broker for security-based swaps positions carried in customer and non-customer accounts;
  - (c) the total uncleared swaps margin as defined in Regulation 23.100;
  - (d) the total initial margin that the FCM is required to post with a broker or clearing organization for all proprietary cleared swap positions carried by the FCM;
  - (e) the total initial margin computed pursuant to SEC Rule 18a-3(c)(1)(i)(B) (17 CFR 240.181-3(c)(1)(i)(B)) for all proprietary uncleared security-based swap positions carried by an FCM, without regard to any exemptions or exclusions that may be available to the FCM under the SEC's proposal; and
  - (f) the total initial margin that the FCM is required to post with a broker or clearing agency for proprietary cleared security-based swaps;
- (3) the amount of net capital required by the SEC if the FCM was a BD; or
- (4) the amount of capital required by the RFA of which the FCM was a member.

The Commission's proposed increase in the FCM's minimum capital requirement from \$1 million to \$20 million is consistent with the Commission's proposal to adopt a minimum \$20 million capital requirement for SDs and MSPs, and is necessary and appropriate given the change and increase in risk when the FCM is registered as an SD and engaging in uncleared swap activities. The Commission also notes that the proposed minimum dollar amount of \$20 million is consistent with the current minimum dollar amount of adjusted net capital imposed by Regulation 1.17(a) on FCMs that engage in OTC forex transactions with counterparties that do not qualify as ECPs, and is consistent with the minimum dollar amount of net capital proposed by the SEC for SBSBs.<sup>70</sup>

The Commission is also proposing amendments to Regulation 1.17(a) to require an FCM to include eight percent

of the uncleared swaps margin in its adjusted net capital. Currently FCMs must maintain adjusted net capital in excess of eight percent of the risk margin on futures, foreign futures and cleared swaps positions carried in customer and noncustomer accounts. The proposed amendments would also include in the FCM's minimum capital requirements eight percent of the "uncleared swaps margin" for uncleared swaps and the initial margin for uncleared security-based swaps position for which the FCM is a counterparty. The term "uncleared swaps margin" is defined in proposed new Regulation 23.100 as the amount of initial margin that an SD would be required to collect pursuant to the Commission's uncleared swaps margin rules for each outstanding swap.<sup>71</sup> The "uncleared swaps margin" would include both swaps that an SD is required to collect margin for under the margin rules as well as swaps that are exempt from the margin rules. For example, the FCM would be required to compute the amount of initial margin that an SD would be required to collect from commercial end users and affiliated counterparties as if the swaps were not exempt from the scope of the Commission's margin requirements. In addition, the FCM would have to compute the initial margin requirements for exempt foreign exchange swaps and foreign exchange forwards as if the transactions were not exempt from the Commission's margin requirements. Finally, the "uncleared swaps margin" amount would not exclude initial margin that was below the initial margin threshold amount or the minimum margin transfer amounts defined in Regulation 23.151. Not excluding these amounts in determining the capital requirement is consistent with the approach as described above for those SDs that elect to apply a net capital standard as these uncollateralized exposures may present risk to the SD for which it should maintain capital. Similarly, the Commission would require an FCM to include in its initial margin amounts for security-based swap positions both the amounts that an SD would be required to collect and the amounts that the SD would not be required to collect if the SD were treated as an SBSB under SEC's proposed rule 18a-3(c)(1)(i)(B) due to the SEC provided an exemption or exclusion on the requirement to post or collect initial margin.

As discussed above, the capital rule is intended to help ensure the safety and soundness of the SD. Accordingly, the FCM's capital should reflect

uncollateralized exposures to swap counterparties.

#### ii. FCM Capital Charges for Swaps and Security-Based Swaps in Computing Adjusted Net Capital

As noted in section II.A.3.i above, in computing its adjusted net capital, an FCM is required to take certain market risk and credit risk capital charges on its proprietary positions. Regulation 1.17(c) provides two approaches for an FCM to take capital charges in computing its adjusted net capital. The first approach is a rules-based approach of standardized haircuts that are set forth in Regulation 1.17(c)(5). The second approach is an approved model approach that is currently available only to FCMs that are dual-registered FCM/BDs that have been approved by the SEC to use internal models to compute market risk and credit risk capital charges in lieu of standardized capital charges. These dually-registered FCM/BDs are referred to as Alternative Net Capital Firms ("ANC Firms").

#### a. Standardized Market Risk and Credit Risk Capital Charges

Currently, Regulation 1.17(c)(5) does not explicitly define market risk capital charges for swaps, and the Commission has imposed the general standardized haircuts that are applicable to inventory, fixed price commitments, and forward contracts to swaps. For example, an energy swap that is not offset by a futures contract is considered a fixed price commitment under Regulation 1.17(c)(5) and the FCM is required to take a market risk capital charge equal to 20 percent of the notional value of the energy swap. The purpose of the capital charge is to require an FCM to reserve a minimum level of capital to cover potential future losses in the value of the swap, which may have to be paid to the swap counterparty in the form of variation margin or otherwise.

The Commission recognizes that the current market risk capital charges, which were not explicitly designed for swaps or security-based swaps, should be amended to provide specific capital charges. Accordingly, the Commission is proposing to amend Regulation 1.17(c)(5)(iii) to provide a schedule of standardized market risk capital deductions for positions in credit default swaps, interest rate swaps, foreign exchange swaps, commodity swaps, and all other uncleared swaps. This schedule of standardized capital deductions is the same as the standardized market risk capital deduction proposed by the SEC for such positions in SEC Rule 15c3-1 (17 CFR

<sup>70</sup> The SEC proposed capital requirements for SBSBs and MSBSPs was proposed in 2012. See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 FR 70214 (Nov. 23, 2012).

<sup>71</sup> See Regulations 23.150, 23.152, and 23.154.



240.15c3-1).<sup>72</sup> The Commission is also proposing to amend Regulation 1.17(c)(5)(iv) to provide that the FCM must impose the standardized market risk capital deduction set forth in SEC Rule 15c3-1 (17 CFR 240.15c3-1) for any security-based swap positions.

Except for credit default swaps as described below, the proposed standardized market risk capital deductions would be the deduction currently prescribed in 17 CFR 240.15c3-1 or proposed amended Regulation 1.17 applicable to the instrument referenced by the swap multiplied by the contract's notional amount.

The proposed standardized market risk deductions for swaps that are credit default swaps are designed to account for the unique attributes of these positions. Credit default swaps are generally defined by the reference asset or entity, the notional amount, the duration of the contract, and credit events. Therefore, the Commission believes that proposing a schedule of deductions for credit default swaps based on a "maturity grid" approach would be appropriate, as the Commission currently applies a maturity grid approach in setting standardized capital deductions for debt instruments.<sup>73</sup> Under the proposal, the market risk capital deductions for credit default swaps would be based on two variables: The length of time to maturity and the amount of the current offered basis point spread on the credit default swap. The Commission's proposed standardized deductions are consistent with the SEC's proposed amendments to its capital rule.

The Commission would allow an FCM to net long and short positions where the credit default swaps reference the same entity or obligation, reference the same credit events that would trigger payment by the seller of the protection, reference the same basket of obligations that would determine the amount of payment by the seller of protection upon the occurrence of a credit event, and are in the same or adjacent maturity and spread categories (as long as the long and short positions each have maturities within three months of the other maturity category). In this case, the FCM would need to take the specified percentage deduction only on the notional amount of the excess long or short position.

The Commission would also allow limited netting in, for example, long and

short credit default swap positions in the same maturity and spread categories and that reference corporate entities in the same industry sector; where the FCM is long (short) the bond or asset and long (short) protection through a credit default swap referencing the same underlying bond or asset.

As noted above, the Commission is proposing the same market risk haircut schedule for swaps as proposed by the SEC in its proposed capital and margin rule for SBSBs. The Commission understands that the proposed capital charges for credit default swaps are derived from the SEC's experience with maturity grids for other securities. Given the Commission's experience with FCMs and the financial transactions that they may enter into, and also in recognition of the SEC's experience with BDs and their financial products, the Commission believes that these charges should account for the risks of engaging in these swaps and security-based swaps. Further, the Commission believes that its approach is appropriate, given its long history of referencing 17 CFR 240.15c3-1 in setting forth capital deductions for certain financial instruments held by FCMs and the SEC's reciprocal practice of referencing Regulation 1.17 when setting forth capital deductions for certain CFTC-regulated products held by BDs. The Commission further believes that this harmonized approach would benefit registrants that are dually registered with the Commission and the SEC.

FCMs also are currently required to take a capital charge to reflect credit risk associated with uncleared swap and security-based swap transactions. Regulation 1.17(c)(2)(ii) requires an FCM to exclude unsecured receivables, which includes any unsecured receivables from swap and security-based swap counterparties and would include any margin collateral for swap or security-based swap transactions that the FCM deposits with a third-party custodian pursuant to the Commission's or SEC's uncleared margin rules.

The Commission is proposing to amend Regulation 1.17(c)(2)(ii) to permit FCM's to include margin deposited with third-party custodians for swap and security-based swap transactions, provided that such margin is held by the custodians in accordance with the requirements established by the Commission and SEC rules, as applicable.

#### b. Model-Based Market Risk and Credit Risk Capital Charges

As noted in section II.A.3 above, the SEC has approved certain BDs to use internal models for computing market

risk capital charges in lieu of the standardized haircuts in SEC Rule 15c3-1(c)(2)(vi) and (vii) (17 CFR 240.15c3-1(c)(2)(vi) and (vii)) for their proprietary positions in securities, debt instruments, futures, security-based swaps and swaps and for computing credit risk charges associated with exposures from swap and security-based swap counterparties in lieu of the unsecured receivable capital charges in Rule 15c3-1(c)(2)(iv) (17 CFR 240.15c3-1(c)(2)(iv)). The BDs that have been approved to use these internal models are referred to as ANC Firms. As described in section II.A.3 above, ANC Firms may obtain SEC approval to use internal models to compute their capital. Once approved by the SEC to use internal models, the ANC Firms that are also registered as FCMs may use the same models to compute market risk and credit risk charges under CFTC Regulation 1.17.

The ANC Firms' market risk and credit risk models must satisfy certain qualitative and quantitative requirements that are set forth in the SEC's rules in order to be approved, and the firms are subject to certain enhanced reporting requirements. The requirements for such models are discussed in section II.A.4 of this release.

ANC Firms are subject to heightened SEC capital requirements in order to qualify to use the market risk and credit risk models. Currently, an ANC Firm must maintain tentative net capital of at least \$1 billion and net capital of at least \$500 million in order to be approved, and to continue to use market risk and credit risk models.<sup>74</sup> The SEC also requires an ANC Firm to provide notice to the SEC if the ANC Firm's tentative net capital falls below \$5 billion.<sup>75</sup> In such situations, the SEC may impose restrictions on the ANC Firm, including limiting its use of the market risk and/or credit risk models.<sup>76</sup>

As previously noted, CFTC Regulation 1.17(c)(6) currently provides that an FCM that is also an ANC Firm, may use the same market risk and credit risk models approved by the SEC in lieu of the standardized capital charges in Regulation 1.17(c)(5). The Commission is proposing to retain this provision in Regulation 1.17(c)(6). Accordingly, FCMs that are ANC Firms that have obtained SEC approval to use market risk and credit risk models may continue to use such models in lieu of

<sup>72</sup> See 77 FR 70214 (Nov. 23, 2012).

<sup>73</sup> The capital deductions for debt instruments are incorporated into Regulation 1.17 by cross reference to the SEC's standardized capital charges for debt instruments. See Regulation 1.17(c)(5)(v).

<sup>74</sup> 17 CFR 240.15c3-1(a)(2)(7)(i).

<sup>75</sup> 17 CFR 240.15c3-1(a)(2)(7)(ii).

<sup>76</sup> See *Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities*, 69 FR 34428 (Jun 21, 2004).

taking the standardized capital chares in Regulation 1.17(c). Maintaining this provision would allow ANC Firms to engage in swap and security-based swap transactions under the existing regulatory structure, including the current capital requirements.

The Commission notes that the SEC has proposed various changes to its regulations as part of its proposed capital requirements for SBSDs that, if adopted, would impact the ANC Firm's CFTC and SEC capital requirements. In this connection, the SEC is proposing to increase the amount of tentative net capital that an ANC Firm must maintain from \$1 billion to \$5 billion, and the amount of net capital that the ANC Firm must maintain from \$500 million to \$1 billion.<sup>77</sup> The early warning threshold for an ANC Firm also would be increased from \$5 billion to \$6 billion.<sup>78</sup>

The SEC is also proposing to subject ANC Firms to liquidity risk management requirements.<sup>79</sup> Under the SEC's proposal, ANC Firms would need to perform a liquidity stress test at least monthly that takes into account certain assumed conditions lasting for 30 consecutive days.<sup>80</sup> The results of the liquidity stress test would need to be provided within ten business days of the month end to senior management responsible for overseeing risk management at the firm.<sup>81</sup> In addition, the assumptions underlying the liquidity stress test would need to be reviewed at least quarterly by senior management responsible for overseeing risk management at the firm and at least annually by senior management of the firm.<sup>82</sup> The Commission is also proposing similar liquidity requirements for SDs, which are discussed in section II.B of this release.

In addition, the SEC is proposing to amend its regulations to limit an ANC Firm's use of credit risk models to credit exposures solely from counterparties that are commercial end users.<sup>83</sup> Currently, an ANC Firm is permitted to compute its credit charges for swaps and security-based swaps from all counterparties. This amendment would result in the uncollateralized receivables from counterparties that are non-commercial end users being subject to a 100 percent charge to capital.

Since those ANC Firms that are also registered as FCMs will be subject to

both the capital requirements of the SEC and CFTC, the SEC proposed amendments, if adopted, would be applicable to the ANC Firm's computation of net capital under CFTC Regulation 1.17(c)(6).

### iii. Market Risk and Credit Risk Capital Models for Futures Commission Merchants That Are Not Alternative Net Capital Firms

As noted in section II.A.3 above, currently only FCMs that are registered with the SEC as ANC Firms and that have obtained SEC approval may use market risk and credit risk models in lieu of standardized haircuts on their swaps, security-based swaps and other proprietary positions in computing net capital. The Commission is proposing to amend current Regulation 1.17(c)(6) to extend the use of capital models to FCMs that are dually-registered as SDs and are not otherwise registered with the SEC as BDs.<sup>84</sup> An FCM/SD that would seek to use capital models would have to obtain approval for the models from the Commission or from an RFA of which the FCM/SD is a member. The Commission is also proposing to amend Regulation 1.17(a)(1)(ii) to provide that any FCM/SD that seeks approval to use market risk and/or credit risk models must maintain a minimum level of net capital of \$100 million and a minimum level of adjusted net capital equal to \$20 million.

Proposed Regulation 1.17(c)(6)(v) would require an FCM/SD to apply in writing to the Commission or RFA of which the FCM/SD is a member for approval to use internal models to compute market risk and credit risk capital deductions in lieu of the standardized charges contained in Regulation 1.17(c)(2) and (5). The models must meet certain qualitative and quantitative requirements proposed to be established by the Commission in new Regulation 23.102 and Appendix A to new Regulation 23.102. The qualitative and quantitative requirements for the models are discussed in detail in section II.A.4 of this release.

The Commission is proposing the higher minimum net capital requirement of \$100 million for FCM/SDs that have received permission to model their credit and market risk charges to account for the limitations that may be inherent in a model. The

Commission notes that the \$100 million minimum net capital requirement is the same as the SEC's proposed minimum net capital requirement for stand-alone SBSDs that receive SEC approval to use internal models to compute their market and credit risk capital deductions, and is consistent with the Commission's proposed requirement for SDs that elect to use a net capital approach as discussed in section II.A.2.ii of this release. The proposed \$100 million net capital requirement for FCM/SDs, however, is not consistent with the SEC's current approach for BDs approved to use internal capital models (*i.e.*, ANC Firms), nor is it consistent with the SEC's proposed capital requirements for SBSDs/ANC Firms approved to use internal models. As noted above, ANC Firms are subject under SEC rules to substantial capital requirements of a \$5 billion "early warning" requirement, a \$1 billion tentative net capital requirement, and a \$500 million net capital requirement.<sup>85</sup>

The Commission believes, however, that FCM/SDs that are not BDs do not raise the same types of risks as ANC firms. ANC firms represent the largest BDs and engage in significant brokerage business including providing customer financing for securities transactions, engaging in repurchase transactions and other activities. FCMs generally have limited proprietary futures trading and operate primarily as market intermediaries for customers trading futures and foreign futures transactions. In this capacity, FCMs receive and hold customer funds in segregated accounts that are used to satisfy the customers' financial obligations to derivatives clearing organizations ("DCOs"). FCMs also collect and hold funds from affiliates for futures trading.

The Commission also expects that FCMs that are not registered as BDs and that register as SDs will provide a market in swaps for customers that may not be able to trade with larger SDs. The FCM/SDs may be more willing to provide swaps markets in commodities to agricultural firms and smaller commercial end users such as farmers and ranchers that might not otherwise be able to use such markets to manage risks in their businesses or might have to pay higher fees to engage in swaps if the number of SDs was limited. The Commission further believes that given the nature of the business operations of FCM/SDs, the proposed minimum capital requirement of \$100 million of

<sup>77</sup> See proposed amendments to Rule 15c3-1(a)(7)(ii), 77 FR 70214, 70329.

<sup>78</sup> *Id.*

<sup>79</sup> See proposed new paragraph (f) to Rule 15c3-1, 77 FR 70214, 70331.

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

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> 77 FR 70214 at 70329.

<sup>84</sup> If an FCM or SD is also a registered BD, it may only use market risk and credit risk capital models if the SEC approves the firm as an ANC Firm. Accordingly, the Commission's proposal to extend models to other FCMs would only apply to FCMs that are not also subject to the SEC's capital requirements.

<sup>85</sup> As noted above, the SEC has proposed to increase the "early warning" requirement to \$6 billion, the tentative net capital requirement to \$5 billion, and the net capital requirement to \$1 billion.

adjusted net capital is consistent with section 4s(e) of the CEA.

The Commission believes that setting the same amount of minimum required capital would ensure a level playing field for SDs and FCMs that engage in swaps. However, to the extent that an FCM is dually registered as a BD and has received permission to use internal models for its credit and market risk charges, the FCM would follow the SEC's requirements with respect to the minimum capital it needs to maintain.

#### iv. Liquidity Requirements

The Commission is further proposing to require an FCM that is also registered as an SD to comply with the liquidity requirements in Proposed Rule 23.104(b)(1). The Commission recognizes that an FCM that acts as an SD is acting as a counterparty rather than as an intermediary between its customer and another counterparty. Therefore, for all the reasons discussed further below in section 3, the Commission is proposing to require FCMs that are also SDs to comply with the liquidity requirement set forth in Proposed Rule 23.104(b)(1).

#### Request for Comment

The Commission requests comment on all aspects of the proposed amendments to the FCM capital requirements. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is the proposed minimum adjusted net capital requirement of \$20 million appropriate for an FCM that is dually-registered as an SD? If not, explain why not. If the minimum dollar amount should be set at a level greater or lesser than \$20 million, explain what that greater or lesser amount should be and explain why that is a more appropriate amount.

2. Is the proposed minimum net capital requirement of \$100 million appropriate for an FCM that is dually-registered as an SD, and has been approved to use internal models to compute market risk and credit risk? If not, explain why not. If the minimum dollar amount should be set at a level greater or lesser than \$100 million, explain what that greater or lesser amount should be and explain why that is a more appropriate amount.

3. The proposal's minimum capital requirement based on 8% of margin, includes swaps exempt or excluded from the CFTC's margin requirements, such as inter-affiliate swaps. Please provide comment on the breadth of the

definition. Should the scope be narrowed? If so, how?

4. Should the 8 percent of margin capital requirement be set at a higher or lower level? If it should be adjusted, what percent should the Commission consider? Please provide analysis in support of the adjustment.

#### 4. Model Approval Process

Under the proposal as discussed above, SDs subject to the bank-based capital approach, the net liquid assets capital approach, or the tangible net worth capital approach are subject to market risk and credit risk capital charges on their swaps, security-based swaps and other proprietary positions in computing their regulatory capital. The Commission is proposing in Regulation 23.102 to permit SDs to compute market risk and credit risk capital charges using internal models in lieu of the standardized rules-based capital charges. The Commission recognizes that internal models, including value-at-risk models, can provide a more effective means of measuring economic risk from complex trading strategies involving uncleared swaps and other investment instruments.

The Commission, however, is concerned, given the number of SDs and the likely complexity of the capital models, that it may not be able to review models as thoroughly and expeditiously as would be necessary with its limited resources. In addition, the Commission recognizes that with its current resources it would be challenged to perform appropriate ongoing monitoring and assessment of the capital models to ensure that such models operate as designed. Accordingly, the Commission is proposing in Regulation 23.102 to permit an SD to use internal capital models that have been approved by the Commission or by an RFA of which the SD is a member to compute market risk and credit risk capital charges in lieu of standardized deductions.<sup>86</sup>

As previously noted, NFA currently is the only RFA. Allowing an SD to use internal capital models that have been approved by NFA is consistent with the Commission's recent approach with respect to margin models for uncleared swap transactions.<sup>87</sup> Specifically, Commission Regulation 23.154(b) allows an SD to obtain NFA's approval

<sup>86</sup> See proposed Regulation 23.102(b).

<sup>87</sup> See 81 FR 636, 654 (Jan. 6, 2016). As an RFA, NFA also is required to establish minimum capital requirements for its members, including SDs and MSPs, that are at least as stringent as the capital rules imposed by the Commission. The Commission anticipates that NFA's capital rules will permit SDs to use NFA approved capital models in computing regulatory capital.

to use a model to calculate the initial margin requirement for uncleared swaps and security-based swap positions. NFA has established a process, and is reviewing the margin models submitted by SDs.

Capital models, however, would pose different challenges for regulators, including NFA. Unlike the approach for initial margin, where SDs jointly developed a standardized initial margin model for swaps and security-based swaps that would be available for use by market participants, each SD seeking NFA approval would submit for review several individually developed capital models to compute the market risk for the full portfolio of trading positions, including swaps and security-based swaps, and counterparty credit risk charges that are discussed below. Therefore, reviewing capital models would significantly increase the number of models that NFA would need to review and approve relative to the margin models.<sup>88</sup> In addition, NFA would have to perform ongoing supervision over the models to assess the effective operation and implementation.

The SD's application to use internal models must be in writing and must be filed with the Commission and with an RFA in accordance with the applicable instructions. The model application must include specified information regarding the models, which is contained in proposed Appendix A to Regulation 23.102. For example, proposed Appendix A would require an SD to submit: (1) A list of categories of positions the SD holds in its proprietary accounts and a brief description of the methods the SD would use to calculate deductions for market risk and credit risk on those categories of positions; (2) a description of the mathematical models to be used to price positions and to compute deductions for market risk, including those portions of the deductions attributable to specific risk, if applicable, and deductions for credit risk; (3) a description of how the SD will calculate current exposure and potential future exposure for its credit risk charges, and (4) a description of how the SD

<sup>88</sup> In many instances, SDs whose capital models would be subject to NFA review would be affiliates of SDs whose capital models are subject to review by one of the prudential regulators, or affiliates of foreign SDs whose capital models are reviewed by a foreign regulatory authority. The Commission expects that a prudential regulator's or foreign regulator's review and approval of capital models that are used throughout the corporate family would be a significant factor in NFA determining the scope of its review, provided that appropriate information would be available to the Commission and NFA.

would determine internal credit risk weights of counterparties, if applicable.

The Commission or RFA may also require the SD to submit supplemental information relating to its models. If any information in an application is found to be or becomes inaccurate before the Commission or RFA approves the application, the SD must notify the Commission and RFA promptly and provide the Commission and RFA with a description of the circumstances in which the information was inaccurate along with updated accurate information. As part of the approval process, and on an ongoing basis, an SD would be required to demonstrate to the Commission or RFA that the models reliably account for the risks that are specific to the types of positions the SD intends to include in the model computations. The Commission or RFA may approve, in whole or in part, an application or an amendment to the application, subject to any conditions or limitations the Commission or RFA may require.

After receiving approval of its models, an SD would be required to amend and submit to the Commission or RFA for approval its application before materially changing its models or its internal risk management control system. Further, an SD would be required to notify the Commission or the RFA 45 days before it ceases using models to compute its capital. The Commission or the RFA may revoke an SD's ability to use models to compute capital if either the Commission or the RFA finds that the use of the models by the SD is no longer appropriate. If the Commission or the RFA revokes an SD's ability to use models to compute capital, the SD would need to use the standardized haircuts for all of its positions.

In developing the proposed market risk and credit risk requirements, including the proposed quantitative and qualitative requirements discussed below, the Commission has incorporated in the proposed requirements the market risk and credit risk model requirements adopted by the Federal Reserve Board for bank holding companies, including the value at risk ("VaR"), stressed VaR, specific risk, incremental risk, and comprehensive risk qualitative and quantitative standards and requirements. The Commission's proposed qualitative and quantitative requirements for capital models also are comparable to the SEC's existing capital model requirements for OTC derivatives dealers and ANC BDs.

#### i. VaR Models

Proposed Regulation 23.102 would require that a VaR model's quantitative criteria include the use of a VaR-based measure based on a 99 percent, one-tailed confidence interval. The VaR-based measure must be based on a price shock equivalent to a ten business-day movement in rates or prices. Price changes estimated using shorter time periods must be adjusted to the ten-business-day standard. The minimum effective historical observation period for deriving the rate or price changes is one year and data sets must be updated at least quarterly or more frequently if market conditions warrant. For many types of positions it is appropriate for an SD to update its data positions more frequently than quarterly. In all cases, an SD must have the capability to update its data sets more frequently than quarterly in anticipation of market conditions that would require such updating.

The SD would not need to employ a single internal capital model to calculate its VaR-based measure. An SD may use any generally accepted approach, such as variance-covariance models, historical simulations, or Monte Carlo simulations. However, the level of sophistication of the SD's internal capital model must be commensurate with the nature and size of the positions the model covers. The internal capital model must use risk factors sufficient to measure the market and credit risk inherent in all positions. The risk factors must address the risks including interest rate risk, credit spread risk, equity price risk, foreign exchange risk, and commodity price risk. For material positions in the major currencies and markets, modeling techniques must incorporate enough segments of the yield curve—in no case less than six—to capture differences in volatility and less than perfect correlation of rates along the yield curve.

The internal capital model may incorporate empirical correlations within and across risk categories, provided that the SD validates and demonstrates the reasonableness of its process for measuring correlations. If the internal capital model does not incorporate empirical correlations across risk categories, the SD must add the separate measures from its internal capital models for the appropriate risk categories as listed above to determine its aggregate VaR-based measure of capital.

The VaR-based measure must include the risks arising from the nonlinear price characteristics of options positions or positions with embedded optionality

and the sensitivity of the fair value of the positions to changes in the volatility of the underlying rates, prices or other material factors. An SD with a large or complex options portfolio must measure the volatility of options positions or positions with embedded optionality by different maturities and/or strike prices, where material.

The internal capital model must be subject to back-testing requirements that must be calculated no less than quarterly. An SD must compare its daily VaR-based measure for each of the preceding 250 business days against its actual daily trading profit or loss, which includes realized and unrealized gains and losses on portfolio positions as well as fee income and commissions associated with its activities. If the quarterly backtesting shows that the SD's daily net trading loss exceeded its corresponding daily VaR-based measure, a backtesting exception has occurred. If an SD experiences more than four backtesting exceptions over the preceding 250 business days, it is generally required to apply a multiplication factor in excess of three when it calculates its capital requirements.

The qualitative requirements would specify, among other things, that: (1) Each VaR model must be integrated into the SD's daily internal risk management system; (2) each VaR model must be reviewed periodically by the firm's internal audit staff and annually by a third party service provider; and (3) the VaR measure computed by the model must be multiplied by a factor of at least three but potentially a greater amount if there are exceptions to the measure resulting from quarterly back-testing results.

An SD would also be subject to ongoing supervision by staff of the Commission and or RFA with respect to its internal risk management, including its use of VaR models.

#### ii. Stressed VaR Models

The Commission is proposing a stressed VaR component for SDs that have permission to use VaR models to compute market risk capital deductions. The stressed VaR measure supplements the VaR measure, as the VaR measure's inherent limitations produced an inadequate amount of capital to withstand the losses sustained by many financial institutions in the financial crisis of 2007–2008.<sup>89</sup> The stressed VaR measure should also contribute to a

<sup>89</sup> See *Revisions to the Basel II market risk framework*, published by the Basel Committee on Banking Supervision for an explanation of the implementation of the stressed VaR requirement.

more appropriate measure of the risks of an SD's positions, as it should account for more volatile and extreme price changes.

An SD would be required to use the same model that it uses to compute its VaR measure for its stressed VaR measure. The model inputs however would be calibrated to reflect historical data from a continuous 12-month period that reflects a period of significant financial stress appropriate to the SD's portfolio. The stressed VaR measure must be calculated at least weekly and be no less than the VaR measure. The Commission would expect that the stressed VaR measure would be substantially greater than the VaR measure.

The Commission would require the stress tests to take into account concentration risk, illiquidity under stressed market conditions, and other risks arising from the SD's activities that may not be captured adequately in the SD's internal models. For example, it may be appropriate for the SD to include in its stress testing large price movements, one-way markets, nonlinear or deep out-of-the-money products, jumps-to-default, and significant changes in correlation. Relevant types of concentration risk include concentration by name, industry, sector, country, and market.

The SD must maintain policies and procedures that describe how it determines the period of significant financial stress used to compute its stressed VaR measure and be able to provide empirical support for the period used. These policies and procedures must address: (1) How the SD links the period of significant financial stress used to calculate the stressed VaR-based measure to the composition and directional bias of the SD's portfolio; and (2) the SD's process for selecting, reviewing, and updating the period of significant financial stress used to calculate the stressed VaR measure and for monitoring the appropriateness of the 12-month period in light of the SD's current portfolio. Before making material changes to these policies and procedures, an SD must obtain approval from the Commission or RFA. The Commission or the RFA may also require the SD to use a different period of stress to compute its stressed VaR measure.

#### iii. Specific Risk Models

The Commission's proposal would allow SDs to model their specific risk. Under the proposal, the specific risk model must be able to demonstrate the historical price variation in the portfolio, be responsive to changes in

market conditions, be robust to an adverse environment, and capture all material aspects of specific risk for its positions. The Commission would require that an SD's models capture event risk (such as the risk of loss on equity or hybrid equity positions as a result of a financial event, such as the announcement or occurrence of a company merger, acquisition, spin-off, or dissolution) and idiosyncratic risk, capture and demonstrate sensitivity to material differences between positions that are similar but not identical, and to changes in portfolio composition and concentrations. If an SD calculates an incremental risk measure for a portfolio of debt or equity positions under paragraph (I) of 23.102 Appendix A, the SD is not required to capture default and credit migration risks in its internal models used to measure the specific risk of these portfolios.

The Commission understands that not all debt, equity, or securitization positions (for example, certain interest rate swaps) have specific risk. Therefore, there would be no specific risk capital requirement for positions without specific risk. An SD must have clear policies and procedures for determining whether a position has specific risk.

The Commission believes that an SD should develop and implement VaR-based models for both market risk and specific risk. An SD's use of different approaches to model specific risk and general market risk (for example, the use of different models) will be reviewed to ensure that the overall capital requirement for market risk is commensurate with the risks of the SD's covered positions.

#### iv. Incremental Risk Models

The Commission is proposing an incremental risk requirement for SDs that measures the specific risk of a portfolio of debt positions using internal models. Incremental risk consists of the default risk and credit migration risk of a position. Default risk means the risk of loss on a position that could result from the failure of an obligor to make timely payments of principal or interest on its debt obligation, and the risk of loss that could result from bankruptcy, insolvency, or similar proceeding. Credit migration risk means the price risk that arises from significant changes in the underlying credit quality of the position. An SD may also include portfolios of equity positions in the incremental risk model with the prior permission from the Commission or RFA, provided that the SD consistently includes such equity positions in how it internally measures and manages the

incremental risk for such positions at the portfolio level. Default is assumed to occur with respect to an equity position that is included in its incremental risk model upon the default of any debt of the issuer of the equity position.

#### v. Comprehensive Risk Models

Under the proposal, an SD would be required to compute all material price risks of one or more portfolios of correlation trading positions using an internal model. The Commission would require the model to measure all price risk consistent with a one-year time horizon at a one-tail, 99.9 percent confidence level, under the assumption either of a constant level of risk or of constant positions. The Commission would expect that the SD remains consistent in its choice of constant level or risk or positions, once it makes a selection. Also, the SD's choice of a liquidity horizon must be consistent between its calculation of its comprehensive and incremental risk.

The Commission would require an SD's comprehensive risk model to capture all material price risk, including, but not limited to: (1) The risk associated with the contractual structure of cash flows of each position, its issuer, and its underlying exposures (for example, the risk arising from multiple defaults, including the ordering of defaults in tranching products); (2) credit spread risk, including nonlinear price risks; (3) volatility of implied correlations, including nonlinear price risks such as the cross-effect between spreads and correlations; (4) basis risks; (5) recovery rate volatility as it relates to the propensity for recovery rates to affect tranche prices; and (6) to the extent that comprehensive risk measure incorporates benefits from dynamic hedging, the static nature of the hedge over the liquidity horizon. The Commission notes that additional risks that are not explicitly discussed but are a material source of price risk must be included in the comprehensive risk measure.

The Commission would require an SD to have sufficient market data to ensure that it fully captures the material price risks of the correlation trading positions in its comprehensive risk measure. Moreover, an SD must be able to demonstrate that its model is an appropriate representation of comprehensive risk in light of the historical price variation of its correlation trading positions. An SD would also be required to inform the Commission and RFA if the SD plans to extend the use of a model that has been

approved to an additional business line or product type.

The comprehensive risk measure must be calculated at least weekly. In addition, an SD must at least weekly apply to its portfolio of correlation trading positions a set of specific stressed scenarios that capture changes in default rates, recovery rates, and credit spreads, and various correlations. An SD must retain and make available to the Commission and the RFA the results of the stress testing, including comparisons with capital comparisons generated by the SD's comprehensive risk model. An SD must promptly report to the Commission or the RFA any instances where the stress tests indicate any material deficiencies in the comprehensive risk model.

#### vi. Credit Risk Models

Swap dealers that obtain Commission or RFA approval to use internal models to compute credit risk would be required to submit credit risk models that satisfy the quantitative and qualitative requirements set forth in Appendix A to proposed Regulation 23.102. With respect to OTC derivatives contracts, an SD would need to determine an exposure charge for each OTC derivatives counterparty. The exposure charge for a counterparty that is insolvent, in a bankruptcy proceeding, or in default of an obligation on its senior debt, is the net replacement value of the OTC derivatives contracts with the counterparty (*i.e.*, the net amount of uncollateralized current exposure to the counterparty). The counterparty exposure charge for all other counterparties is the credit equivalent amount of the SD's exposure to the counterparty multiplied by an applicable credit risk weight factor multiplied by eight percent. The credit equivalent amount is the sum of the SD's (1) maximum potential exposure ("MPE") multiplied by a back-testing determined factor; and (2) current exposure to the counterparty. The MPE amount is a charge to address potential future exposure and is calculated using the VaR model as applied to the counterparty's positions after giving effect to a netting agreement, taking into account collateral received, and taking into account the current replacement value of the counterparty's positions.

The Commission in its margin requirements (*see* Regulations 23.150 through 23.161) has set forth the requirements for eligible collateral for uncleared swaps. In order to account for collateral in its VaR model for the credit risk charges, the Commission would expect an SD to account for only the

collateral that complies with Regulation 23.156 and is held in accordance with Regulation 23.157 for uncleared swaps that are subject to the Commission's margin rules. An SD would be able to take into consideration in its VaR calculation collateral that does not comply with Regulation 23.156 and is not held in accordance with Regulation 23.157 for uncleared swaps that are not subject to the Commission's margin rules.

The Commission is allowing SDs to use internal methodologies to determine the appropriate credit risk weights to apply to counterparties, if it has received the Commission's or the RFA's approval. A higher percentage credit risk weight factor would result in a larger counterparty exposure charge amount. The Commission expects that the counterparty credit risk weight should be based on an assessment of the creditworthiness of the counterparty.

The second component to the credit risk charge would be a counterparty concentration charge. This charge is intended to account for the additional risk resulting from a relatively large exposure to a single counterparty. This charge is triggered if an SD's current exposure to a counterparty exceeds five percent of the tier 1 or tentative net capital of the SD. In this case, an SD must take a counterparty concentration charge equal to: (1) Five percent of the amount by which the current exposure exceeds five percent of the tier 1 or tentative net capital of the SD for a counterparty with a credit risk weight of 20 percent or less; (2) 20 percent of the amount by which the current exposure exceeds five percent of the tentative net capital for a counterparty with a risk weight factor of greater than 20 percent and less than 50 percent; and (3) 50 percent of the amount by which the current exposure exceeds five percent of the tier 1 or tentative net capital for a counterparty with a risk weight factor of 50 percent or more.

The Commission is also proposing a portfolio concentration charge to address the risk of having a large amount of exposure relative to the capital of the SD. This charge is triggered when the aggregate current exposure of the SD to all counterparties exceed 50 percent of the SD's common equity tier 1 capital or tentative net capital. In this case, the portfolio concentration charge would be equal to 100 percent of the amount by which the aggregate current exposure exceeds 50 percent of the SD's common equity tier 1 capital or tentative net capital.

The Commission believes that its approach to calculating credit risk charges is appropriate given that its

requirements are based on a method of computing capital charges for credit risk exposures in the international capital standards for banking institutions. Since credit risk is the risk that a counterparty could not meet its obligations on an OTC derivatives contract in accordance with agreed terms (such as failing to pay), the considerations that inform an SD's assessment of a counterparty's credit risk should be broadly similar across the various relationships that may arise between the dealer and the counterparty. Therefore, the Commission believes that its approach should be a reasonable model, as the SEC also uses a similar approach for its ANC broker-dealers or security-based SDs using models.

SDs that are subject to the bank-based capital requirement could also request Commission or RFA approval to use the Federal Reserve Board's internal ratings-based and advanced measurement model approaches to compute risk-weighted assets for the credit exposures listed in subpart E of 12 CFR 217. The SD would have to include such exposures in its application to the Commission and RFA, and explain how its proposed models are consistent with the Federal Reserve Board's model criteria in subpart E of 12 CFR 217.

#### Request for Comment

The Commission requests comment on all aspects of the proposed model approval process and the computation of the credit risk charges. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Do the proposed models appropriately account for the market and credit risk of swaps and security-based swaps? If not, explain why and provide alternatives that the Commission should consider.
2. Is the proposed model review process appropriate? If not, explain why not and provide alternatives that the Commission should consider.
3. The proposal states that the Commission expects that a prudential regulator's or foreign regulator's review and approval of capital models that are used in the corporate family of an SD would be a significant factor in NFA determining the scope of its review, provided that appropriate information sharing agreements are in place. Given the number and complexity of the model review process, please provide comments on the viability of the proposed model review process? What other alternatives should the Commission consider?

4. Should the Commission provide for automatic approval or temporary approval of capital models already approved by a prudential or foreign regulator? If so, please provide information regarding on what conditions such models should be approved?

5. What factors should the Commission consider in setting an effective date for the capital rules given the application process and the model approval process? Are most SDs that would be subject to the rule already using models that are consistent with the proposed regulations?

6. Are there other approaches available to facilitate the timely review of applications from SDs to use internal models? For example, could a more limited review be performed of models that have been approved by another regulator? If so, what conditions, if any, should the Commission consider prior to approving the model?

7. How much implementation time is needed for the Commission's proposed model review and approval process?

8. Are the proposed methods of computing the credit risk charge appropriate for nonbank SDs? If not, explain why not. For example, are there differences between FCM/BDs that are also SDs and standalone SDs that would make the method of computing the credit risk charge appropriate for the former but not the latter. If so, identify the differences and explain why they would make the credit risk charge not appropriate for nonbank SDs. What modifications should be made in that case?

9. Is the method of computing the counterparty exposure charge appropriate for nonbank SDs? If not, explain why not. For example, is the calculation of the credit equivalent amount (*i.e.*, the sum of the MPE and the current exposure to the counterparty) a workable requirement for nonbank SDs? If not, explain why not.

10. Are the conditions for taking collateral into account when calculating the credit equivalent amount appropriate for nonbank SDs? If not, explain why not.

11. Are the conditions for taking netting agreements into account when calculating the credit equivalent amount appropriate for nonbank SDs? If not, explain why not.

12. Are the standardized risk weight factors (20%, 50%, and 150%) proposed for calculating the credit equivalent amount appropriate for nonbank SDs? If not, explain why not.

13. Is the method of computing the counterparty concentration charge

appropriate for nonbank SDs? If not, explain why not.

14. Is the method of computing the portfolio concentration charge appropriate for SDs? If not, explain why not.

#### *B. Swap Dealer and Major Swap Participant Liquidity Requirements and Equity Withdrawal Restrictions*

##### 1. Liquidity Requirements

The Commission is proposing liquidity requirements for SDs that elect a bank-based capital approach under proposed Regulation 23.101(a)(1)(i) or a net liquid assets capital approach under proposed Regulation 23.101(a)(1)(ii). The Commission also is proposing liquidity requirements for SDs that are registered FCMs. The Commission's proposed liquidity requirements are designed to address the potential risk that an SD may not be able to efficiently meet both expected and unexpected current and future cash flow and collateral needs as a result of adverse events impacting the SD's daily operations or financial condition. The proposed liquidity requirements for SDs subject to the bank-based capital approach are consistent with existing liquidity requirements adopted by the Federal Reserve Board for bank holding companies.<sup>90</sup> The proposed liquidity requirements for SDs subject to the net liquid assets capital approach are consistent with liquidity requirements proposed by the SEC for SBSBs.<sup>91</sup>

SDs that are subject to the capital requirements of a prudential regulator, would not be subject to the Commission's proposed liquidity requirements as such SDs are subject to regulation by the prudential regulators, including liquidity requirements established by the prudential regulators. The Commission also is not proposing liquidity requirements for SDs that are eligible to use the tangible net worth capital approach under proposed Regulation 23.101(a)(2)(i). SDs that are eligible to use the net worth capital approach are required to be primarily engaged in commercial activities, with their financial activities limited by the 15% asset test or 15% revenue tests discussed in section II.A.2.iii of this release. Accordingly, the business operations of SDs that are eligible to use the tangible net worth capital approach are significantly different from the traditional business activities of financial firms and financial market intermediaries whose need for access to liquidity is crucial to meet their

obligations to make daily payments to their clients and to meet other daily funding obligations. In contrast, the liquidity needs of SDs that are eligible to use the tangible net worth approach would encompass the daily funding and payment obligations of the non-financial business with which the SD is connected.

##### i. Swap Dealers Subject to the Bank-Based Capital Approach

Proposed Regulation 23.104(a)(1) would provide that an SD that elects the bank-based capital approach would need to meet the liquidity coverage ratio requirements set forth in 12 CFR part 249, and apply such requirements as if the SD were a bank holding company subject to 12 CFR part 249. The proposed liquidity coverage ratio would require the SD to maintain each day an amount of high quality liquid assets ("HQLAs"), as defined in 12 CFR 249.20, that is no less than 100 percent of the SDs total net cash outflows over a prospective 30 calendar-day period.<sup>92</sup>

HQLAs are assets that are unencumbered by liens and other restrictions on the ability of the SD to transfer the assets.<sup>93</sup> There are three categories of HQLAs (level 1 and levels 2A and 2B),<sup>94</sup> and there are haircuts and concentration restrictions on the level 2A and level 2B assets.<sup>95</sup> Specifically, level 2A and level 2B assets are valued at 85 percent and 50 percent, respectively, of the fair value of the assets.<sup>96</sup> The HQLA categories are designed so that the assets that are HQLAs could be converted quickly into cash without reasonably expecting to incur losses in excess of the applicable haircuts during a stress period.

An SD's total net cash outflow amount would be determined by applying outflow and inflow rates, which reflect certain standardized stressed assumptions, against the balances of an SD's funding sources, obligations, transactions, and assets over a prospective 30 day period.<sup>97</sup> Inflows that can be included to offset outflows are limited to 75 percent of the outflows

<sup>92</sup> See 12 CFR 249.10. Federal Reserve Board rules require a regulated institution to maintain a liquidity coverage ratio of HQLA to net cash outflows that is equal to or greater than 1.0 on each business day.

<sup>93</sup> See 12 CFR 249.22(b).

<sup>94</sup> See 12 CFR 249.20.

<sup>95</sup> See 12 CFR 249.21. Level 2A liquid assets are subject to a 15 percent haircut, and level 2B liquid assets are subject to a 50 percent haircut. The concentration limits on level 2A and 2B assets are set forth in 12 CFR 249.21(d), and effectively provide that level 2A and level 2B assets may not comprise more than 40 percent and 15 percent, respectively, of an entity's HQLAs.

<sup>96</sup> See 12 CFR 249.21(a).

<sup>97</sup> See 12 CFR 249.32.

<sup>90</sup> See 12 CFR part 249.

<sup>91</sup> See SEC proposed Rule 18a-1(f), 77 FR 226 (Nov. 23, 2012).



to ensure that the SD is maintaining sufficient liquidity and is not overly reliant on inflows. The stressed assumptions include events such as a partial loss of secured, short-term financing with certain collateral and counterparties and losses from derivatives positions and the collateral supporting those positions.

The Commission recognizes that certain portions of 12 CFR part 249 may not be applicable to a particular SD. For example, an SD may not have certain of the instruments listed in 12 CFR part 249 as an asset or may not have certain of the cash inflows and outflows listed in the regulation.<sup>98</sup> However, the Commission believes that the portion of the regulations applicable to derivative transactions would be applicable to an SD. Therefore, the SD would be required to apply the portions of 12 CFR part 249 that are applicable to it, based on its balance sheet and the composition of its assets and liabilities.

Furthermore, the Commission is proposing to adjust the Federal Reserve Board's liquidity coverage ratio to better reflect the business of an SD. Specifically, the proposal would explicitly include an SD's cash deposits that are readily available to meet the general obligations of the SD as a level 1 liquid asset in computing its liquidity coverage ratio.<sup>99</sup> The Commission is also modifying the proposal to provide that an SD organized and domiciled outside of the U.S. may include in its HQLAs assets held in its home country jurisdiction.<sup>100</sup> The Commission believes that these adjustments are appropriate to better align the liquidity coverage ratio with the expected operations of certain SDs.

The Commission also believes that the results of stress tests play a key role in shaping an SD's liquidity risk contingency planning. Thus, stress testing and contingency planning are closely intertwined. Under proposed Regulation 23.104(a)(4), an SD would be required to establish a contingency funding plan. The contingency funding plan would need to clearly set out the strategies and funding sources for addressing liquidity shortfalls in emergency situations and would need to address the policies, roles, and

<sup>98</sup> The Commission is also proposing to explicitly include an SD's cash deposits that are readily available to meet the general obligations of the SD as a level 1 liquid asset. The Commission is also modifying the proposal to provide that SDs organized and domiciled outside of the U.S. may include in its HQLAs held outside of the U.S. (See proposed Regulation 23.104(a)(1)).

<sup>99</sup> See proposed Regulation 23.104(a)(1).

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

responsibilities for meeting the liquidity needs of the SD.

The proposal further provides that the SD's senior management that has responsibility for risk management would need to be informed if the SD did not maintain a liquidity coverage ratio of at least 1.0. In addition, the assumptions underlying the calculation of the liquidity coverage ratio would need to be reviewed at least quarterly by senior management that has responsibility to oversee risk management at the SD and at least annually by senior management of the SD.<sup>101</sup>

The Commission also is proposing to require an SD to obtain Commission approval prior to transferring HQLAs to the SD's affiliates or parent if, after the transfer of those liquid assets, the SD would not be able to comply with the liquidity coverage ratio requirement.<sup>102</sup> Therefore, an SD may not transfer assets that would qualify for the numerator of the liquidity coverage ratio to its affiliates or parent if, after the transfer, the SD's HQLA would be below 100 percent of its total projected net cash flows over a 30 day period.

#### ii. Swap Dealers Subject to the Net Liquid Assets Capital Approach

An SD that elects to be subject to a net liquid assets capital approach would need to comply with liquidity risk management requirements set forth in proposed Regulation 23.104(b). The Commission understands that many financial institutions have traditionally used liquidity funding stress tests as a means to measure liquidity risk. These tests would generally estimate cash and collateral needs over a period of time and assume that sources to meet those needs (*e.g.*, obtaining secured funding lines and lines of credit) will become impaired or be unavailable. Therefore, to raise funds during a liquidity stress event, a firm would generally keep a pool of unencumbered liquid assets that can be used to meet its current liabilities or other funding needs. The size of the pool of unencumbered liquid assets would be based on a firm's estimation of how much of a diminution of value in those liquid assets and the amount of funding that would be lost from external sources during a stress event and the duration of the event.

Under proposed Regulation 23.104(b), an SD would need to perform a liquidity stress test at least monthly that takes into account certain assumed conditions lasting for 30 consecutive days. The results of the liquidity stress test would

<sup>101</sup> See proposed Regulation 23.104(a)(2) and (3).

<sup>102</sup> See proposed Regulation 23.104(a)(2).

need to be provided within 10 business days of the month end to senior management responsible for overseeing risk management at the SD. In addition, the assumptions underlying the liquidity stress test would need to be reviewed at least quarterly by senior management responsible for overseeing risk management at the SD and at least annually by senior management of the SD.<sup>103</sup>

As noted above, the Commission's proposed liquidity requirements for SDs that are subject to a net liquid assets capital approach are consistent with the SEC's proposed liquidity requirements for SBSDs, and are intended to address the types of liquidity outflows experienced by ANC Firms in times of stress. Consistent with the SEC approach, the Commission's liquidity stress test proposal is designed to ensure that SDs are using a stress test that is severe enough to produce an estimate of a potential funding loss of a magnitude that might be expected in a severely stressed market. Proposed Regulation 23.104(b)(3) would require an SD to maintain at all times liquidity reserves based on the results of the liquidity stress test in the form of unencumbered cash or U.S. government securities. The Commission is proposing this requirement to ensure that only the most liquid instrument are held in reserves, given that the market for less liquid instruments may not be available during a time of market stress.

As noted above, the results of stress tests play a key role in shaping an SD's liquidity risk contingency planning. Therefore, similar to the requirement for an SD that elects to be subject to a bank-based capital approach, an SD that elects to be subject to a net liquid assets capital approach would be required by proposed Regulation 23.104(b)(4) to establish a contingency funding plan. The plan would need to clearly set out the strategies and funding sources for addressing liquidity shortfalls in emergency situations and would need to address the policies, roles, and responsibilities for meeting the liquidity needs of the SD.

#### Request for Comment

The Commission requests comment on all aspects of the proposed capital rule and liquidity requirements, including empirical data in support of

<sup>103</sup> The assumptions would include (1) a decline in creditworthiness of the SD severe enough to trigger contractual credit related commitment provisions of counterparty agreements; the loss of all existing unsecured funding at the earlier of its maturity and an inability to acquire a material amount of new unsecured funding; and, the potential for a material loss of secured funding.

comments. In addition, the Commission requests comment in response to the following questions:

1. Should the Commission phase-in the implementation of any final capital rule? For example, the capital requirements would be implemented first and the liquidity requirements would be implemented second. Please provide recommendations and implementation time-periods.

2. Should the Commission consider alternative approaches to the proposed liquidity requirements? If so, explain the alternatives and the rationale for the alternatives. Please provide any quantitative analysis in support of alternative approaches, if possible.

## 2. Swap Dealer Equity Withdrawal Restrictions

The Commission is proposing certain equity withdrawal restrictions for SDs that elect either the bank-based capital approach or the net liquid assets capital approach. Proposed Regulation 23.104(c) would provide that the capital of an SD, or any subsidiary or affiliate of the SD that has any of its liabilities or obligations guaranteed by the SD, may not be withdrawn by action of an SD or equity holder of the SD, or by redemption of shares of stock by the swap dealer or such affiliates or subsidiaries, or through the payment of dividends or any similar distribution, if such withdrawal or payment, and any other similar transactions that are scheduled to occur within the succeeding six months, results in the SD holding less than 120 percent of the minimum regulatory capital that the SD is required to hold pursuant to proposed Regulation 23.101. The proposal includes an exception for paying required tax payments and for paying reasonable compensation to equity holders of the SD. The proposal is consistent with existing equity withdrawal restrictions imposed on FCMs and BDs, and is consistent with equity withdrawal restrictions proposed by the SEC for SBSBs.<sup>104</sup>

Proposed Regulation 23.104(d) would grant the Commission the ability to issue an order temporarily restricting for up to 20 business days the withdrawal of capital from an SD, or prohibiting the SD from making an unsecured loan or advance to any stockholder, partner, member, employee or affiliate of the SD. The Regulation would further provide that the Commission may issue such an

order if, based upon the information available, the Commission concludes that such withdrawal, loan or advance may be detrimental to the financial integrity of the SD, or may unduly jeopardize the SD's ability to meet its financial obligations to counterparties or to pay other liabilities which may cause a significant impact on the markets or expose the counterparties and creditors of the SD to loss. The proposal further provides that the SD may request a hearing on the order, which must be held within two business days of the date of the written request by the SD. The proposed grant of authority to the Commission to issue an order temporarily restricting certain unsecured loans or advances is consistent with the existing Commission authority under Regulation 1.17(g)(1) for FCMs and with the SEC's authority over BDs.<sup>105</sup> The proposed Commission authority to temporarily restrict equity withdrawals also is consistent with the SEC's proposal governing SBSBs.<sup>106</sup>

Both the limitation on the withdrawal of equity capital and the authority of the Commission to temporarily restrict the withdrawal of capital are intended to provide mechanisms for the Commission to assess the financial and operational condition of SDs in times of financial stress. In such situations, it is a priority for the Commission that SDs maintain the financial strength and liquidity to meet their financial obligations to counterparties and creditors.

### *C. Swap Dealer and Major Swap Participant Financial Recordkeeping, Reporting and Notification Requirements*

#### 1. Swap Dealer and Major Swap Participant Financial Recordkeeping and Financial Statement Reporting Requirements

Section 4s(f) of the CEA directs the Commission to adopt regulations governing reporting and recordkeeping for SDs and MSPs, including financial condition reporting and position reporting. Consistent with section 4s(f), the Commission is proposing new Regulation 23.105, which would require SDs and MSPs to satisfy current books and records requirements, "early warning" and other notification filing requirements, and periodic and annual financial report filing requirements with the Commission and with any RFA of which the SDs and MSPs are members.

As discussed below, however, the proposed notice and financial reporting requirements differentiate between SDs and MSPs that are subject to the Commission's capital requirements and SDs and MSPs that are subject to the prudential regulators' capital requirements.<sup>107</sup> The Commission is proposing not to impose the majority of the financial reporting provisions contained in Regulation 23.105 on SDs and MSPs that are subject to the capital rules of a prudential regulator from, with the exception of certain financial and swaps position and margin reporting requirements and notice filing requirements discussed below, as the financial condition of these entities will be supervised by the applicable prudential regulator and subject to its financial reporting requirements. The Commission believes that the proposal is consistent with section 4s of the CEA which grants the prudential regulators the authority to establish capital requirements for SDs and MSPs subject to their jurisdiction. Additionally, the Commission's proposed approach avoids imposing potential duplicative, and potentially contradictory, requirements on SDs and MSPs that are subject to both Commission and prudential regulator oversight.

Proposed Regulation 23.105(b) is based upon existing FCM and BD financial recordkeeping and reporting requirements and would require an SD or MSP to prepare current ledgers or other similar records showing or summarizing each transaction affecting its asset, liability, income, expense and capital accounts.<sup>108</sup> The accounts must be classified in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") provided, however, that if the SD or MSP is organized under the laws of a foreign jurisdiction and is not otherwise required to prepare its records or financial statements in accordance with U.S. GAAP, the SD or MSP may prepare the required records in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB").<sup>109</sup> Proposed Regulation

<sup>107</sup> See proposed Regulation 23.105(a)(2).

<sup>108</sup> Commission Regulation 1.18 requires each FCM to prepare and keep current ledgers or other similar records which show or summarize, with appropriate references to supporting documents, each transaction affecting its asset, liability, income, expense and capital accounts. SEC Rule 17a-3 (17 CFR 240.17a-3) requires a BD to make and maintain comparable ledgers and other similar records reflecting its assets, liabilities, income and expenses.

<sup>109</sup> FCMs are required to classify accounts only in accordance with U.S. GAAP.

<sup>104</sup> Equity withdrawal restrictions for FCMs are set forth in Regulation 1.17(e), and for BDs is set forth in 17 CFR 240.15c3-1(e)(2). SEC proposed equity withdrawal restrictions for SBSBs is contained in proposed Rule 18a-1(e)(2). See 77 FR 226 (Nov. 23, 2012).

<sup>105</sup> See Rule 15c3-1(e)(3) (17 CFR 240.15c3-1(e)(3)).

<sup>106</sup> See SEC proposed Rule 18a-1(e)(3) (77 FR 20214 (Nov. 23, 2012)).

23.105(b) also would require an SD or MSP to maintain its ledgers or other similar records showing or summarizing each transaction affecting its asset, liability, income, expense and capital accounts for a period of five years pursuant to Regulation 1.31.

The Commission is proposing in Regulation 23.105(b) to permit an SD or MSP organized and domiciled outside of the U.S. to maintain financial books and records in accordance with IFRS in recognition that U.S. GAAP may not be the native accounting principles for a non-U.S. firm and that these firms may be subject to existing non-U.S. GAAP financial reporting requirements in their home country jurisdictions. These SDs and MSPs would be subject to substantial expense and burden if they were required to maintain two separate accounting records and systems to satisfy two separate financial reporting requirements. The Commission, however, is proposing that if the SD or MSP is otherwise required to maintain books and records in accordance with U.S. GAAP, the SD or MSP must maintain its records pursuant to U.S. GAAP in order to comply with Regulation 23.105(b).

The Commission is also proposing to require SDs and MSPs to file periodic financial reports with the Commission and with the SDs' or MSPs' RFA. Consistent with the recordkeeping requirements, the proposed financial reporting requirements are consistent with existing Commission requirements for FCMs and SEC requirements for BDs.<sup>110</sup>

Proposed Regulation 23.105(d)(1) would require an SD or MSP to file a monthly unaudited financial report within 17 business days of the close of business each month, and proposed Regulation 23.105(e)(1) would require an SD or MSP to file an annual audited financial report within 60 days of the close of the SD's or MSP's fiscal year-end date.<sup>111</sup> The monthly unaudited

<sup>110</sup> Regulation 1.10 requires FCMs to submit unaudited monthly and audited annual financial reports to the Commission and to the FCMs' respective designated self-regulatory organization. SEC Rule 17a-5 (17 CFR 240.17a-5) directs BDs to file unaudited monthly reports and annual audited reports with the SEC.

<sup>111</sup> The Commission also is proposing certain technical, administrative provisions for SD and MSP financial statements. Proposed paragraph (g) to Regulation 23.105 would prohibit an SD or MSP from changing its fiscal year end date unless the SD or MSP has requested and received written approval for the change from the RFA of which it is a member. Proposed paragraph (j) would provide that an SD or MSP may request an extension of time to file its unaudited monthly or audited annual report from the RFA, which may be granted on a conditional or unconditional basis, or disapproved by the RFA. Proposed paragraphs (g) and (j) of

and the annual audited financial reports must be prepared in the English language and denominated in U.S. dollars.<sup>112</sup> The monthly unaudited and annual audited financial reports also must include: (1) A statement of financial condition; (2) a statement of income or loss; (3) a statement of cash flows; (4) a statement of changes in ownership equity; (5) a statement of the applicable capital computation; and (6) any further materials that are necessary to make the required statements not misleading.<sup>113</sup> Proposed Regulation 23.105(e)(4)(iii) would further require that the annual audited financial statements also include any necessary footnote disclosures. Proposed Regulation 23.105(e)(2) would require the annual financial statements to be audited by a public accountant that is in good standing in the accountant's home country jurisdiction.<sup>114</sup>

The monthly unaudited and annual audited financial statements must be prepared in accordance with U.S. GAAP, provided, however, that the Commission is proposing to permit SDs or MSPs that are organized and domiciled outside of the U.S., and otherwise are not required to prepare financial statements in accordance with U.S. GAAP, to prepare the financial statements in accordance with IFRS or another local accounting standard, after requesting approval by the Commission, which is discussed below, in lieu of U.S. GAAP.<sup>115</sup> The use of IFRS in lieu of U.S. GAAP is consistent with the proposed treatment in Regulation 23.105(b) discussed above that would allow a these SDs and MSP to maintain their financial books and records in accordance with IFRS.

The Commission, however, is proposing that if the non-U.S. SD or non-U.S. MSP is otherwise required to prepare financial statements in accordance with U.S. GAAP, the SD or MSP must submit financial statements prepared in accordance with U.S. GAAP to the Commission and to the firm's RFA in order to comply with the regulations. This requirement reflects the fact that certain foreign-based SDs or

Regulation 23.105 are consistent with current provisions governing FCMs under Regulation 1.10.

<sup>112</sup> See proposed Regulations 23.105(d)(2) and (e)(3).

<sup>113</sup> See proposed Regulations 23.105(d)(2) and (e)(4).

<sup>114</sup> FCMs currently are required to file unaudited financial reports and an annual financial report with the Commission within 17 and 60 days, respectively, of the end of the reporting period. See Regulation 1.10(b).

<sup>115</sup> See proposed Regulations 23.105(d)(2) and (e)(3). Regulation 1.10 provides that FCMs must present its unaudited monthly reports and audited annual reports in accordance with U.S. GAAP.

MSPs that consolidate into a U.S. parent organization may prepare U.S. GAAP financial statements as part of the consolidation. Under the proposed regulations, if the foreign-based SD or MSP prepares U.S. GAAP financial statements as part of the consolidation, it would be required to submit such U.S. GAAP statements to the Commission and to the firm's RFA to comply with Regulation 23.105(d)(2) and (e)(3).

While the Commission has proposed to permit SDs or MSPs organized and domiciled outside the U.S. to use IFRS in lieu of U.S. GAAP in the preparation and presentation of the monthly unaudited and annual audited financial reports, the Commission recognizes that not all non-U.S. jurisdictions have adopted IFRS. In addition, the Commission understands that even in certain foreign jurisdictions that have adopted IFRS, SDs and MSPs may be permitted to prepare and present their financial statements in accordance with local accounting standards. To address this issue, the Commission is proposing in Regulation 23.105(o) to permit an SD or MSP organized and domiciled outside of the U.S. to petition the Commission to use local accounting standards in lieu of U.S. GAAP or IFRS in monthly unaudited and annual audited financial reports filed with the Commission.

The process for seeking Commission approval to use local accounting standards is set forth in proposed Regulation 23.106 and is discussed in more detail in section II.D below. The Commission would review each request on a case-by-case basis and determine what, if any, additional information would be necessary in order to accept financial reports prepared in accordance with local accounting standards, including possible reconciliations of the financial information to U.S. GAAP. The Commission notes further that notwithstanding the proposed substituted compliance provisions, financial statements from all SDs and MSPs must be prepared in the English language and denominated in U.S. dollars, as proposed in Regulation 23.105(d)(2) and 23.105(e)(3).

The Commission is also proposing in Regulation 23.105(d)(3), (4) and (e)(5) to permit an SD or MSP that is registered with the Commission as an FCM or registered with the SEC as a BD to satisfy the Commission's SD or MSP financial statement reporting requirements by submitting a CFTC Form 1-FR-FCM or its applicable SEC Financial and Operational Combined Uniform Single ("FOCUS") Report in lieu of the specific financial statements required under proposed Regulation

23.105.<sup>116</sup> The financial information that would be required under proposed Regulation 23.105(d) for SDs and MSPs is consistent with the Commission's current requirements for Form 1-FR-FCM and the SEC's requirements for FOCUS Reports for BDs. The proposal also is consistent with the Commission's long history of permitting SEC registrants to meet their financial statement filing obligations with the Commission by submitting a FOCUS Report in lieu of CFTC Form 1-FR-FCM and reduces the burden on dually-registered firms by not requiring two separate financial reporting requirements.<sup>117</sup>

In addition to the specific financial reporting requirements discussed above, the Commission is also proposing in Regulation 23.105(h) to require any SD or MSP to file additional financial or operational information as the Commission may deem necessary in order to adequately assess the SD's or MSP's financial condition or operational status. This additional financial and operational information may be necessary at times when an SD or MSP is experiencing a financial or operational crisis, and the additional information is necessary for the Commission to assess whether the SD or MSP will be able to continue to meet its obligations to counterparties and other creditors. The authorization to request additional information from a registrant also is consistent with existing Regulation 1.10 which provides the Commission with the authority to request financial information from FCMs and IBs, and it is consistent with existing authority that the SEC has with respect to BDs and with the proposed authority that the SEC would have over SBSDs and MSBSPs.<sup>118</sup>

<sup>116</sup> FCMs are required to file monthly unaudited and annual audited Forms 1-FR-FCM with the Commission and with their designated self-regulatory organization. The Forms 1-FR-FCM include, among other information, a statement of financial condition, a statement of income or loss, a statement of changes in ownership equity, a statement of liabilities subordinated to the claims of general creditors, a statement of the computation of regulatory minimum capital, and any further information as may be necessary to make the required statements not misleading. See Regulation 1.10(d).

SEC FOCUS Reports are required to contain, among other statements and information, a statement of financial condition, a statement of income or loss, a statement of changes in ownership equity, a statement of liabilities subordinated to the claims of general creditors, and a statement of the computation of regulatory minimum capital. See SEC Rule 17a-5 (17 CFR 240.17a-5).

<sup>117</sup> See Regulation 1.10(h), which permits an FCM that is also registered as a BD to file its SEC FOCUS Report in lieu of the Commission's Form 1-FR-FCM.

<sup>118</sup> See CFTC Regulation 1.10(b)(4).

The Commission also is proposing limited financial reporting for SDs and MSPs that are subject to the capital requirements of a prudential regulator as such regulators have existing financial reporting requirements in place for these SDs and MSPs. The financial reporting requirements for such SDs and MSPs are described in section II.C.6 below.

The Commission, however, is proposing that SDs and MSPs that are subject to capital rules of a prudential regulator file financial reports and specific position and margin information with the Commission and with the RFA of which the SDs and MSPs are members within 17 business days of the end of each calendar quarter and not on a monthly basis. The financial reports and specific position information that would be required is set forth in Appendix B to proposed Regulation 23.105.

SDs and MSPs that are dually registered as FCMs will continue to be subject to the capital requirements in Regulation 1.17, and along with proposed conforming amendments in Regulation 1.17 applicable to dually registered SDs and MSPs discussed above, will be permitted to comply with the applicable financial recordkeeping, notification and reporting under Regulation 23.105 by following applicable FCM requirements in Regulations 1.10, 1.12, and 1.16.<sup>119</sup> Similarly, SDs and MSPs dually registered with the SEC as either SBSDs or MSBSPs will be permitted to comply with the Commission's financial reporting and notification requirements under Regulation 23.105 by filing simultaneously with the Commission all applicable notices or reports required under the SEC's rules.<sup>120</sup>

The Commission is further proposing to require that SDs and MSPs provide public disclosure on their Web site of some of the proposed required financial reporting, including a statement of financial condition and of the amount of minimum regulatory capital required and the amount of regulatory capital of the SD or MSP no less than quarterly, with the same information provided from an audited financial statement no

<sup>119</sup> See Regulation 23.105(d)(4) and (e)(6), wherein SDs and MSPs dually registered as FCMs will be permitted to comply with the monthly and annual financial reporting requirements by filing form 1-FR-FCM in lieu of the financial reports required under proposed Regulation 23.105.

<sup>120</sup> See Regulation 23.105(c)(5) referencing proposed 17 CFR 240-18a-8 for notification requirements for SBSDs and MSBSPs. See § 23.105(d)(3) and § 23.105(e)(5) referencing proposed 17 CFR 240-18a-7, for monthly and annual financial reporting requirements for SBSDs and MSBSPs.

less than annually. The proposal for public disclosure is consistent with financial reporting information the Commission has previously determined should not qualify as exempt from the Freedom of Information Act for FCMs. The proposal to require quarterly reporting is intended to make the frequency of such public disclosure consistent with publicly available information provided by bank entities in call reports.

## 2. Swap Dealer and Major Swap Participant Notice Requirements

The Commission is proposing to require SDs and MSPs to file certain regulatory notices with the Commission and with the RFA of which the SDs or MSPs are members if certain defined triggering events occur. Proposed Regulation 23.105(c) would require an SD or MSP that is not subject to the capital rules of a prudential regulator to provide the Commission and RFA with immediate written notice when the firm is: (1) Undercapitalized; (2) fails to maintain capital at a level that is in excess of 120 percent of its minimum capital requirement; or (3) fails to maintain current books and records.

Proposed Regulation 23.105(c) would further require an SD or MSP, as applicable, to provide notice to the Commission and to the RFA within 24 hours of: (1) Failing to comply with the liquidity requirements under proposed Regulation 23.104, (2) experiencing a 30 percent reduction in capital as compared to the last reported capital in a financial report filed with the Commission, or (3) failing to post or collect initial margin for uncleared swap transactions or exchange uncleared swap variation margin as required under the Commission's uncleared swaps margin rules and the initial margin that would be required for uncleared security-based swaps as required under 17 CFR 240.18a-3(c)(1)(i)(B), if the total amount that has not been either collected by and exchanged with or posted by and exchanged with the SD is equal to or greater than: (1) 25 percent of the SD's required capital under the Commission's proposal calculated for a single counterparty or group of counterparties that are under common ownership or control; or (2) 50 percent of the SD's required capital under the Commission's proposal calculated for all of the SD's counterparties.<sup>121</sup>

Proposed Regulation 23.105(c) also would require an SD to provide the Commission and the RFA with two business day's advance notice of a withdrawal that would exceed 30

<sup>121</sup> See CFTC Regulations 23.152 and 23.153.

percent of the SD's excess regulatory capital.<sup>122</sup> Finally, the proposal would also require an SD or MSP that is dually-registered with the SEC as an SBSB or MSBSP to file with the Commission and with its RFA a copy of any notice that the SBSB or MSBSP is required to file with the SEC under SEC Rule 18a-8 (17 CFR 240.18a-8). SEC proposed Rule 18a-8 requires SBSBs and MSBSPs to provide written notice to the SEC for comparable reporting events as proposed by the Commission in Regulation 23.105(c), including if a SBSB or MSBSP is undercapitalized or fails to maintain current books and records. The Commission is proposing to require SDs and MSPs that are dually-registered with the SEC to file copies with the Commission of notices filed with the SEC under Rule 18-8 to allow the Commission to be aware of any events that may indicate that the SD or MSP is unable to meet its operational or financial obligations on an ongoing basis.

The proposed notice provisions are intended to provide the Commission and the appropriate RFA with timely notice of potentially adverse financial or operational issues that may warrant immediate attention and ongoing surveillance. The proposed notice requirements are comparable to the notice requirements concerning capital currently required for FCMs under Regulation 1.12 of the Commission's regulations and with the SEC's notice requirements for BDs.<sup>123</sup>

### 3. Electronic Filing Requirements for Financial Reports and Regulatory Notices

Proposed Regulation 23.105(m) would require all notifications and financial statement filings submitted to the Commission pursuant to Regulation 23.105 to be filed in an electronic manner using a user authentication process approved by the Commission. The Commission notes that the many SDs and MSPs are already familiar with the Commission approved WinJammer filing system maintained jointly by NFA and Chicago Mercantile Exchange. WinJammer currently allows Commission registrants that are authorized to use the electronic system to file financial reports and notices with the Commission and NFA simultaneously. The Commission views this system, as well as other future Commission approved systems, as the most effective way to ensure that the

filings required under proposed Regulation 23.105 would be submitted promptly and directly to the Commission.

### 4. Swap Dealer and Major Swap Participant Reporting of Position Information

Proposed Regulation 23.105(l) would require each SD or MSP that was not subject to the capital rules of a prudential regulator to file monthly swap and security-based swap position information with the Commission and with the RFA of which the SD or MSP is a member. The information required to be submitted would be included in proposed Appendix A to Regulation 23.105, and is based upon the information that the SEC is proposing be filed with the SEC by SBSBs.<sup>124</sup> Accordingly, SDs or MSPs that are dually-registered as SBSBs would be subject to file the same position information with both regulators.

The position information that would be required by proposed Regulation 23.105(l) would include an SD's or MSP's: Current net exposure by the top 15 counterparties, and all other counterparties combined; total exposure by the top 15 counterparties, and all others combined; the internal credit rating, gross replacement value, net replacement value, current net exposure, total exposure, and margin collected for the top 36 counterparties. The SD or MSP would also have to provide current exposure and net exposure by country for the top 10 countries. The Commission would use this information as part of its financial surveillance program to monitor the financial condition and positions of SDs and MSPs.

### 5. Reporting Requirements for Swap Dealers Approved To Use Internal Capital Models

The Commission is proposing reporting requirements for SDs that have received approval from the Commission or from an RFA under proposed Regulation 23.102(d) to use internal models to compute market risk capital charges or credit risk capital charges. The Commission's proposed requirements for the collection of model information are largely based on existing requirements for ANC Firms under Regulation 1.17 and the rules of the SEC, and on SEC proposed Rules for SBSBs and BDs.

Regulation 23.105(k) would require an SD to file, on a monthly basis, a listing of each product category for which the SD does not use an internal model to

compute market, and the amount of the market risk deduction; a graph reflecting, for each business line, the daily intra-month VaR; the aggregate VaR for the SD; for each product for which the SD uses scenario analysis, the product category and the deduction for market risk; and, credit risk information on swap, mixed swap, and security-based swap exposures, including: (A) Overall current exposure, (B) current exposure listed by counterparty; (C) the 10 largest commitments listed by counterparty, (D) the SD's maximum potential exposure listed by counterparty for the 15 largest exposures; (E) the SD's 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 the SD's current exposure for each of the top 10 countries to which the SD is exposed.

Regulation 23.105(k) would also require an SD to report the results of the liquidity stress tests required by proposed Regulation 23.104. Regulation 23.104 also would require each SD approved to use internal capital models to submit a report identifying the number of business days for which the actual daily net trading loss exceeded the corresponding daily VaR and the results of backtesting of all internal models used to compute allowable capital, including VaR, and credit risk models, indicating the number of backtesting exceptions. All of the information required to be submitted to the Commission or RFA under proposed Regulation 23.105(k) would be required to be filed within 17 days of the close of each month, with the exception of the report identifying the number of business days for which the actual daily net trading loss exceeded the corresponding daily VaR, which would be required on a quarterly basis.

### 6. Financial Reporting Requirements for Swap Dealers and Major Swap Participants Subject to the Capital Rules of a Prudential Regulator

The Commission is proposing not to require an SD or MSP that is subject to the capital rules of a prudential regulator to file monthly unaudited or annual audited financial statements with the Commission or with the RFA of which the SD or MSP is a member. The Commission also is proposing to not to require such SDs or MSPs to file notifications contained in Regulation 23.105(c) with the Commission or with an RFA.

The Commission is, however, proposing to require SDs and MSPs that are subject to capital rules of a

<sup>122</sup> The term "regulatory capital" is defined in proposed Regulation 23.100 and means the relevant capital approach applicable to the SD under proposed Regulation 23.101.

<sup>123</sup> See SEC Rule 17a-11 (17 CFR 240.17a-11).

<sup>124</sup> See SEC proposed Form SBS part 4.

prudential regulator to file quarterly unaudited financial reports and certain regulatory notices with the Commission and with an RFA. Proposed Regulation 23.105(p) would require SDs and MSPs that are subject to the capital requirements of a prudential regulator to file quarterly unaudited financial reports with the Commission that are largely based on existing “call reports” that the SDs and MSPs are required to file with their respective prudential regulator.<sup>125</sup> The proposed financial reporting requirement is consistent with the SEC proposed filing requirement for SBSBs that are subject to the capital rule of a prudential regulator.<sup>126</sup> Specifically, the Commission is proposing that the SDs and MSPs submit to the Commission Appendix B of proposed Regulation 23.105, which is largely based on the SEC’s proposed Form SBS part 2 and part 5.

The financial information required by Regulation 23.105(p) would include the SD’s or MSP’s balance sheet and details of the SD’s or MSP’s capital composition and capital ratios. The financial information would further focus on the SD’s or MSP’s swap and security-based swap activities, including requiring aggregate security-based swaps, mixed swaps, swaps, and other derivatives information. The information would include both cleared and uncleared positions and would further differentiate between long and short positions. The Commission is requiring this information in order to provide the Commission and the SD’s or MSP’s RFA with swap and security-based swap trading data, which may be monitored as part of their respective financial and market surveillance monitoring programs.

Proposed Regulation 23.105(p) would also require SDs and MSPs that are subject to the capital rules of a prudential regulator to file regulatory notices with the Commission and with an RFA. Proposed Regulation 23.105(p)(3)(i) would require an SD or MSP to file a notice with the Commission and with an RFA if the SD or MSP filed a notice of change of its reported capital category with the Federal Reserve Board, the OCC, or the FDIC. Prudential regulators have established five capital categories that are used to describe a bank’s capital strength: (1) Well capitalized; (2) adequately capitalized; (3) undercapitalized; (4) significantly

undercapitalized; and (5) critically undercapitalized.<sup>127</sup> The definition of each capital category is based on capital measures under the bank capital standard and other factors.<sup>128</sup>

A bank is required to notify its appropriate prudential regulator of adjustments to the bank’s capital category that may have occurred that would put the bank into a lower capital category from the category previously assigned to it. Following the notice, the prudential regulator determines whether the bank needs to adjust its capital category.<sup>129</sup> Because these notices may indicate that a bank is in or approaching financial difficulty, the Commission is proposing to include a notification requirement in proposed regulation 23.105(p)(3)(i) that would require a bank SD or a bank MSP to give notice to the Commission when it files an adjustment of reported capital category with its prudential regulator by transmitting a copy of the notice to the Commission.

The rules of the Federal Reserve Board, OCC and FDIC also establish minimum capital requirements in the form of capital ratios that banks and bank holding companies are required to meet in order to comply with the respective Agencies capital requirements.<sup>130</sup> The Commission is proposing to require a bank SD or bank MSP to file notice with the Commission if the SD’s or MSP’s regulatory capital is less than the applicable minimum capital requirements set forth in the prudential regulators’ rules.

The Commission also is proposing in Regulation 23.105(p)(3) to require an SD that is a foreign bank to notify the Commission if the SD’s files a notice of a change in its capital category or a notice of falling below its minimum capital requirement with a prudential regulator or with its home country supervisors. This notice requirement is intended to provide the Commission with information that a registered SD may be experiencing financial issues, and provides the Commission with the opportunity to consult with the appropriate prudential regulator.

The Commission also is proposing to require a bank SD or a bank MSP to file a notice in the event the SD or MSP fails to post or collect initial margin for uncleared swap transactions or post or collect uncleared swap variation margin as required under the respective prudential regulators’ rules, if the total

amount that has not been either collected or posted by and exchanged with the SD or MSP is equal to or greater than: (1) 25 percent of the SD’s or MSP’s minimum capital requirement; or (2) 50 percent of the SD’s or MSP’s minimum capital requirement.

Consistent with section 4s(e) of the CEA, bank SDs and bank MSPs are subject to the capital rules of the prudential regulators. The proposed bank SD and MSP notice requirements contained in Regulation 23.105(p) are intended to provide the Commission with sufficient information to effectively monitor these entities as market participants in the swap markets subject to Commission oversight. For example, bank SDs and bank MSPs may be swap counterparties to non-bank SDs and non-bank MSPs subject to the Commission’s capital and margin rules. The proposed notice provisions will assist Commission staff with monitoring these bank SDs and bank MSPs for compliance with other statutory and regulatory requirements, such as the existing business conduct rules applicable on all SDs, and the potential impacts these bank SDs and bank MSPs may have on other Commission registrants and on the market as a whole. The Commission anticipates that its staff, as appropriate, would engage with staff of the relevant prudential regulator in assessing the potential market impacts upon receiving a regulatory notice.

Proposed paragraph (p) of Regulation 23.105 would also include identical oath and affirmation provisions and electronic filing requirements for SDs and MSPs that are subject to the capital rules of a prudential regulator as the Commission is proposing under paragraphs (f) and (n) of Regulation 23.105 for SDs and MSPs that are subject to the Commission’s capital rules.

## 7. Weekly Position and Margin Reporting

The Commission is proposing weekly reporting of position and margin information for the purposes of conducting risk surveillance of SDs and MSPs. This requirement would apply to SDs and MSPs subject to the capital and margin rules of either the Commission or a prudential regulator. Similar reporting is currently provided on a daily basis by DCOs for cleared swaps.<sup>131</sup>

Proposed Regulation 23.105(q)(1) would require SDs and MSPs to report position information, in a format specified by the Commission, (i) by

<sup>125</sup> See proposed § 23.105(p) and Appendix B. See also Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices (“call reports”); 12 U.S.C. 324; 12 U.S.C. 1817; 12 U.S.C. 161; and 12 U.S.C. 1464.

<sup>126</sup> See proposed SEC Rule 17 CFR 240.18a–8.

<sup>127</sup> See 12 CFR 325.103; 12 CFR 6.4; 12 CFR 208.43.

<sup>128</sup> See *id.*

<sup>129</sup> See 12 CFR 6.3(c); 12 CFR 208.42(c); 12 CFR 325.102(c).

<sup>130</sup> See 12 CFR 3.10; 12 CFR 217.10; 12 CFR 324.10.

<sup>131</sup> 17 CFR 39.19(c)(1).

counterparty, and (ii) for each counterparty, by the following asset classes—commodity, credit, equity, and foreign exchange or interest rate. Under the uncleared margin rules, these are asset classes within which margin offsets may be taken.<sup>132</sup>

Proposed Regulation 23.105(q)(2) would require SDs and MSPs to report margin information, in a format specified by the Commission, showing (i) the total initial margin posted by the SD or MSP with each counterparty; (ii) the total initial margin collected by the SD or MSP from each counterparty; and (iii) the net variation margin paid or collected over the previous week with each counterparty.

The Commission currently uses the position and margin information filed by DCOs to identify and to take steps to mitigate the risks posed to the financial system by participants in cleared markets including DCOs, clearing members, and large traders. The Commission would incorporate the additional data file by SDs and MSPs into that program. The Commission would analyze positions and margin across cleared and uncleared markets in order to obtain a picture of the risks posed by large market participants to one another and to the financial system.

#### Request for Comment

The Commission requests comment on all aspects of the proposed financial reporting, recordkeeping and notification requirements. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. For SDs or MSPs organized and domiciled outside the U.S., is IFRS issued by the IASB an appropriate accounting standard that would allow the Commission and RFA to properly assess the financial condition of SDs and MSPs? If not, explain why not, and suggest what modifications the Commission should make to the proposed regulation.

2. Should the Commission accept financial statements prepared in accordance with local accounting standards from SDs or MSPs located in foreign jurisdictions and are not required to prepare financial statements in accordance with U.S. GAAP or IFRS? If not, explain why not. Should such firms be required to submit a reconciliation of the local accounting to U.S. GAAP? Would such a reconciliation provide the necessary information for the Commission and RFA to fully understand the financial

position of the SD or MSP? What costs would be incurred by the SD or MSP in preparing the reconciliation?

3. Should SDs or MSPs that file non-U.S. GAAP financial statements also file a reconciliation of the non-U.S. GAAP financial statements to U.S. GAAP?

Would such a reconciliation provide the Commission with necessary information to understand the non-U.S. GAAP financial statements? What costs would be incurred by the SD or MSP in preparing the reconciliation?

4. Are there competitive advantages to SDs and MSPs that would be permitted to prepare financial statements in accordance with IFRS or another non-U.S. GAAP reporting standard? If so, is it necessary for the Commission to address such advantages? How should the Commission address those advantages?

5. The Commission is proposing to require SDs and MSPs that are subject to the capital rules of a prudential regulator to file notices with the Commission and with the SDs' or MSPs' RFA. Such notices include if the SD's or MSP's regulatory capital is less than the applicable minimum requirements set forth in the prudential regulators' rules or an adjustment in the SD's or MSP's reported capital category. The proposal would also require SDs that are foreign banks to file notice with the Commission and with their RFA if they experience an adjustment in their regulatory capital category under the rules of a prudential regulator or a similar provision of the regulations of its home country supervisors, and to file notice with the Commission and with their RFA if their regulator capital is below the minimum required by the prudential regulators or their home country supervisors. Should the Commission require SDs that are subject to the capital rules of a prudential regulator to file notices with the Commission regarding changes to their capital status? If not, explain why not? Are SDs that are banks subject to an legal restrictions on disclosing such capital information to the Commission? If so, cite such legal restrictions. Should the Commission differentiate between SDs that are U.S. banks from SDs that are non-U.S. banks? If so, explain how and why the Commission should differentiate between such SDs. Are there other notices that the Commission should consider receiving from SDs or MSPs that are subject to the capital and margin rules of a prudential regulator? Do these rules adequately address SDs and MSPs that are foreign domiciled entities subject to prudential regulation by foreign banking authorities? Are there alternative provisions that the

Commission should consider for both domestic and foreign SDs and MSPs that are subject to prudential regulation?

6. Are the reporting elements to Appendix A adequately defined to capture the relevant information? If not, what specific changes should the Commission consider?

7. Are the reporting elements to Appendix B adequately defined to capture the relevant information? If not, what specific changes should the Commission consider?

8. Should the Commission make public any other monthly unaudited or annual audited financial information filed by an SD or MSP under Regulation 23.105? If so, how would the public disclosure of such information be consistent with the FOIA and Sunshine Act exemptions?

9. What SD or MSP financial information should the Commission make publicly available?

10. Is it appropriate to have different disclosure rules for SDs and MSPs? If so, explain why disclosure rules should be different for SDs and MSPs?

11. Would disclosure of certain financial information provide SD and MSP counterparties with necessary information concerning some SDs or MSPs without adversely impacting that particular SD's or MSP's ability to maintain a trading book?

12. Should the Commission post SD and MSP financial data on the Commission's Web site?

#### *D. Comparability Determinations for Eligible Swap Dealers and Major Swap Participants*

The Commission is proposing to permit eligible SDs and MSPs to rely on substituted compliance to meet certain components of the Commission's capital and financial reporting requirements to the extent that the Commission determines that the relevant foreign jurisdiction's capital and financial reporting requirements are comparable to the Commission's corresponding capital and financial reporting requirements (*i.e.*, "Comparability Determination"). Proposed Regulation 23.106 outlines a framework for the Commission's Comparability Determinations, including establishing a standard of review for determining whether some or all of the relevant foreign jurisdiction's capital and financial reporting requirements are comparable to the Commission's corresponding capital and financial reporting requirements. This framework is generally consistent with the framework set forth in Regulation 23.160 for assessing substituted compliance for applying margin to

<sup>132</sup> 17 CFR 23.154(b)(2)(v).



uncleared cross border swap transactions.

Proposed Regulation 23.106 identifies persons eligible to request a Comparability Determination with respect to the Commission's capital and financial reporting requirements, including any SD or MSP that is eligible for substituted compliance under Regulation 23.101 and any foreign regulatory authority that has direct supervisory authority over one or more SDs or MSPs that are eligible for substituted compliance under Regulation 23.101 and that is responsible for administering the relevant foreign jurisdiction's capital adequacy and financial reporting requirements over the SD or MSP. The proposal would permit eligible persons to request a Comparability Determination individually or collectively with respect to the Commission's capital and financial reporting requirements. Eligible SDs and MSPs may wish to coordinate with their home regulators and other SDs or MSPs in order to simplify and streamline the process. The Commission would make Comparability Determinations on a jurisdiction-by-jurisdiction basis.

Persons requesting Comparability Determinations would need to provide the Commission with certain documents and information in support of their request. Notably, the proposal would require requesters to provide copies of the relevant foreign jurisdiction's capital and financial reporting requirements (including English translations of any foreign language documents), descriptions of their objectives and how they are comparable to or differ from the Commission's capital and financial reporting requirements (e.g., the net liquid assets approach and bank-based approach), international standards such as Basel bank capital requirements, if applicable, and how they address the elements of the Commission's capital requirements. The requesters would need to identify the regulatory provisions that correspond to the Commission's capital requirements (and, if necessary, whether the foreign jurisdiction's capital requirements do not address a particular element). Requesters would also need to provide a description of the ability of the relevant foreign regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's capital requirements and any other information and documentation the Commission deems appropriate.

The proposal identifies certain key factors that the Commission would consider in making a Comparability

Determination. Specifically, the Commission would consider the scope and objectives of the relevant foreign jurisdiction's capital requirements; how and whether the relevant foreign jurisdiction's capital adequacy requirements compare to international Basel capital standards for banking institutions or to other standards such as those used for securities brokers or dealers; whether the relevant foreign jurisdiction's capital requirements achieve comparable outcomes to the Commission's corresponding capital requirements; the ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's capital adequacy and financial reporting requirements; as well as any other facts or circumstances the Commission deems relevant. In making a comparability determination, it is possible that a foreign capital regime may be comparable in some, but not all, elements of the Commission's capital requirements.

Proposed Regulation 23.106 would provide that any SD or MSP that, in accordance with a Comparability Determination, complies with a foreign jurisdiction's capital requirements would be deemed in compliance with the Commission's corresponding capital adequacy and financial reporting requirements. Accordingly, the failure of such an SD or MSP to comply with the relevant foreign capital and financial reporting requirements may constitute a violation of the Commission's capital adequacy and financial reporting requirements. In addition, all SDs and MSPs remain subject to the Commission's examination and enforcement authority regardless of whether they rely on a Comparability Determination. The proposal would further provide that the Commission retains the authority to impose any terms and conditions it deems appropriate in issuing a Comparability Determination and to further condition, modify, suspend, terminate or otherwise restrict any Comparability Determination it has issued in its discretion. This could result, for example, from a situation where, after the Commission issues a comparability determination, the basis of that determination ceases to be true.

In this regard, Comparability Determinations issued by the Commission would require that the Commission be notified of any material changes to information submitted in support of a Comparability Determination, including, but not limited to, changes in the relevant foreign jurisdiction's supervisory or

regulatory regime. The Commission expects that the comparability determination process would require close consultation, cooperation, and coordination with other appropriate U.S. regulators and relevant foreign regulators. The Commission would also expect that the relevant foreign regulator will enter into, or will have entered into, an appropriate memorandum of understanding or similar arrangement with the Commission in connection with a Comparability Determination.

#### *E. Technical Amendments*

##### 1. Amendments to the Financial Reporting Requirements in Regulation 1.10 and 1.16

Regulation 1.10 currently requires each FCM to file within 17 business days of the close of each month an unaudited financial with the Commission and with the firm's designated self-regulatory organization.<sup>133</sup> Regulation 1.10 also requires each FCM to file within 60 days of the end of the firm's fiscal year end an audited annual financial report. An FCM's monthly financial reports must be submitted on CFTC Form 1-FR-FCM, while the annual financial report may be submitted on Form 1-FR-FCM or, subject to certain conditions, presented in a manner consistent with U.S. GAAP.<sup>134</sup>

Regulation 1.10 requires each IB to file an unaudited financial report with NFA on a semi-annual basis, and an audited annual financial report with the NFA. The IB unaudited reports must be submitted on Form 1-FR-IB and the audited annual report may be filed on Form 1-FR-IB or, subject to certain conditions, presented in a manner consistent with U.S. GAAP.

Regulation 1.10(h) currently provides relief from the Form 1-FR filing requirements to FCMs or IBs that are dually-registered as BDs. Such dual-registrants are permitted to file the SEC's Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II, Part IIA, or Part II CSE (FOCUS Report), in lieu of a Form 1-FR-FCM or Form 1-FR-IB.

The Commission is proposing to amend Regulation 1.10(h) to permit an

<sup>133</sup> The term "self-regulatory organization" ("SRO") is defined in Regulation 1.3(ee) as a contract market (as defined in Regulation 1.3(h)), a swap execution facility (as defined in Regulation 1.3(rrrr)), or a registered futures association under section 17 of the Act. The term "designated self-regulatory organization" is defined in Regulation 1.3(ff) and generally means the SRO that has primary financial surveillance responsibilities over a registrant.

<sup>134</sup> See Regulation 1.10(d)(3).

FCM or IB that is dually-registered as SBSB or MSBSP to file its SEC FOCUS Report in lieu of a CFTC Form 1-FR-FCM or CFTC Form 1-FR-IB. The proposed amendment would be consistent, as noted above, with the current relief provided to entities that are dually-registered as an FCM and a BD. Furthermore, the Commission's experience with Regulation 1.10(h) indicates that the FOCUS Reports include information that is substantially comparable to the Form 1-FR and adequate for the Commission to conduct financial surveillance of the registrant.

Regulations 1.10(f) and 1.16(f) currently provide that a dually-registered FCM/BD or IB/BD may automatically obtain an extension of time to file its unaudited and audited financial reports required under Regulation 1.10 by submitting a copy of the written approval for the extension issued by the BD's securities designated examining authority ("DEA"). The Commission is proposing to amend Regulations 1.10(f) and 1.16 to provide that an FCM or IB that is also registered with the SEC as a SBSB or MSBSP may obtain the automatic extension of time to file its unaudited or audited FOCUS Report or Form SBS with the Commission and with the firm's DSRO, as applicable, by submitting a copy of the SEC's or the DEA's approval of the extension request. This proposed amendment maintains the intent of the current regulations by retaining a consistent approach to the granting to dual registrants extensions of time to file financial reports. The Commission also is proposing a technical amendment to Regulation 1.16 to correct a cross reference to SEC Rule 17a-5 (17 CFR 240.17a-5) for extensions of time to file audited financial statements.

## 2. Amendments to the Notice Provisions in Regulation 1.12

Regulation 1.12 requires an FCM or IB to file a notice with the Commission and with the firm's DSRO when certain prescribed events occur that trigger a notice filing requirement. Such events include the firm: (1) Failing to maintain compliance with the Commission's capital requirements or the capital rules of a SRO; (2) failing to hold sufficient funds in segregated or secured amount accounts to meet its regulatory requirements; (3) failing to maintain current books and records; and (4) experiencing a significant reduction in capital from the previous month-end.

The Commission is proposing several amendments to Regulation 1.12. The proposed amendments to Regulation 1.12(a) would revise the obligation of an FCM or IB to file a notice when it fails

to meet the capital requirement of the Commission or of an SRO to include if the firm fails to meet the SEC's capital requirements when the firm is a dual-registrant. Such notice is appropriate as it would provide Commission staff with the opportunity to assess the potential impact on its CFTC regulated activities, and to initiate discussions with the SEC regarding the capital deficiency.

Commission Regulation 1.12(b) requires an FCM or IB to file notice with the Commission and with the firm's DSRO if the firm's adjusted net capital falls below the applicable "early warning level" set forth in the regulation.<sup>135</sup> The Commission is proposing amendments to Regulation 1.12(b) to require an FCM or IB that is also registered with the SEC as a SBSB or a MSBSP to file a notice if the SBSB or MSBSP falls below the "early warning level" established in the rules of the SEC. The proposal is intended to provide additional information to the Commission in its efforts to monitor the financial condition of its registrants.

## 3. Commissions Receivable for Certain Swap Transactions in Regulation 1.17

The Commission is proposing to amend Regulation 1.17(c)(2)(ii)(B) to codify several staff no-action letters that permit IBs to reflect certain commissions receivable balances from swap transactions that are aged not more than 60 days from the month-end accrual date as a current asset in computing the IB's adjusted net capital, provided that the commissions are promptly billed. The proposed amendments would extend the current asset treatment to commission receivables from both cleared swaps and uncleared swaps.

## 4. Changes to Notice and Disclosure Requirements for Bulk Transfers in Regulation 1.65

Regulation 1.65 describes the notice and disclosure requirements to customers and to the Commission, which must be given prior to the transfer of customer accounts other than at the request of the customer, to another futures commission merchant or introducing broker. Regulation 1.65(b) requires that notice of such a transfer be filed with the Commission at least five business days in advance of the transfer if the transfer meets certain enumerated conditions. Further, Regulation 1.65(d) requires, among other things, that such notice to the Commission must be filed

<sup>135</sup> If an FCM's or IB's adjusted net capital falls below a certain threshold, such as 120 percent of its minimum adjusted net capital requirement, the firm is deemed to be maintaining adjusted net capital at a level below its "early warning level."

by mail, addressed to the Deputy Director, Compliance and Registration Section, Division of Swap Dealer and Intermediary Oversight and does not provide for electronic filing. Finally, Regulation 1.65(e) provides that in the event notice cannot be filed with the Commission within five days, then it must be filed as soon as practicable and no later than the day of the transfer along with a brief statement explaining the circumstances necessitating the delay in filing.

The Commission has found that five days' notice, when given, is often not a sufficient amount of time to allow the Commission to oversee the bulk transfer of customer accounts. Accordingly, the Commission is proposing to amend Regulation 1.65(b) to require that the notice of a bulk transfer of customer accounts be filed with the Commission at least ten business days in advance of a transfer. The Commission notes that bulk transfers of customer accounts are generally planned well in advance such that the FCM should be able to provide the Commission ten days advance notice of such a transfer. The Commission is also proposing to amend Regulation 1.65(d) to require the notice to be filed electronically. This is consistent with the filing requirements of other notices and financial forms with the Commission, which are already required to be filed electronically. The Commission notes that the electronic system to file such notices already exists and is in use by registrants, therefore, this change should not result in any additional costs either to the Commission or to registrants.

Finally, the Commission is proposing to amend Regulation 1.65(e) to delegate to the Director of the Division of Swap Dealer and Intermediary Oversight the authority to accept a lesser time period for the notification provided for in Regulation 1.65(b). However, the notice must be filed as soon as practicable and in no event later than the day of the transfer.

## 5. Conforming Amendments to Delegated Authority Provisions in Regulation 140.91

Commission Regulations 1.10, 1.12, and 1.17 reserve certain functions to the Commission, the greater part of which the Commission has delegated to the Director of the Division of Swap Dealer and Intermediary Oversight through the provisions of Regulation 140.91. The Commission proposes to amend Regulation 140.91 to provide similar delegations with respect to functions reserved to the Commission in part 23.

Proposed Regulation 23.101(c) would require an SD or MSP to be in

compliance with the minimum regulatory capital requirements at all times and to be able to demonstrate such compliance to the Commission at any time. Proposed Regulation 23.103(d) would require an SD or MSP, upon the request of the Commission, to provide the Commission with additional information regarding its internal models used to compute its market risk exposure requirement and OTC derivatives credit risk requirement. Proposed Regulation 23.105(a)(2) would require an SD or MSP to provide the Commission with immediate notification if the SD or MSP failed to maintain compliance with the minimum regulatory capital requirements, and further authorizes the Commission to request financial condition reporting and other financial information from the SD or MSP. Proposed Regulation 23.105(d) authorizes the Commission to direct an SD or MSP that is subject to capital rules established by a prudential regulator, or has been designated a systemically important financial institution by the Financial Stability Oversight Council and is subject to capital requirements imposed by the Board of Governors of the Federal Reserve System to file with the Commission copies of its capital computations for any periods of time specified by the Commission.

The Commission is proposing to amend Regulation 140.91 to delegate to the Director of the Division of Swap Dealer and Intermediary Oversight, or the Director's designee, the authority reserved to the Commission under proposed Regulations 23.101(c), 23.103(d), and 23.105(a)(2) and (d). The delegation of such functions to staff of the Division of Swap Dealer and Intermediary Oversight is necessary for the effective oversight of SDs and MSPs compliance with minimum financial and related reporting requirements. The delegation of authority also is comparable to the authorities currently delegated to staff under Regulation 140.91 regarding the supervision of FCMs compliance with minimum financial requirements.

### III. Related Matters

#### A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA") requires that agencies consider whether the regulations they propose will have a significant economic impact on a substantial number of small entities.<sup>136</sup> This proposed rulemaking would affect the obligations of SDs, MSPs, FCMs, and IBs. The Commission

has previously determined that SDs, MSPs, and FCMs are not small entities for purposes of the RFA.<sup>137</sup> Therefore, the requirements of the RFA do not apply to those entities. The Commission has found it appropriate to consider whether IBs should be deemed small entities for purposes of the RFA on a case-by-case basis, in the context of the particular Commission regulation at issue.<sup>138</sup> As certain IBs may be small entities for purposes of the RFA, the Commission considered whether this proposed rulemaking would have a significant economic impact on such registrants. Only a few of the regulations included in this proposed rulemaking, the amendment of Commission regulations 1.10, 1.12, 1.16 and 1.17, will impact the obligations of IBs. As discussed above, these amendments will permit the filing and harmonization of financial reporting and notification rules as adopted by the SEC for dual registered SBS and MSBSPs and accommodate common billing practices in the swap industry surrounding the collection of commission receivables. Because these amendments benefits IBs, they are not expected to impose any new burdens or costs on them. The Commission does not, therefore, expect small entities to incur any additional costs as a result of this proposed rulemaking.

Accordingly, for the reasons stated above, the Commission believes that this proposed rulemaking will not have a significant economic impact on a substantial number of small entities. Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the proposed regulations being published today by this **Federal Register** release will not have a significant economic impact on a substantial number of small entities. The Commission invites comment on the impact of this proposal on small entities.

#### B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 ("PRA")<sup>139</sup> imposes certain requirements on Federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of

information as defined by the PRA. This proposed rulemaking, would result in an amendment "Regulations and Forms Pertaining to Financial Integrity of the Market Place; Margin Requirements for SDs/MSPs"<sup>140</sup> as discussed below. The Commission, therefore, is submitting this proposed rulemaking to the Office of Management and Budget ("OMB") for its review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR Regulation 1320.11.

The responses to this collection of information are mandatory. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number issued by OMB.

#### 1. New Information Collection Requirements and Related Burden Estimates<sup>141</sup>

Currently, there are approximately 104 SDs and no MSPs provisionally registered with the Commission that may be impacted by this proposed rulemaking and, in particular, the collections of information contained herein and discussed below.<sup>142</sup>

##### i. Form SBS

The proposed amendments to Commission regulation 1.10(h) would allow an FCM or IB that is also a securities broker or dealer to file, subject to certain conditions, its Form SBS in lieu of its Form 1-FR. Because these amendments would provide an alternative to filing Form 1-FR, the Commission believes that the amendments would not cause FCMs or IBs to incur any additional burden. Rather, to the extent that the proposed rule provides an alternative to filing a Form 1-FR and is elected by FCMs or

<sup>140</sup> See OMB Control No. 3038-0024, <http://www.reginfo.gov/public/do/PRAOMBHistory?ombControlNumber=3038-0024> (last visited Apr. 7, 2016). This collection is being retitled "Regulations and Forms Pertaining to Financial Integrity of the Market Place."

<sup>141</sup> This discussion does not include information collection requirements that are included under other Commission regulations and related OMB control numbers. For example, Proposed Commission Regulation 1.17(c)(5)(iii)(E)(4) would require that appropriate documentation of qualifying master netting agreements be maintained by dual-registered FCM-SDs for purposes of certain margin deductions from net capital. As noted in the Margin rulemaking, this collection is already covered under OMB Control Number 3038-0088 pertaining to swap trading relationship documentation. See 81 FR 636, 680 (Jan. 6, 2016).

<sup>142</sup> The number of impacted SDs and MSPs is significantly smaller than the 300 expected in the Commission's previous proposed rulemaking, and the Commission has reduced its burden estimates accordingly herein. See, *Capital Requirements of Swap Dealers and Major Swap Participants*, 76 FR 27802 (May 12, 2011).

<sup>137</sup> See Policy Statement and Establishment of Definitions of "Small Entities" for Purposes of the Regulatory Flexibility Act, 47 FR 18618 (Apr. 30, 1982) (FCMs) and Registration of Swap Dealers and Major Swap Participants, 77 FR 2613, 2620 (Jan. 19, 2012) (SDs and MSPs).

<sup>138</sup> See Introducing Brokers and Associated Persons of Introducing Brokers, Commodity Trading Advisors and Commodity Pool Operators; Registration and Other Regulatory Requirements, 48 FR 35248, 35276 (Aug. 3, 1983).

<sup>139</sup> 44 U.S.C. 3501 *et seq.*

<sup>136</sup> 5 U.S.C. 601 *et seq.*

IBs, it is reasonable for the Commission to infer that the alternative is less burdensome to such FCMs and IBs.

The proposed amendments to Commission regulation 1.10(f) would allow an FCM or IB that is dually-registered with the SEC as either a SBSB or MSBSP to request an extension of time to file its uncertified Form SBS. The Commission is unable to estimate with precision how many requests it would receive from registrants under proposed § 1.10(f) in relation to Form SBS annually. The Commission anticipates that it would receive one such request in the aggregate annually, and that preparing such a request would consume five burden hours, resulting in an annual increase in burden of five hours in the aggregate.

#### ii. Notice of Failure To Maintain Minimum Financial Requirements

Commission regulations 1.12(a) and (b) currently require FCMs and IBs, to file notices if they know or should have known that certain specified minimum financial thresholds have been exceeded. The amendments to Commission regulation 1.12(a) and (b) would add as an additional threshold for such notices certain financial requirements of the SEC if the applicant or registrant is registered with the SEC as an SBSB or MSBSP. The Commission is unable to estimate with precision how many additional notices it would receive from such entities as a result of the additional minimum threshold. In an attempt to provide conservative estimates, the Commission anticipates that it would receive 10 such notices in the aggregate annually, and that preparing such a notice would consume five burden hours, resulting in an annual increase in burden of 50 hours in the aggregate.

#### iii. Requests for Extensions of Time To File Financial Statements

The proposed amendments to Commission regulation 1.16(f) would allow an FCM or IB that is registered with the SEC as an SBSB or MSBSP to request an extension of time to file its audited annual financial statements.<sup>143</sup> The Commission is unable to estimate with precision how many of such requests it would receive from such entities. The Commission anticipates that it would receive one of such requests in the aggregate annually, and that preparing such a request would

consume five burden hours, resulting in an annual increase in burden of five hours in the aggregate.

#### iv. Capital Requirement Elections

Proposed Commission regulation 23.101(a)(7) would require that certain SDs that wish to change their capital election submit a written request to the Commission and provide any additional information and documentation requested by the Commission. The Commission is unable to estimate with precision how many of such requests it would receive from such entities. The Commission anticipates that it would receive one such request in the aggregate annually, and that preparing such a request would consume five burden hours, resulting in an annual increase in burden of five hours in the aggregate.

#### v. Application for Use of Models

Commission regulation 23.102(a) would allow an SD to apply to the Commission or an RFA of which it is a member for approval to use internal models when calculating its market risk exposure and credit risk exposure under §§ 23.101(a)(1)(i)(B), 23.101(a)(1)(ii)(A), or 23.101(a)(2)(ii)(A), by sending to the Commission and such RFA an application, including the information set forth in Appendix A to Commission regulation 23.102 and meeting certain other requirements. Proposed Commission regulation 1.17(c)(6)(v) relatedly would allow an FCM that is also an SD to apply in writing to the Commission or an RFA of which it is a member for approval to compute deductions for market risk and credit risk using internal models in lieu of the standardized deductions otherwise required under Commission regulation 1.17.<sup>144</sup>

Appendices A and B to Commission regulation 23.102 contain further related information collection requirements, including that the SD: (i) Provide notice to the Commission and RFA and/or update its application and related materials for certain inaccuracies and amendments; (ii) notify the Commission or RFA before it ceases to use such internal models to compute deductions; (iii) if a VaR model is used, have an annual review of such model conducted by a qualified third party service, (iv) conduct stress-testing, retain and make available to the Commission and the

RFA records of the results and all assumptions and parameters thereof, and notify the Commission and RFA promptly of instances where such tests indicate any material deficiencies in the comprehensive risk model; (v) demonstrate to the Commission or the RFA that certain additional conditions have been satisfied and retain and make available to the Commission or the RFA records related thereto; and (vi) comply with additional conditions that may be imposed on the SD by the Commission or the RFA.

As discussed above, there are currently 104 SDs and 0 MSPs provisionally registered with the Commission. Of these, the Commission estimates that approximately 53 SDs and no MSPs would be subject to the Commission's capital rules as they are not subject to the capital rules of a prudential regulator. The Commission further estimates conservatively that 32 of these SDs would seek to obtain Commission approval to use models for computing their market and credit risk capital charges.

The Commission staff estimates that an SD approved to use internal models would spend approximately 5,600 hours per year to review and update the models and approximately 640 hours per year to back-test the models for the aggregate of 6240 annual burden hours for each SD.<sup>145</sup> Consequently, Commission staff estimates that reviewing and back-testing the models for the 32 SDs would result in an aggregate annual hour burden of approximately 199,680 hours.<sup>146</sup>

#### vi. Liquidity Requirements

Commission regulation 23.104 proposes additional liquidity requirements and equity withdrawal restrictions on certain SDs. Commission regulation 23.104(a)(2) would provide that certain SDs may not dispose of, or transfer to an affiliate, a high quality liquid asset without prior notice to and approval by the Commission. Section 23.104(a)(3) would require certain SDs to have a written contingency funding plan that addresses the SD's policies and the roles and responsibilities of relevant personnel for meeting the liquidity needs of the SD and communicating with the public and other market participants during a liquidity stress event.

Commission regulations 23.104(a)(2) and 23.104(a)(3) apply only to SDs that have elected to be subject to the requirements of 23.101(a)(1)(i) as if the

<sup>143</sup> The registrant would also be required to promptly file with the DSRO designated self-regulatory organization and the Commission copies of any notice it receives from its designated examining authority to approve or deny the requested extension of time.

<sup>144</sup> Note that the changes to proposed 1.17(c)(6)(i), which permit any dual registered FCM Broker-Dealer who has received approval by the SEC under § 240.15c3-1(a)(7) to use models to calculate its market and credit risk charges, do not add an additional collection of information and therefore are not considered in this analysis.

<sup>145</sup> *Id.* at 70294.

<sup>146</sup> 343,200 is the product of 55 and the sum of 5,600 and 640.

SD were regulated by the Federal Reserve Board. Out of the 104 provisionally registered SDs, the Commission currently estimates that 16 SDs will elect to be subject to the requirements of 23.101(a)(1)(i). Accordingly, the Commission estimates these proposed regulations will add 50 burden hours per month, or 600 burden hours per year, for each of the 16 electing SDs, resulting in an aggregate annual burden of 9,600.

Commission regulation 23.104(b)(1) would require that certain SDs perform a monthly liquidity stress test, provide the results of that test to senior management, and perform a quarterly and annual reviews with appropriate levels of management. Commission regulation 23.104(b)(2) would require that an SD document any differences with those of the liquidity stress test of the consolidated parent and regulation 23.104(b)(4) would require that an SD have a written contingency funding plan. Regulation 23.104(b) applies only to SDs that have elected to be subject to the requirements of regulation 23.101(a)(1)(ii). The Commission estimates that 11 SDs out of the 104 provisionally registered will fall into this category and that all 11 will be part of a consolidated entity that performs a liquidity stress test. As such, the Commission estimates that the proposed regulations will add 50 burden hours per month, or 600 burden hours per year, resulting in an aggregate annual burden of 6,600 hours.

Commission regulation 23.104(c) would allow an SD to apply in writing for relief from restrictions on certain equity withdrawals. Regulation 23.104(c) applies to SDs that have elected to comply under regulation 23.101(a)(1)(i) and 23.101(a)(1)(ii). Commission staff estimates that 28 of the 104 currently provisionally registered SDs would be subject to this regulation. Commission staff estimates that each of these 28 SDs would file approximately two notices annually with the Commission and that it would take approximately 30 minutes to file each of these notices. This results in an aggregate annual hour burden estimate of approximately 28 hours.

#### vii. Financial Recordkeeping, Reporting and Notification Requirements for SDs and MSPs

Commission regulation 23.105 would require generally that each SD and MSP maintain certain specified records, report certain financial information and notify or request permission from the Commission under certain specified circumstances, in each case, as provided in the proposed regulation. For

example, the regulation requires generally that SDs and MSPs maintain current books and records, provide notice to the Commission of regulatory capital deficiencies and related documentation, provide notice of certain other events specified in the proposed rule, and file financial reports and related materials with the Commission (including the information in Appendix A and B to the proposed regulation, as applicable). Regulation 23.105 also requires the SD or MSP to furnish information about its custodians that hold margin for uncleared swap transactions and the amounts of margin so held, and for SDs approved to use models (as discussed above), provide additional information regarding such models, as further described in regulation 23.105(k).

The Commission estimates that there are 28 SD firms which will be required to fulfill their financial reporting, recordkeeping and notification obligations under Regulation 23.105(a)–23.105(n) because they are not subject to a prudential regulator, not already registered as an FCM, and not dually registered as a SBSB. The Commission expects these 28 firms will apply to use models. Commission staff estimates that the preparation of monthly and annual financial reports for these SDs, including the recordkeeping, related notification and preparation of the specific information required in proposed Appendix A to regulation 23.105, would impose an on-going burden of 250 hour per firm annually. The Commission further estimates it would cost each SD \$300,000 to retain an independent public accountant to audit its financial statements each year. Thus, the total burden hours estimated for compliance with 23.105(a)–23.105(n) for these 28 SD firms would be 7,000 hours annually.

Regulation 23.105(p) and its accompanying Appendix B propose a quarterly financial reporting and notification obligations on SDs which are subject to a prudential regulator. The Commission expects that approximately 51 of the 104 currently provisionally registered SDs are subject to a prudential regulator. The Commission estimates that this proposed reporting and notification requirements will impose a burden of 33 hours on-going annually. This results in a total aggregate burden of 1,683 hours annually.

Regulation 23.105(q) requires all SDs and MSPs to report to the Commission weekly summary position and margin data. The Commission expects that all 104 SDs and no MSPs will be subject to this requirement. The Commission

estimates that it would impose 520 burden hours per firm annually. This results in total aggregate burden of 54,080 hours annually.

#### viii. Capital Comparability Determinations

Commission regulation 23.106 would allow certain SDs, MSPs, and foreign regulatory authorities to request a Capital Comparability Determination with respect to capital adequacy and financial reporting requirements for SDs or MSPs, as discussed above. As part of this request, persons are required to submit to the Commission certain specified supporting information and further information, as requested by the Commission. Further, if such a determination was made by the Commission, an SD or MSP would be required to file a notice with the RFA of which it is a member of its intent to comply with the capital adequacy and financial reporting requirements of the foreign jurisdiction. Moreover, in issuing a Capital Comparability Determination, the Commission would be able to impose any terms and conditions it deems appropriate, including additional capital and financial reporting requirements.

The Commission expects that 17 firms out of the 104 currently provisionally registered SDs would seek Capital Comparability Determinations. These 17 firms are located in five different jurisdictions, all of which appear to have adopted some level of Basel compliant capital rule or another capital rule that would apply to SDs. As such, Commission staff estimates that it will take approximately ten hours per firm annually to prepare and submit requests for Capital Comparability Determinations and otherwise comply with the requirements of proposed Regulation 23.106, resulting in aggregate annual burden of 170 hours.

#### 2. Information Collection Comments

The Commission invites the public and other Federal agencies to comment on any aspect of the proposed information collection requirements discussed above. Pursuant to 44 U.S.C.3506(c)(2)(B), the Commission will consider public comments on such proposed requirements in:

- Evaluating whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;
- Evaluating the accuracy of the estimated burden of the proposed information collection requirements, including the degree to which the

methodology and the assumptions that the Commission employed were valid;

- Enhancing the quality, utility, and clarity of the information proposed to be collected; and

- Minimizing the burden of the proposed information collection requirements on respondents, including through the use of appropriate automated, electronic, mechanical, or other technological information collection techniques, *e.g.*, permitting electronic submission of responses.

Copies of the submission from the Commission to OMB are available from the CFTC Clearance Officer, 1155 21st Street NW., Washington, DC 20581, (202) 418-5160 or from <http://RegInfo.gov>. Organizations and individuals desiring to submit comments on the proposed information collection requirements should send those comments to the OMB Office of Information and Regulatory Affairs at:

- The Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503, *Attn:* Desk Officer of the Commodity Futures Trading Commission;

- (202) 395-6566 (fax); or
- [OIRASubmissions@omb.eop.gov](mailto:OIRASubmissions@omb.eop.gov) (email).

Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rule preamble. Please refer to the **ADDRESSES** section of this rulemaking and the margin rulemaking for instructions on submitting comments to the Commission. OMB is required to make a decision concerning the proposed information collection requirements between thirty (30) and sixty (60) days after publication of the NPRM in the **Federal Register**. Therefore, a comment to OMB is best assured of receiving full consideration if OMB (as well as the Commission) receives it within thirty (30) days of publication of this NPRM.

#### IV. Cost Benefit Considerations

##### A. Background

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its discretionary actions before promulgating a regulation under the CEA or issuing certain orders.<sup>147</sup> Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and

financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. In this cost benefit section, the Commission discusses the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors.<sup>148</sup> In addition, in Appendix A to this section, the Commission, using available data, estimates the cost of the proposal to each type of SD or MSP and the overall market.

This proposed rulemaking implements the new statutory framework of Section 4s(e) of the CEA, added by Section 731 of the Dodd-Frank Act, which requires the Commission to adopt capital requirements for SDs and MSPs that do not have a prudential regulator (*i.e.*, “covered swap entities” or “CSEs”) and amends Commission Regulation 1.17 to impose specific market risk and credit risk capital charges for uncleared swap and security-based swap positions held by an FCM.<sup>149</sup> Section 4s(e) of the CEA requires the Commission to adopt minimum capital requirements for CSEs that are designed to help ensure the CSE’s safety and soundness and be appropriate for the risk associated with the uncleared swaps held by a CSE. In addition, section 4s(e)(2)(C) of the CEA, requires the Commission to set capital requirements for CSEs that account for the risks associated with the CSE’s entire swaps portfolio and all other activities conducted by the CSE. Lastly, section 4s(e)(3)(D) of the CEA provides that the Commission, the prudential regulators, and the SEC, must “to the maximum extent practicable” establish and maintain comparable capital rules. The proposal also includes certain financial reporting requirements related to an SDs and MSPs financial condition and capital requirements.

In the following cost-benefit considerations, the Commission will discuss the costs and benefits of this proposal and some critical decisions it made in developing this proposal. The Commission will: (i) Discuss the general benefits and costs of regulatory capital; (ii) summarize the proposal; (iii) set the baseline for which the cost and benefits of this proposal will be compared; (iv) provide an overview of the different capital approaches set out in this proposal and the rationale for proposing each approach; (v) set out the costs and

benefits to each type of SD and MSP under their corresponding capital approaches; (vi) discuss the proposal’s liquidity and funding requirements; (vii) discuss the proposal’s reporting requirements; and (viii) analyze the proposal as it relates to each of the 15(a) factors.

##### B. Regulatory Capital

Regulatory capital is designed to ensure that a firm will have enough capital, in times of financial stress, to cover the risk inherent of the activities in the firm. Regulatory capital’s framework can be designed differently, but its primary purpose remains the same—to meet this objective. Although a firm may mitigate its risks through other methods, including risk management techniques (*e.g.*, netting, credit limits, margin), capital is viewed as the last line of defense of an entity, ensuring its viability in times of financial stress. In designing this proposal, the Commission was cognizant of the purpose of capital and the potential trade-off between the costs of requiring additional capital and the Commission’s statutory mandate of helping to ensure the safety and soundness of SDs and MSPs thereby promoting the stability of the U.S. financial system.

##### C. General Summary of Proposal

The Commission designed this proposal on well-established existing capital regimes. The proposal’s framework, which draws upon the principles and structures of bank-based capital, broker-dealer capital, and FCM capital, provides CSEs, operating under a current capital regime, with the ability to continue to comply with that regime, with minor adjustments to account for the inherent risk of swap dealing and to mitigate regulatory arbitrage. The Commission, in developing its capital framework, provides CSEs with the flexibility to continue operating under a similar capital framework, which should result in minor disruptions to the markets and mitigate the possibility of duplicative or even conflicting rules, while helping to ensure the safety and soundness of the CSE and the stability of the U.S. financial system.

The proposal details minimum capital requirements for different “types” or “categories” of CSEs and further defines the capital computations, including various market risk and credit risk charges, whether using models or a standardized rules-based or table-based approach, to determine whether a CSE satisfies the minimum capital requirements. The Commission is proposing to permit SDs that are neither

<sup>148</sup> The Commission notes that the costs and benefits considered in this proposal, and highlighted below, have informed the policy choices described throughout this release.

<sup>149</sup> See Section 4s(e)(2)(B).

<sup>147</sup> U.S.C. 19(a).

registered as FCMs nor subject to the capital rules of a prudential regulator to elect a capital requirement that is based on existing bank holding company (“BHC”) capital rules adopted by the Federal Reserve Board (the “bank-based capital approach”) or a capital requirement that is based on the existing FCM/BD net capital rules (the “net liquid assets capital approach”). The Commission is also proposing to permit certain SDs that meet defined conditions designed to ensure that they are “predominantly engaged in non-financial activities” to compute their minimum regulatory capital based upon the firms’ tangible net worth (the “tangible net worth capital approach”). Further, the Commission is proposing to allow SDs to obtain approval from the Commission, or from an RFA of which the SDs are members, to use internal models to compute certain market risk and credit risk capital charges when calculating their capital.<sup>150</sup>

The Commission is proposing to require SDs that elect to use the bank-based capital approach or the net liquid assets capital approach to perform prescribed liquidity stress testing and to maintain liquid assets above defined levels. The Commission is further proposing to impose certain restrictions on the withdrawal of capital from SDs if certain defined triggers are breached.

The proposal also establishes a program of “substituted compliance” that would allow a CSE that is organized and domiciled in a non-U.S. jurisdiction (“non-U.S. CSE”) (or an appropriate regulatory authority in the non-U.S. CSE’s home country jurisdiction) to petition the Commission for a determination that the home country jurisdiction’s capital and financial reporting requirements are comparable to the CFTC’s capital and financial reporting requirements for such CSE, such that the CSE may satisfy its home country jurisdiction’s capital and financial reporting requirements (subject to any conditions imposed by the Commission) in lieu of the Commission’s capital and financial reporting requirements (*i.e.*, “Comparability Determination”).

<sup>150</sup> Section 17 of the CEA sets forth the registration requirements for RFAs. RFAs are defined as self-regulatory organizations under Regulation 1.3(ee). The Commission recognizes that SDs that seek model approval from the Commission or from an RFA will be required to submit documentation addressing several capital models including value at risk, stressed value at risk, specific risk, comprehensive risk and incremental risk. To the extent that models are reviewed and approved by an RFA, additional costs may be incurred by the RFA which may be passed on to the SDs.

Consistent with section 4s(f), the Commission is proposing to require SDs and MSPs to satisfy current books and records requirements, “early warning” and other notification filing requirements, and periodic and annual financial report filing requirements with the Commission and with any RFA of which the SDs and MSPs are members.

#### D. Baseline

In determining the costs and benefits of this proposal, the Commission’s benchmark from which this proposal is compared against is the market’s status quo, *i.e.*, the swap market as it exists today. As the proposal will implement capital and financial reporting on CSEs and recordkeeping requirements on SDs and MSPs, the Commission will discuss the incremental costs and benefits to each type or category of SD and MSP, as to their current capital and financial reporting and recordkeeping requirements. As each CSE or its parent holding company may be complying with current capital requirements, based on capital requirements that are a result of the entity or its parent entity registering with a financial agency, as a result of it being a financial intermediary (*e.g.*, as an BD, FCM or BHC), the Commission has set different baselines for each type or category of entity. In the case that a CSE does not have current capital requirements, the Commission considered the full cost and benefit of its proposal on the entity. The following is a list of types or categories of registered entities and their corresponding capital regimes that the CSE currently complies with, if there is any, and their corresponding financial reporting and capital requirements. Therefore, the Commission is using the status quo or baseline for this proposal for the following types or categories of CSEs:

##### (1) SDs That Are Bank Subsidiaries

(a) *Capital.* Currently U.S. CSEs that are bank subsidiaries and are not a BD or an FCM are not subject to capital requirements; however, as part of a BHC or a subsidiary of a bank, the CSE’s parent entity must comply with the prudential regulators’ capital requirements. In addition, certain non-U.S. CSEs that are subsidiaries within a bank holding company and are not BDs or FCMs are currently complying with a foreign jurisdiction’s capital, liquidity and financial reporting requirements and these CSEs are covered below, in the Substituted Compliance section.

(b) *Liquidity.* Although the U.S. CSE entities do not have liquidity or funding requirements, their BHC must comply

with the Federal Reserve Board’s liquidity requirements.<sup>151</sup>

(c) *Reporting.* These SDs do have reporting requirements, but not for the information that is requested in this proposal; however, a BHC must report the requested information to the Federal Reserve Board, which includes certain swap and security-based swap positions held at its SD subsidiary.

##### (2) SDs That Are BDs (Including, OTC Derivatives Dealers) (With and Without Models)

(a) *Capital.* If a CSE is also registered as a BD with the SEC, the CSE is already meeting the SEC’s BD capital requirements.

(b) The SEC currently imposes the net liquid assets capital approach on BDs. However, the SEC has modified certain parts of this approach to address certain types of BDs (*i.e.*, ANC Firms and OTC derivatives dealers). As discussed below, an ANC Firm is currently using SEC-approved capital models to calculate certain market and credit risk charges. In addition, OTC derivatives dealers that are registered as BDs may use SEC-approved capital models provided that they maintain a minimum of \$100 million in tentative net capital and at least \$20 million in net capital. Certain non-U.S. SDs are already complying with capital, liquidity and reporting requirements in other jurisdictions. Therefore, the Commission will cover these SDs in the Substituted Compliance section.

(c) *Liquidity.* These SDs do not have any existing regulatory liquidity requirements.

(d) *Reporting.* As a BD, these SDs must comply with the SEC’s BD reporting requirements (the Commission’s proposed reporting requirements are based on the SEC reporting requirements).

##### (3) SDs That Are FCMs and Not BDs (With and Without Models)

(a) *Capital.* For CSEs that are also registered with the Commission as FCMs, the Commission is proposing a net liquid asset capital approach that is similar to the capital requirements of a registered BD.

(b) *Liquidity.* These SDs do not have existing regulatory liquidity requirements.

(c) *Reporting.* As an FCM, these SDs must comply with the Commission’s FCM reporting requirements (the

<sup>151</sup> The Federal Reserve Board has proposed funding requirements for certain large bank holding companies. See *Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements*, 81 FR 35123 (Jun. 1, 2016).



Commission’s proposed reporting requirements are based on these).

(4) SDs That Are BDs and/or FCMs (ANC Firms With Models and One Other SD)

(a) *Capital.* For CSEs that are also registered as BDs/FCMs (using approved models), a significant percentage of these SDs are currently using the ANC capital approach, as discussed below. There is currently one other SD that is not an ANC Firm, but meets the requirements set out above for SD/BDs and SD/FCMs.

(b) *Liquidity.* These SDs must comply with the SEC’s and the CFTC’s reporting requirements.

(c) *Reporting.* As an ANC firm, these SDs must comply with the SEC’s and the CFTC’s ANC firm reporting requirements.

(5) Stand-Alone SDs and Commercial SDs (With and Without Models)

(a) *Capital.* Currently a CSE that is a stand-alone SD has no capital requirements; however, certain non-US Stand-alone SDs are complying with a foreign jurisdiction’s capital, liquidity and reporting requirements and therefore, will be included in the Substituted Compliance benchmark below.

(b) *Liquidity.* These CSEs do not have existing liquidity requirements.

(c) *Reporting.* As CSEs, these entities have reporting requirements, but not for the information requested in this proposal.

(6) MSPs

(a) *Capital.* Although there are no MSPs at this time, it is possible that an MSP in the future may have existing capital requirements. For example, if a bank is determined to be an MSP or an insurance company, these entities may have existing capital requirements.

(b) *Liquidity.* These MSPs do not have existing regulatory liquidity requirements.

(c) *Reporting.* As MSPs, these entities have reporting requirements, but not for the information requested in this proposal.

(7) Substituted Compliance <sup>152</sup>

(a) *Capital.* As discussed above, there are certain non-U.S. CSEs that comply with a foreign jurisdiction’s capital and financial reporting requirements. Commission staff understands that generally these foreign capital requirements are either a bank-based capital regime or a dealer-based regime, which, as the Commission has been informed by these foreign regulators, are similar to the net liquid assets capital approach.

(b) *Liquidity.* The Commission is aware that there are certain liquidity requirements that some of these non-U.S. CSEs are currently complying with. The Commission understands that some of these non-U.S. CSEs or their parent entities are complying with a bank-based liquidity requirement.

(c) *Reporting.* The Commission understands that some of these non-U.S. CSEs are currently complying with a foreign jurisdiction’s financial reporting requirements; however, these financial reporting requirements may not be the same as the Commission is requiring in this proposal.

(8) Prudentially Regulated SDs <sup>153</sup>

(a) *Reporting.* These SDs comply with their applicable prudential regulator’s reporting requirements.

E. Overview of Approaches

In developing the proposed capital approaches in this proposal, the Commission selected from well-established frameworks. As a result of the financial crisis and over the years after the crisis, each of the approaches has undergone significant analysis and changes. After conducting its analysis, BCBS and the prudential regulators acknowledged that capital alone was not

enough to prevent certain financial entities from failing and, therefore, adopted requirements for banks and bank holding companies to meet defined liquidity requirements. As the financial crisis has shown, a firm can be adequately capitalized, but due to a lack of liquidity or funding in the firm, it may be unable to meet its current obligations. Accordingly, the Commission is proposing to include in its capital frameworks liquidity and funding requirements for SDs that are based upon the liquidity and funding requirements adopted by the prudential regulators and proposed by the SEC for SBSDs. As detailed above, the Commission is not including BCBS’s leverage ratio, as the Commission believes that this ratio is designed to cover a consolidated entity (*i.e.*, the BHC), however, as noted above, the Commission may in the future include a similar leverage requirement. In addition, the Commission is not including a leverage ratio under the net liquid assets approach, but may consider leverage requirements in the future.

Under the proposal, the Commission is providing certain CSEs with an option to choose between a bank-based capital approach (similar to the prudential regulators’ capital approach) and a net liquid assets capital approach (similar to the SEC’s and CFTC’s capital approach). As detailed below, the bank-based capital approach is designed to require an SD to have enough common equity tier 1 capital (as defined above) to absorb losses in a time of stress, while the net liquid assets method is designed to require an SD to hold at all times more than one dollar of highly liquid assets for each dollar of unsubordinated liabilities.

The following table summarizes the Commission capital proposal followed by a summary of each approach:

| Approaches                      | SD entities   | Equity type                | The greatest of the following:  |
|---------------------------------|---|----------------------------|---|
| <i>Bank-Based Capital</i> ..... | <i>Non-Bank Subsidiaries of BHC .... Stand-Alone SDs. BDs (including, OTC Derivatives Dealers and ANC Firms).</i> | Common Tier 1 Equity ..... | \$20 million.<br>8% of RWA (Basel Model or Regulation 1.17 table) plus current counterparty credit risk.<br>8% of the total amount of a swap dealer’s margin.<br>RFA. |

<sup>152</sup> The Commission estimates that there are 17 SDs that may be eligible for substituted compliance under this proposal.

<sup>153</sup> The Commission notes that under Section 4s(e) of the CEA, these SDs must comply with the prudential regulators’ capital requirements, but

must comply with the Commission’s reporting and recordkeeping requirements.

| Approaches  | SD entities   | Equity type   | The greatest of the following:  |
|---|---|---|---|
| <i>Net Liquid Assets Capital</i> .....<br><i>Regulation 1.17.</i> | <i>Non-Bank Subsidiaries of BHC</i> ....<br><i>FCMs (SDs).</i><br><i>Stand-Alone SDs.</i> | Net Discounted Assets (Assets – Liabilities = Net Capital, which is discounted (according to Regulation 1.17)).               | \$20 million or \$100 million if approved to use capital models.<br>8% of the total amount of a swap dealer’s margin.<br>RFA.   |
| <i>Net Liquid Assets Capital</i> .....<br><i>SEC Rule 15c3–1.</i> | <i>BDs (SDs)</i> .....<br><i>BDs (OTC Derivatives Dealers).</i>                           | Net Discounted Assets (Assets – Liabilities = Net Capital, which is discounted (according to SEA 15c3–1 or VaR based models). | \$20 million.<br>8% of the total amount of a swap dealer’s margin.<br>RFA.  |
| <i>ANC</i> .....  | <i>ANC Firms</i> .....  | Net Discounted Assets (Assets – Liabilities = Net Capital, which is discounted (VaR based model)).                            | \$5 billion tentative net capital (not discounted). <sup>154</sup><br>\$6 billion early warning net capital (not discounted).<br>\$1 billion Net Discounted Assets.<br>RFA. |
| <i>Non-Financial Swap Dealers</i> .....                           | <i>Non-financial Entities (15% test)</i> ..   | Equity .....  | \$20 million plus market and credit risk charges.<br>8% of the total amount of a swap dealer’s margin.<br>RFA.  |
| <i>MSPs</i> .....   | <i>MSP</i> .....  | Equity .....  | ≥\$1.<br>RFA.   |

1. Bank-Based Capital

Under the bank-based capital approach a CSE would need to maintain common equity tier 1 capital equal to the greatest of the following:

- \$20 million;
- Eight percent of the sum of the following: (i) The amount of its risk-weighted-assets (“RWA”), which is the market risk capital charge under a VaR computation or a standardized formula table (Reg. 1.17); (ii) the amount of current counterparty credit risk (“CCR”), which is the sum of the default risk capital charge and a credit value adjustment (“CVA”) risk capital charge, which is under either a standardized formula table or a VaR method;
- Eight percent of the total amount of a swap dealer’s uncleared swap margin, uncleared security-based swap margin and initial margin required for its cleared positions; or
- The amount required by its RFA.

As noted above, the Commission is proposing a \$20 million fixed-dollar floor, as this is the minimum amount of required capital under all proposed approaches. The Commission is proposing this minimum level as it believes that this is the minimum amount of capital that should be required for a CSE, without regard to the volume of swaps the CSE engages in, to

conduct its dealing activity. As noted above, this amount is based on the Commission’s experience with other registered entities that are currently subject to capital requirements. The Commission is also proposing, however, an eight percent of margin requirement, as through its experience in supervising FCMs, it recognizes that this capital computation is a determinative condition in computing their required capital and requires an SD to maintain a higher level of capital as the risks associated with its dealing activities increases, as measured by the initial margin requirements on the swaps positions. Moreover, under the net liquid assets approach, the Commission is including the same eight percent margin requirement.

In calculating the eight percent of the total uncleared margin, the Commission is including all uncollateralized exposures from uncleared swaps (e.g., inter-affiliate swaps, swaps with commercial end users, and legacy swaps), as these are exposures where no initial margin is collected and, therefore, are part of the SD’s counterparty credit risk, which the Commission believes must be part of the SD’s required capital. The Commission believes that not requiring capital on these uncollateralized amounts would leave a significant gap in determining a level of capital that adequately reflects the overall risk of the SD and would not help to ensure that safety and soundness of the SD.

In addition, the Commission is also requiring the inclusion of an SD’s

required initial margin from clearing organizations for all its cleared positions. The Commission’s eight percent of margin requirement is intended to serve as a proxy for the level of risk associated with the SD’s swap activities and proprietary trading. The Commission believes it is appropriate to include the margin for both cleared and uncleared products in this calculation as it provides a measure of the potential risks posed by the cleared and uncleared positions.

In addition, the Commission has proposed to include a standardized table for market risk that is currently not part of the BCBS or prudential regulator capital framework. The Commission included the standardized table in calculating an SD’s market risk charges to address SDs that do not use approved models in computing market risk charges. The Commission included the Regulation 1.17 standard market risk charges, as it believes these charges result in adequate capital computations for the level of market risk inherent in these financial instruments. In addition, the Commission is currently using these standardized charges in computing an FCM’s market risk charges on the same financial instruments for an FCM’s required capital.

2. Net Liquid Assets

Under this proposed approach, an SD would be required to maintain minimum net capital equal to or exceeding the greatest of:

- \$20 million; or
- Eight percent of the total amount of a swap dealer’s uncleared swap margin,

<sup>154</sup> The SEC is proposing to increase the minimum capital requirements for ANC Firms to require the firms to maintain a minimum of \$1 billion of net capital and \$5 billion of tentative net capital. Under the SEC proposal, ANC Firms also must file a regulatory notice (i.e., “early warning notice”) with the SEC if its tentative net is below \$6 billion.

uncleared security-based swap margin and initial margin required for its cleared positions.

Net capital is generally defined as an SD's current and liquid assets minus its liabilities (excluding certain qualifying subordinated debt), with the remainder discounted according to either a CFTC-approved VaR-based model or a standardized rules-based approach set out in Regulation 1.17.

As noted and discussed above, under this approach, the Commission is proposing a \$20 million fixed-dollar floor. In addition, the Commission is proposing, under this approach, a net liquid assets test that is designed to allow an SD to engage in activities that are part of its swaps business (*e.g.*, holding risk inherent in swaps into its dealing inventory), but in a manner that places the SD in the position of holding at all times more than one dollar of highly liquid assets for each dollar of unsubordinated liabilities (*e.g.*, money owed to customers, counterparties, and creditors). Further, the Commission is requiring a liquidity ratio and a funding plan under this approach. The Commission believes that the net liquid assets approach, although structurally different than the bank-based approach, helps to ensure the safety and soundness of the SD, while providing the same protections to the financial system.

As discussed above and for the same reasons, the Commission is requiring an SD to include in its eight percent of the total uncleared margin calculation all uncollateralized exposures from uncleared swaps (*e.g.*, inter-affiliate swaps, swaps with commercial end users, and legacy swaps) and with clearing organizations.

### 3. Alternative Net Capital ("ANC")

Under the ANC approach, an SD would need to maintain its net capital in accordance with the following requirements:

- \$1 billion net capital;<sup>155</sup>
  - \$5 billion tentative net capital;<sup>156</sup>
- and
- \$6 billion early warning net capital.<sup>157</sup>

Under the proposal, an SD that is registered with the SEC as a BD and is approved by the SEC to use internal models to compute certain market risk and credit risk capital charges (an "ANC

Firm") will be able to continue to use the ANC approach in calculating its SD capital; however, with enhancements to the minimum capital requirements as proposed by the SEC.

Under the proposal, an ANC Firm must maintain, at all times, tentative net capital, which is the net capital of an ANC Firm before deductions for market and credit risk, of \$5 billion. In addition, an ANC Firm must maintain, at all times, early warning net capital, which is the net capital of an ANC Firm before deductions for market and credit risk, of \$6 billion. Lastly, an ANC Firm must maintain, at all times, \$1 billion of net capital, which is net discounted assets (discounted by VaR models for market and credit risk).

In proposing to adopt this approach, but with some amendments to the requirements, the Commission recognizes that ANC Firms are dual registrants with the Commission and SEC that offer a wide-range of financial services and act as different types of intermediaries (*e.g.*, BD, FCM, SD). As a result of the additional complexity and risk inherent in these entities, and the Commission's experience with these ANC Firms, the Commission is proposing to increase their minimum capital requirements in this proposal consistent with the SEC. In addition, as with the other approaches, the Commission is proposing to require ANC Firms to meet liquidity and funding requirements consistent with the SEC.

The Commission expects that SDs that are ANC Firms will elect to use this capital approach for its swaps transactions. The Commission believes that since this approach has been in effect for more than 10 years and it properly accounts for the inherent risk and complexity of these firms, including their swap dealing activities, that it is appropriate to propose to permit ANC Firms to continue using this approach, but with some enhancements based on the Commission's experience. As discussed above, the Commission is proposing to increase the minimum capital requirements for ANC Firms in a manner consistent with the SEC's proposed increases for ANC Firms. The Commission believes that the increases are appropriate to reflect the potential increase in swaps activities that ANC Firms may engage in, particularly if affiliates move their swaps activities into the ANC Firms to effectively use the capital held by the ANC Firms.

### 4. Tangible Net Worth

The Commission is proposing a tangible net worth approach for both SDs and MSPs. With respect to SDs, the

proposal would require an SD to maintain minimum net capital equal to or in excess of the greater of:

- \$20 million plus market and credit risk charges;
- 8 percent of the total amount of a swap dealer's uncleared swap margin, uncleared security-based swap margin and initial margin required for its cleared positions; or
- The amount required by its RFA.

The term tangible net worth is proposed to be defined to mean an SD's net worth as determined in accordance with generally accepted accounting principles in the United States, excluding goodwill and other intangible assets.

As noted above, the Commission is proposing this approach as it recognizes that certain SD's that are primarily engaged in non-financial activities may engage in a diverse range of business activities different from, and broader than, the dealing activities conducted by a financial entity. Under the proposal, an SD, availing itself of this approach, must meet the Commission's 15% revenue test and 15% asset test as discussed in section II.A.2.iii of this proposal to demonstrate that entity is primarily engaged in non-financial activities.

As discussed below, the Commission believes that the tangible net worth capital approach meets statutory mandate, as it is designed to help ensure the safety and soundness of the SD, while calibrated to the inherent risk of the uncleared swaps held by the SD and the overall activity of the SD. In addition, the Commission is not requiring these SDs to meet its liquidity and funding requirements. As discussed below, the Commission believes that the imposition of such requirements would result in an over-inclusive requirement, as it would include all non-financial funding requirements; likewise, if it narrowed the scope of the liquidity requirement to just swap dealing activity, the requirement would be under-inclusive as the required liquid assets would be comingled with the SD's other liquid assets, which could be used for all the entity's liabilities and not just for its swap dealing related liabilities. As the proposed tangible net worth capital approach would only be available to SDs that are primarily engaged in non-financial activities, the Commission believes that this approach has proper controls to ensure that it is not exploited by financial entities seeking a regulatory advantage.

With respect to MSPs, the Commission is proposing to require an MSP to maintain net tangible net worth in the amount equal to or in excess of

<sup>155</sup> See proposed 17 CFR 240.15c3-1(a)(7) in *Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers*; Proposed Rule, 77 FR 70214, at 70228 (Nov. 23, 2012).

<sup>156</sup> See *Id.*

<sup>157</sup> See *Id.*

the greater of the MSP's positive net worth or the amount of capital required by an RFA of which the MSP is a member. There are currently no MSPs and the only previously registered MSP were required to register as a result of their legacy swaps and not any current swap activity. The Commission believes that the proposed capital requirements for MSPs are appropriate given that no entities are currently registered and the Commission is uncertain of the types of entities that may register in the future. As noted above, the Commission has taken this uncertainty into consideration by proposing to allow an RFA to establish an MSP's minimum capital requirements. Such RFA's are required under section 17 of the CEA to establish capital requirements for all members that are subject to a Commission minimum capital requirement. Accordingly, RFAs may adjust their rules going forward depending on the nature of any entities that may seek to register as MSPs, and adopt minimum capital requirements as appropriate. Such RFA rules must be submitted to the Commission for review prior to the rules becoming effective.

#### 5. Substituted Compliance

As described above, the Commission is providing certain non-U.S. CSEs with the ability to petition the Commission for approval to comply with comparable foreign capital and financial reporting requirements in lieu of some or all of the Commission's requirements. In proposing this approach, the Commission recognizes that this may provide these CSEs with cost advantages by avoiding the costs of potentially duplicative or conflicting regulation.

In limiting the scope of substituted compliance, the Commission does not believe it should make available substituted compliance to all CSEs. The Commission is proposing substituted compliance only to non-U.S. CSEs, as it believes that it is necessary that its capital requirements apply to U.S. CSEs, as they are integral to the U.S. swaps market and critical in ensuring the stability of the U.S. financial system.

Additionally, the Commission recognizes that substituted compliance, to the extent that it puts conditions on its comparability determination, may result in additional costs to these CSEs; however, the Commission believes that providing a substituted compliance regime that allows for conditions instead of an all-or-nothing approach will benefit these CSEs and provide for a more competitive swaps market. Moreover, to the extent that a non-U.S. CSE must comply with a foreign regime and the Commission does not find that

regime comparable, the Commission recognizes that these non-U.S. CSE may be burdened with additional costs and subject to conflicting and/or duplicative costs.

#### F. Entities

The following section discusses the related incremental costs and benefits of the proposal's capital approaches and reporting requirements on each type or category of SDs and MSPs. The Commission understands that certain SDs and MSP organized and domiciled outside of the U.S. would be included in these types or categories of entities. These non-U.S. SDs and MSPs are discussed in the Substituted Compliance section below.

##### 1. Bank Subsidiaries

All U.S. CSEs that are subsidiaries in a BHC and are not a BD or FCM currently are not subject to capital requirements;<sup>158</sup> however, their parent BHC currently complies with the Federal Reserve's capital requirements. Under the Federal Reserve Board's capital requirements, which are based on Basel III requirements, a BHC must maintain adequate capital for the entire consolidated entity.<sup>159</sup> That is, all the assets and liabilities of the BHC's consolidated subsidiaries are consolidated into the holding company. The Federal Reserve Board's capital requirements are then imposed on the BHC, requiring the BHC to maintain capital levels according to those requirements.

As these CSEs are not currently required to be capitalized, the Commission understands that this may add incremental cost to the consolidated entity and/or the CSE as it will have to retain earnings or further capitalize the CSE to the required capital levels. However, the Commission recognizes that a consolidated entity may capitalize

<sup>158</sup> The Commission acknowledges that some subsidiaries in a BHC may be an insurance company and, therefore, may have capital requirements set by its insurance regulator. Such entities are outside the scope of the Commission's proposed rulemaking, as these entities are currently not registered with the CFTC as an SD or MSP. The Commission further acknowledges that there are some non-U.S. subsidiaries that are part of a bank and those subsidiaries and/or their parent may be subject to the capital regime of a foreign regulator. The Commission believes that in such a case, the capital regime that is likely to be applicable would be either the Basel III-based approach or a version of the net liquid assets approach.

<sup>159</sup> See *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule*; Final Rule, 78 FR 62018 (Oct. 11, 2013).

one of its subsidiaries in many different ways, including retaining earnings from the CSE or from within the consolidated group. Even with this proposed requirement imposing capital on the subsidiaries, as noted above, the BHC must maintain capital levels in accordance with the Federal Reserve Board's capital requirements, which are calculated on a consolidated basis; therefore, incremental costs may be mitigated, as it may be possible for the consolidated entity to keep the same level of capital within the BHC, but reallocated among its subsidiaries.<sup>160</sup> In addition, the Commission recognizes that earnings may now have to be retained in the CSE and may no longer be available to be reallocated to fund other more profitable activities within the consolidated group or to be returned to shareholders; however, the Commission believes that by providing these CSEs with the option of differing capital approaches, these CSEs will select the capital approach most optimal for its operations, financial structure and which will reduce duplicative or conflicting rules and the administrative costs of calculating and maintaining additional sets of books and records.

The Commission believes that although the proposed capital approaches may be structurally different, they require a CSE to maintain adequate capital levels for its activities, which should help ensure the safety and soundness of the CSE and the stability of the U.S. financial system.

In requiring capital for a bank subsidiary that is an SD, as discussed above, the SD may incur additional costs. As a result of the additional costs, some SDs may be put at a competitive disadvantage, when compared to those dealers with lesser capital requirements or with no capital requirements. As a result of this additional cost, some swap dealing activity may become too costly—becoming a low margin activity—and, therefore, some SDs may limit their dealing activity or exit the swaps market. Additional costs may also be passed on to customers in the form of higher prices; however, if these SDs are to remain competitive in the swaps market, they must compete with competitors by matching or beating prices. In addition, as most of the largest swap dealers are part of a BHC, these SDs are already incurring capital charges at the consolidated level, and, therefore, the incremental cost and the effect on competition and pricing of

<sup>160</sup> The Commission notes that the bank or an insurance company in a BHC must maintain certain capital and as such, may not be able available to capitalize the CSE.

swaps may be mitigated. Because these SDs have the option to select the most optimal capital approach for them, they can control some of the burdens placed on them by the proposal and thereby, mitigate the proposal's effect on pricing.

## 2. SD/BD (Without Models)

Under the proposal, an SD that is also a BD that does not use SEC/CFTC-approved models to calculate its market and credit risk charges has the option to use either the bank-based approach or the net liquid assets approach, but with a standardized capital charges for market risk and credit risk. The Commission recognizes that although it is giving an option to these SDs to comply with either approach, these SDs must still meet the SEC's BD capital requirement.

The standardized capital charges impose significant capital requirements for uncleared swaps primarily in the form of rules-based market risk charges and credit risk charges. Therefore, these firms currently engage in limited swaps activity in the BD, and the Commission does not anticipate that SD/BDs engaging in significant swaps activity in the future absent SEC rule amendments.

## 3. SD/BD/OTC Derivatives Dealers (Without Models)

Under the proposal, an SD that is registered with the SEC as an OTC derivatives dealer will have the option to comply with either the bank-based capital approach or the net liquid assets capital approach. As OTC derivatives dealers, these SDs already comply with the SEC's net liquid assets capital requirements. OTC derivative dealers also may be approved by the SEC to use internal models to calculate market and credit risk charges in lieu of standardized, rules and table-based capital charges for swaps, security-based swaps and other financial instruments.

The Commission believes that since SDs that are registered OTC derivatives dealers are already complying with the SEC's net liquid assets approach, they will select this approach in meeting with the Commission SD's proposed capital requirements. The Commission believes that allowing these entities to continue using current capital requirements will reduce the possibility of duplicative or conflicting rules and administrative costs of calculating and maintaining additional sets of books and records. The Commission believes that its proposal will result in only a small incremental cost to OTC derivative dealers.

The Commission recognizes that OTC derivatives dealers already have SEC-approved models in computing their

current capital requirements and, therefore, will not incur any additional costs in developing and implementing this model-based approach in computing capital charges.

## 4. SD/FCM (Without Models)

Under the proposal, an SD that is also registered with the Commission as an FCM that does not use Var models to calculate market and credit risk charges, must compute its capital in accordance with the rules-based approach set forth in Regulation 1.17. In the proposal, the Commission is amending certain provisions of Regulation 1.17 to reduce the burden on an FCM engaging in swaps. The amendments align the FCM capital requirements with that of new net liquid assets capital approach set out in proposed Regulation 23.101. In amending the requirements, the Commission believes that it is reducing the burden placed on SDs/FCMs, as the amount of capital on uncleared swaps would have been significantly higher under the current requirements and would have placed SD/FCMs at a competitive disadvantage. Specifically, Regulation 1.17 currently does not allow an FCM to recognize collateral held at a third-party custodian as capital. Therefore, under Regulation 1.17 an SD/FCM would have to take a 100 percent capital charge for margin posted with third-party custodians even though the Commission's uncleared margin rules require initial margin to be held at a third-party custodian. This is true even though the custodian has no ability to rehypothecate the initial margin and the SD has the ability to retrieve the initial margin back from the custodian with no encumbrance. Therefore, the Commission believes that its proposed amendments to Regulation 1.17 to allow an SD/FCM to recognize margin posted with third-party custodians in accordance with the Commission's margin rules will make it easier for an SD/FCM to meet its minimum level of required capital while also requiring an SD/FCM to maintain adequate capital levels, when considering the amount of initial margin that the SD has at its disposal in the event of a counterparty default.

As a result of the proposal's amendments, these SD/FCMs should benefit from lower capital charges and should allow these SD/FCMs to continue to comply with one capital rule, which should mitigate some of the administrative costs and reduce the possibility of duplicative or conflicting rules. The Commission is not providing these SDs with an option to use the bank-based capital approach, as the Commission believes that this option is

unnecessary and costly, and the current FCM capital approach reflects that the firm acts as an intermediary for customers on futures markets. The Commission has made amendments to account for SD/FCMs' swap activities and in allowing these FCMs to change their current capital method, the Commission believes that this would add an additional layer of complexity and costs to the FCMs, as the FCMs would have to change, modify or migrate all of their current systems to a new capital regime. In addition, the Commission believes that requiring the same capital regime, with beneficial amendments, is more appropriate in transitioning the Commission's capital requirements to these entities, as it should result in fewer burdens and a simple transition in implementing the Commission's proposed capital requirements. In addition, the Commission believes that this would simplify the Commission's ability to supervise these entities, as the Commission will be able to seamlessly transition from its current capital regime to these new requirements; however, the Commission recognizes that by not providing these SDs with the option to use the bank-based capital approach it may be foreclosing the ability of these SDs to use a capital approach that may be more cost effective than the one proposed.

As a result of this proposal, the Commission recognizes that by amending Regulation 1.17 capital charges it is reducing the burden currently placed on SD/FCMs' swaps activities, which may result in greater liquidity in the swaps market, as this activity will be less costly and may incentivize these entities to engage in more swap dealing activity.

As a result of the amendments to Regulation 1.17, these SD/FCMs may be able to realize some of the cost saving of the amendments when competing with other dealers for counterparties. This cost savings may also result in more efficient pricing for their counterparties. However, the Commission notes, as stated above, that as a result of the Commission's margin requirements for uncleared swaps these benefits may be limited.

## 5. ANC Firms (SD/BDs and/or FCMs That Use Models)

Under the proposal, an SD that is an ANC Firm (*i.e.*, also a BD and/or FCM, with approval by the SEC/CFTC to use models in computing market risk and credit risk charges), will incur minimal additional capital charges, as a result of this proposal. The Commission is retaining this approach for these firms,

but with an increase in the capital thresholds, as noted above. The Commission is proposing these amendments based on market experience in supervising ANC Firms, and in recognition that the proposal is consistent with the SEC's proposed capital increases for ANC Firms. The Commission notes that the current ANC Firms are already maintaining more than the amended thresholds; however, by increasing these capital requirements the Commission recognizes that this may have an additional cost, as ANC Firms will now be required to maintain these capital levels, as under the current capital thresholds, these were held at their discretion.

The Commission recognizes that ANC firms already have SEC-approved models in computing their current capital requirements and, therefore, they will not incur any additional costs in developing and implementing this model-based approach in computing capital charges.

#### 6. Stand-Alone SD (With and Without Models)

Under the proposal, a stand-alone SD is provided with an option to comply with either the bank-based capital approach or the net liquid assets capital approach. In providing this option, the Commission, as discussed above, believes that both options provide adequate capital requirements and account for the financial activities of an SD. Therefore, under the proposal, the Commission believes that these SDs will benefit, as these SDs will have the ability to select the most optimal approach, based on their organizational and operational structure and the composition of their assets. In addition, this option will also reduce the possibility of duplicative or conflicting rules and administrative costs of calculating and maintaining additional sets of books and records.

Under the proposal, a stand-alone SD that does not use models must compute their market risk and credit risk charges in accordance with rules-based requirements and a standardized table. The Commission recognizes that under the bank-based capital approach, market risk charges are calculated with a prudential regulator's approved model; however, to allow stand-alone SDs to use the bank-based capital approach without a model, the Commission is proposing to incorporate Regulation 1.17 market risk charges into the framework. In providing this alternative, the Commission is providing an option to those stand-alone SDs that do not have Commission-approved models. In doing so, the Commission is providing

these SDs with a benefit, as they are still able to choose the most efficient capital approach. The Commission incorporated Regulation 1.17 market risk charges, with proposed amendments, as it believes that this is a well-established method that properly accounts for market risk charges.

However, the Commission recognizes that many of these entities are not currently subject to minimum capital requirements, and as such, will incur additional costs on all of their financial activities, including their swap activities, which may result in possible increases in costs and pricing. In addition, a stand-alone SD selecting to use models in computing its market and credit risk charges may incur additional costs in developing and implementing these models.

As a result of this proposal, the Commission recognizes that by requiring capital for SDs this may put these SDs at a competitive disadvantage, when compared to those entities with a lesser capital requirement or with no capital requirements. As a result of this additional cost, some swap activities may become too costly and, therefore, some SDs may limit their activity or exit the swaps market. This additional cost may in turn be passed on to customers in the form of higher prices; however, if these SDs are to remain competitive in the swaps market, they must compete by matching or beating prices of their competitors. If an SD decides to limit its activity or withdraw from the swaps market, this may result in a reduced level of liquidity in the swaps market.

In requiring minimum capital requirements, the Commission believes that it is complying with its statutory mandate, as these standards are calibrated to the level of risk in an SD and are designed to help ensure safety and soundness of the SD and the stability of the U.S. financial system. In addition, the Commission's proposal is modeled after two well-established capital regimes, which should help ensure safety and soundness of the SD and competition among all registered SDs.

#### 7. Non-Financial SD (With and Without Models)

Under the proposal, an SD that is predominantly engaged in non-financial activities, as defined in proposed Regulation 23.100 (85% non-financial threshold), may use the tangible net worth capital approach. This approach is designed after GAAP's tangible net worth computation and excludes

intangibles and goodwill.<sup>161</sup> The Commission is also requiring that the non-financial SD include in its capital requirement its market risk and credit risk charges.

The Commission believes that this approach, which is tailored to non-financial entities that are SDs, provides these entities with the flexibility to meet an appropriate capital requirement, without requiring the firms to engage in costly restructuring of their operations and business. The Commission recognizes that these SDs deal in swaps, but the Commission also recognizes that these entities are primarily engaged in commercial activities and counteract with primarily with commercial clients. BCBS, the Commission and the SEC did not fully consider this type of business model when developing the bank-based capital approach and the net liquid assets capital approach set out in this proposal. In allowing these entities to maintain their current structure, the Commission believes that its proposed approach will allow for less disruption to these SDs and in the markets, as these SDs may serve smaller clients that would not otherwise be able to participate in the swaps market without these SDs. However, the Commission, in helping to ensure the safety and soundness of these SDs, is requiring that these entities maintain a level of tangible net worth equal to or greater than the greatest of (i) \$20 million plus the SD's market and credit risk charges, (ii) eight percent of its margin amount (*i.e.*, eight percent of all of the SD's uncleared swap margin, uncleared security-based swap margin and initial margin required for its cleared positions), or (iii) the amount of capital required by an RFA, as this would account for the SD's exposure (market and credit risk) to the swaps markets, without penalizes the SD's commercial activities.

In developing this approach, the Commission also recognizes that the commercial activities of a commercial SD could affect the overall financial health of the SD. That is, in the event of a substantial loss emanating from its commercial activities, this loss may have a substantial negative affect on the SD, which may find itself in financial distress. As the Commission is not accounting for the risk in the commercial activities, it is possible that the amount and type of capital that a commercial SD is required to maintain may not be adequate to prevent the failure of the SD, which then will affect

<sup>161</sup> Under GAAP, tangible net equity is determined by subtracting a firm's liabilities from its tangible assets.

all of its swap counterparties. However, in tailoring this method to these commercial SDs, the Commission is taking a position that is consistent with the Commission's prior positions on commercial entities, as it believes these commercial entities and their corresponding activities are less risky than a financial entity.<sup>162</sup> In addition, and as discussed above, an RFA will have the ability to assess capital levels at all SDs and may adopt rules to impose capital requirements that are more stringent than the Commission's capital requirements on SDs as their experience with these firms develops.

The Commission recognizes that these entities are not currently subject to minimum capital requirements, and as such, will incur additional costs on all of their swap activities, which may result in possible increases in pricing; however, as the Commission has developed its capital requirements to better target these commercial SDs, it believes that the additional cost should be mitigated by this approach.

In addition, as the Commission expects that these SDs will use models in computing its market and credit risk charges, this may also result in additional costs in developing and implementing these models; however, this cost should be mitigated by the savings that may be realized by using such models.

#### 8. MSP

Under the proposal, an MSP must maintain capital (*i.e.*, tangible net worth) of the greater of positive tangible net worth or the amount of capital required by a registered futures association of which the MSP is a member. This approach is designed after GAAP's tangible net worth computation and excludes intangible assets and goodwill. Currently there are no MSPs. The Commission cannot determine if other entities will register in the future as MSPs, however, the Commission is required to propose a capital requirement to address potential future registrants.

In proposing the tangible net worth approach for MSPs, the Commission is allowing these entities to continue their operations if they become registered as MSPs with little to no changes to the entities' structures. In providing for this, the Commission believes that these entities if they become registered as MSPs will incur minimal additional costs to comply with the proposed requirements.

The Commission believes that the proposed capital requirements will help

ensure the safety and soundness of MSPs, as these entities will typically be posting and collect margin on all of their new uncleared swaps and, therefore, as these MSPs are registered only as a result of being an end-user of swaps and not a swap dealer, the margin requirements are better tailored to cover that same risk, which is on a \$1 for \$1 basis, than through its capital requirements. Therefore, the Commission is only proposing to require MSPs to be solvent, while nothing that the entity may be subject to other capital requirements and hence required to comply with those capital requirements.

As the Commission's capital requirements will result in minimal additional costs to these MSPs, there should be little to no effect on competition, as they are end-users (*i.e.*, price takers) and little to no incremental effect on pricing.

#### 9. Substituted Compliance

Under the proposal, a non-U.S. CSE that is already complying with a comparable foreign jurisdiction's capital or financial reporting regime is provided with the ability to meet the Commission's capital requirements by meeting the foreign jurisdiction's capital requirements. In providing these CSEs with the ability to continue to comply with their current capital and financial reporting regimes the Commission believes that it is limiting the potential for conflicting and duplicate capital requirements. In addition, as each foreign jurisdiction must be determined to be comparable, the possible negative effect on the U.S. financial system is mitigated.

The Commission further recognizes that non-U.S. CSEs that use conditional substituted compliance may incur additional costs; however, the Commission believes that conditional substituted compliance provides an offsetting benefit to these CSEs as it allows for a conditional substituted compliance determination instead of an all-or-nothing approach, which may result in the Commission not recognizing a foreign jurisdiction's capital requirements, resulting in additional cost, including possible conflicting and/or duplicative requirements.

#### G. Liquidity and Funding Requirements

Under the proposal, the Commission is requiring that SDs, excluding SDs that are predominantly engaged in non-financial activities, be required to comply with a liquidity requirement and to adopt a funding plan. Depending on the capital approach that the SD is

complying with, the SD must comply with the corresponding liquidity requirement. Any SD that complies with the bank-based capital approach must comply with liquidity coverage ratio ("bank-based liquidity"). Alternatively, any SD that complies with the net liquid assets capital approach must comply with the liquidity stress test requirement ("liquidity stress test").

As discussed above, in recognizing the limitations that were highlighted by the financial crisis and acknowledged by BCBS, the Commission is adopting a liquidity requirement to enhance protection provided by its capital requirements. During the financial crisis, it was evident that although many firms had adequate capital levels they did not have enough liquidity or funding sources to cover their current obligations, which resulted in firms being adequately capitalized under the applicable regulations, but nonetheless in default on their obligations.

Therefore, the Commission believes that in proposing this requirement it is enhancing the safety and soundness of SDs and thereby, helping to ensure stability of the U.S. financial system.

The Commission selected these two approaches from the prudential regulators' liquidity model and the SEC's proposed capital requirements, which contains a liquidity requirement. Each approach is designed to ensure that an SD has enough liquid assets over a stressed 30-day period to meet its obligations, over that same period. As the bank-based liquidity ratio is required under the prudential regulators' capital rules, the Commission believes that it would be consistent in tying these two requirements, as it was developed to complement its corresponding capital requirements. Alternatively, the Commission is requiring the liquidity stress test approach for those SDs that comply with the net liquid assets capital approach, as the Commission believes these two approaches complement each other, as these both focus on net liquid assets of a SD. The Commission believes that matching these two requirements will benefit SDs, as they will not have to comply with possible duplicative and/or conflicting requirements.

The Commission is also requiring these SDs to maintain a funding plan. The Commission believes that these costs are marginal and are accounted for in the proposal's PRA. As discussed above in regard to the proposal's liquidity requirements and for the same reasons, under the proposal the Commission is requiring a funding plan, as it believes that this requirement is necessary to further enhance the

<sup>162</sup> See *e.g.*, 17 CFR 39.6.



Commission's capital requirements and to help ensure the safety and soundness of the CSEs.

As noted above, SDs are not required by the Commission to comply with any liquidity or funding requirements. In requiring these SDs to comply with its liquidity requirements, the Commission recognizes that these SDs may have to hold more liquid assets; however, the Commission believes that this requirement increases the possibility that an SD will be able to withstand another financial crisis. As the Commission is mandated to set capital requirements to help ensure the safety and soundness of the SD, and in learning from the events of the financial crisis, the Commission believes that this requirement is necessary to ensure the viability of SDs. In addition, non-bank subsidiaries of a BHC, although not required to retain a certain level of liquid assets, are constrained on the amount of illiquid assets that they can hold on their balance sheet indirectly, as their BHC parent must meet the Federal Reserve's liquidity requirements. This will mitigate some of the costs incurred by certain SDs that select the bank-based capital requirements. Moreover, the Commission recognizes that these costs will also be mitigated to some degree, as liquidity can be moved around an organization, provided there are no legal restrictions or constraints.<sup>163</sup>

The Commission believes that to the extent that all of its financial SDs must comply with one of the two liquidity requirements, the competitive effects should be mitigated. In addition, as a result of a liquidity requirement being an internationally accepted requirement under BCBS, this should mitigate some of the competitive advantages that non-CFTC registered dealers may have over financial SDs. In addition, to the extent that SDs maintain liquid assets to cover their initial margin requirements and variation margin requirements (under the Commission's variation margin requirements, swaps between two CSEs require the exchange of cash or U.S. treasuries), this may also mitigate the cost of this proposed liquidity requirement.

In proposing a liquidity requirement, the Commission understands that this may have a negative effect on liquidity of the swaps market. This proposed requirement will require financial SDs to hold more liquid assets than prior to

this proposal. Therefore, this may cause some of these financial SDs, to limit or withdraw from swap dealing activity, as the proposal may make swaps activity more costly, which may result in a reduction in market liquidity.

Under the proposal, the Commission is not requiring Commercial SDs to comply with its proposed liquidity and funding requirements. The Commission believes that if it were to impose liquidity and funding requirements on Commercial SDs it would result in an over-inclusive requirement, as it would include all non-financial liquidity and funding requirements. Alternatively, if the Commission narrowed the scope of the liquidity and funding requirements to just swap dealing activity, the Commission believes that it would be under-inclusive, as the required liquid assets will be comingled with the SD's other liquid assets, which could be used for all the entity's liabilities and not just for its swap dealing related liabilities. In addition, the Commission understands that if the Commercial SD defaults on any obligation, including commercial, this may have a negative impact on the entity's SD. With these two conflicting views, the Commission believes it is not appropriate at this time to propose liquidity or funding requirements on Commercial SDs.

As noted in the section F.9., the Commission is providing substituted compliance to certain non-U.S. CSEs. As discussed above and for the same reasons, the Commission believes that, in regards to its liquidity and funding requirements, providing substitute compliance to these non-U.S. CSEs should reduce the possibility of additional costs and duplicative or conflicting requirements.

#### *H. Reporting and Recordkeeping Requirements*

The recordkeeping, reporting and notification requirements set out in this proposal are intended to facilitate effective oversight and improve internal risk management, via requiring robust internal procedures for creating and retaining records central to the conduct of business as an SD or MSP. Requiring registered SDs and MSPs to comply with recordkeeping and reporting rules should help ensure more effective regulatory oversight. The proposal would help the Commission determine whether an SD or MSP is operating in compliance with the Commission's capital requirements and allow the Commission to assess the risks and exposures that these entities are managing.

As detailed above in Section II.C of this proposal, the Commission is

requiring all SDs to file certain financial information pertaining to their capital requirements. Those SDs that are prudentially regulated are provided with the option to submit their financial information that is reported to their prudential regulator to the Commission. In addition, those SDs that are also FCMs may file their financial information pertaining to their capital requirements under this proposal with the Commission, including notices, in the same manner as they currently report. For those SDs that are also registered with the SEC as a BD or a SBSB, these SDs may file the same financial information to the Commission, as they file with the SEC. In filing the proposed required financial information with the Commission, these entities must file through the Winjammer electronic filing system. Alternatively, these same SDs have the option to report their financial information like stand-alone SDs, commercial SDs and MSPs report their financial information to the Commission. The Commission is providing this option, as the information reported to the Commission under this proposal and that is filed with the Commission or other financial regulatory agencies are similar, as the information provides the Commission with the ability to assess and monitor an SD's financial condition and whether the SD is currently meeting the Commission's capital requirements. In permitting these SDs to use their current required information, the Commission believes that this should mitigate some additional costs to prepare and report this information to the Commission. In addition, these SDs should already have developed policies, procedures and systems to aggregate, monitor, and track their swap dealing activities and risks. As such, this should also mitigate some of the costs incurred under the proposal.

Under the proposal, those SDs and MSPs that are not subject to current capital requirements will have to develop and establish policies, procedures and systems to monitor, track, calculate and report the required information. In developing these policies, procedures and systems, these SDs will incur costs; however, as these entities are registered with the Commission as SDs, the Commission believes that they should already have developed policies, procedures and systems to aggregate, monitor, and track their swap activities and risks, as is required under the Commission's swap dealer framework. This should mitigate some of the burdens of the proposed reporting and recordkeeping

<sup>163</sup> The Commission notes that Section 23A and 23B may constrain the ability of moving liquidity in a BHC. In addition, if an entity must currently comply with liquidity provisions, this may also limit the ability to move liquidity among consolidated entities.

requirements. In addition, as the information that the Commission is proposing to require is based on GAAP or another accounting method, this information is already being prepared for other purposes and therefore, should again mitigate the costs in meeting these proposed requirements.

The Commission also believes that as a result of the proposed reporting and recordkeeping requirements, SDs should be able to more effectively track their trading and risk exposure in swaps and other financial activities. To the extent that these SDs can better monitor and track their risks, this should help them better manage risk.

As noted in the section F.9., the Commission is providing substituted compliance to certain non-U.S. CSEs. As discussed above and for the same reasons, the Commission believes that, in regards its reporting requirements, providing substitute compliance to these non-U.S. CSEs it should reduce the possibility of additional costs and duplicative or conflicting requirements

#### *I. Section 15(a) Factors*

The following is a discussion of the cost and benefit considerations of the proposal, as it relates to the five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations.

##### 1. Protection of Market Participants and the Public

The proposed rules are intended to strengthen the swaps market by requiring all CSEs to maintain a minimum level of capital and liquidity. These minimum capital requirements should enhance the loss absorbing capacity of CSEs and reduce the probability of financial contagion in the event of a counterparty default or a financial crisis. In addition, capital functions as a risk management tool by limiting the amount of leverage that a CSE can incur. Moreover, the proposal's liquidity and funding requirements should provide CSEs with the ability, in times of financial stress, to meet their current and other obligations as they come due, which should lower the probability of a CSE defaulting. This should help mitigate the overall risk in the financial system and ultimately reduce systemic risk. Financial reporting requirements for CSEs set out in this proposal should help the Commission and investors monitor and assess the financial condition of these

CSEs. As this proposal is designed to protect financial entities from default, this should have a direct benefit to the public, as the failure of these CSEs could result in a financial contagion, which could negatively impact the general public. On the other hand, the proposed capital rules may require additional capital to be raised and may increase the cost of swaps, as described above.

##### Request for Comment

Do proposed capital, liquidity, and financial reporting requirements properly protect market participants and the public? Please explain.

##### 2. Efficiency, Competitiveness, and Financial Integrity of Swaps Markets

In this proposal, the Commission sought to promote efficiency and financial integrity of the swaps market, and where possible, mitigate undue competitive disparities. Most notably, the Commission aligned the proposed regulations with that of the prudential regulators', SEC's and the Commission's current capital frameworks to the greatest extent possible. Doing so should promote greater operational efficiencies for those SDs that are part of a BHC or are also registered with the SEC as a BD or the Commission as an FCM, as they may be able to avoid creating duplicative compliance and operational infrastructures and instead, rely on the infrastructure supporting the other registered entities. In addition, this approach should also enhance efficiency and limit conflicting rules, as these entities can continue to operate under their current regimes. Moreover, the proposal permits CSEs to calculate credit and market risk charges under a standardized or model-based approach, which allows them to choose the methodology that is the most suitable for their asset composition.

The Commission notes that the proposed capital rule, like other requirements under the Dodd-Frank Act, could have a substantial impact on competition in the swaps market. As the Commission's proposal will result in additional costs to certain CSEs that do not have current capital requirements, these CSEs may either limit their swap activities or withdraw from the swaps market. In this event, it is possible that this may result in less competition and increases in prices of swaps. Depending on the relative cost of the Commission's capital and liquidity requirements compared with corresponding requirements under prudential regulators' regime, SEC's regime or in other jurisdictions, certain CSEs may have a competitive advantage or

disadvantage; however, the Commission, in developing the proposal, harmonized the proposal with those of the prudential regulators and the SEC to the maximum extent practicable.

As noted above, the Commission, recognizing that SDs are critical to the financial integrity of the financial markets, designed their capital requirements to help ensure the safety and soundness of these SDs. In doing so, this should protect an SD in the event of a default by its counterparty or a financial crisis, which should reduce the probability of financial contagion.

##### Request for Comment

Is market integrity adversely affected by the proposed rules? If so, how might the Commission mitigate any harmful impact?

##### 3. Price Discovery

As noted above, the proposal may have a negative effect on competition, as a result of increasing costs, which may result in some SDs limiting or withdrawing from the swaps markets. In that event, this negative effect on competition could result in a less liquid swaps market, which will have a negative effect on price discovery. However, as discussed above, most of the larger SDs or their parent entities are already subject to capital requirements that impose capital charges for their swap activities and, therefore, the proposal's effect on competition, liquidity and price discovery should be limited.

##### Request for Comment

How might this proposal affect price discovery? Please explain.

##### 4. Sound Risk Management Practices

A well-designed risk management system helps to identify, evaluate, address, and monitor the risks associated with a firm's business. As discussed above, capital plays an important risk management function and limits the amount of leverage an entity can incur. In addition, capital serves as the last line of defense in the event of a counterparty default or severe losses at a firm. The Commission's proposal is developed from two well-established capital regimes. In addition, the Commission is requiring certain liquidity standards and a funding requirement. Therefore, the Commission's proposal should promote increase risk management practices within a CSE. Moreover, the Commission believes that as a result of the proposed reporting and recordkeeping requirements, SDs may

more effectively track their trading and risk exposure in swaps and other financial activities. To the extent that these SDs can better monitor and track their risks, this should help them better manage risk within the entity.

**Request for Comment**

How might this proposal affect sound risk management practices? Please explain.

**5. Other Public Interest Considerations**

The Commission has not identified any additional public interest considerations related to the costs and benefits of the proposed rule.

**Request for Comment**

Are there other public interest considerations that the Commission should consider? Please explain.

**Appendix to Cost Benefit Considerations**

The Commission generally requests comments about its analysis of the general costs and benefits of the proposed rule. The Commission

requests data to quantify and estimate the costs and the value of the benefits of the proposals. Are there additional costs and benefits that the Commission should consider? Has the Commission misidentified any costs or benefits? Commenters are encouraged to include both quantitative and qualitative assessments of benefits as well as data, or other information of support for such assessments.

*i. Minimum Capital Requirement*

The Commission focuses its analysis on cost arising from minimum capital requirement, due to data availability. As discussed above, this proposal would prescribe capital requirements for SDs and MSPs, and proposed amendments to existing capital rules for FCMs would prescribe capital requirement for FCMs that are also registered as SDs and increase capital requirement for FCMs to account for risk arising from their swaps and security-based swaps. The Commission first discusses cost at the entity level, and then quantifies cost at the industry level using SDR data.

As of Nov. 9, 2016, there are approximately 104 SDs and no MSPs provisionally registered with the Commission. The Commission estimates that out of the 104 provisionally registered SDs, 15 U.S. Prudential Regulated Registrants SDs are exempt from the Commission's capital requirement; 36 SDs which are Non-U.S. Registrants Overseen by the FRB are also exempt from the Commission's capital requirement. For the rest 53 provisionally registered SDs, eight SDs are currently also registered with the Commission as FCMs, while the other 45 SDs currently are not FCMs.<sup>164</sup>

**Discussing Capital Requirement Cost at Entity Level**

The Commission collects monthly financial and capital information from FCMs. There are currently eight SDs which are also registered as FCMs. The Commission proposed following amendments to existing FCM capital rule to increase capital requirement to account for risk arising from swaps.

**TABLE 1—MINIMUM CAPITAL REQUIREMENT FOR SDs THAT ARE ALSO FCMs**

|                                 | Tentative net capital  |                        | Adjusted net capital                            |  |
|---------------------------------|------------------------|------------------------|---|--|
|                                 | Fixed dollar (million) | Fixed dollar (million) | Financial ratio                                 |  |
| FCM SD (not using models) ..... | N/A                    | \$20                   | 8% of risk margin plus "uncleared swap margin". |  |
| FCM SD (using models) .....     | \$100                  | \$20                   | 8% of risk margin plus "uncleared swap margin". |  |

The Commission expects most if not all entities would use models. For the purpose of discussing cost of complying with these proposed minimum capital

requirements, the Commission further separates these SDs that are also FCMs into two categories: SDs that are also SEC registered ANC firms, and FCMs

that are not ANC firms registered with the SEC.

**1. SDs That Are FCMs and ANC Firms With the SEC**

**TABLE 2—CAPITAL FOR SDs THAT ARE ALSO FCMs AND ANC FIRMS AS OF APRIL 30, 2016**

| Name of swap dealers               | Registered as | Adjusted net capital | Net capital requirement | Excess net capital |
|------------------------------------|---------------|----------------------|-------------------------|--------------------|
| CITIGROUP GLOBAL MARKETS INC ..... | FCM BD SD     | 7,378,708,335        | 1,449,570,569           | 5,929,137,766      |
| GOLDMAN SACHS & CO .....           | FCM BD SD     | 16,978,669,484       | 2,553,867,535           | 14,424,801,949     |
| JP MORGAN SECURITIES LLC .....     | FCM BD SD     | 13,539,160,236       | 2,542,050,203           | 10,997,110,033     |
| MORGAN STANLEY & CO LLC .....      | FCM BD SD     | 10,906,187,328       | 1,818,426,660           | 9,087,760,668      |

Source: FCM financial data as of April 30, 2016.

The Commission estimates that four SDs are already registered as ANC broker-dealers with SEC. ANC firms registered with the SEC are currently required to maintain a minimum of five billion dollars of tentative net capital and a minimum of one billion dollars of net capital. In addition, all ANC firms

use models for risk charge computations. These required minimum capital for ANC firms by the SEC are much higher than the proposed minimum capital requirement by the Commission, thus are more likely the binding constraints for these firms. Based on financial information reported

by these SDs in their monthly reports filed with the Commission, these four SDs maintain a significant amount of net capital in excess of SEC's requirement and the Commission's proposal. Therefore, the Commission expects that incremental costs from this

<sup>164</sup> CAs of Nov. 9, 2016, one SD has filed a request with the Commission to withdraw its SD registration.

proposed capital requirement may not be significant for these firms.  
 2. SDs That Are FCMs but Currently Are Not ANC Firms Registered With SEC

The Commission estimates that there are four SDs in this category with one SD withdrawn pending. Based on the FCM Financial data provided to the

Commission, three SDs currently have excess net capital ranging from \$26.4 million to \$312 million.<sup>165</sup> The Commission expects that smaller SDs with less than 100 million adjusted net capital might need to raise additional capital and might incur significant cost to comply with this proposal. The Commission would like to request

comments on (1) how much capital these SDs might need to raise? (2) Is it feasible for these SDs to raise capital? (3) If these SDs would raise capital through retained earnings, what would be the estimated ratio of required capital as percent of their current retained earnings?

TABLE 3—CAPITAL FOR SDs THAT ARE FCMs BUT NOT ANC FIRMS AS OF APRIL 30, 2016

| Name of swap dealers            | Registered as | Adjusted net capital | Net capital requirement | Excess net capital |
|---------------------------------|---------------|----------------------|-------------------------|--------------------|
| FOREX CAPITAL MARKETS LLC ..... | FCMRFD SD     | 58,264,892           | 31,858,770              | 26,406,122         |
| MIZUHO SECURITIES USA INC ..... | FCM BD SD     | 575,181,123          | 263,266,797             | 311,914,326        |
| RJ OBRIEN ASSOCIATES LLC .....  | FCM SD        | 209,084,814          | 138,749,913             | 70,334,901         |
| IBFX INC * .....                |               |                      |                         |                    |

IBFX INC \* withdrawn pending.  
 Source: FCM financial data as of April 30, 2016.

For SDs that are not FCMs, the Commission prescribes following minimum capital requirements depending whether SDs use models to compute credit and market risk charges and whether SDs are financial entities

or commercial entities. In addition, the Commission proposes positive tangible net worth requirement for MSPs. The Commission expects that most, if not all, stand-alone SDs would use models. For the purpose of discussing the cost

of complying with minimum capital requirement, the Commission separates stand-alone SDs into following categories.

TABLE 4—MINIMUM CAPITAL REQUIREMENT FOR STAND-ALONE SDs/MSPs

| Type of registrant   | Net liquid asset approach  |                        |                                   | Bank-based capital approach |                                   |                            | Tangible net worth approach                                  |                                   |
|--|--|------------------------|-----------------------------------|-----------------------------|-----------------------------------|----------------------------|--|-----------------------------------|
|  | Tentative net capital  | Adjusted net capital   |                                   | Common equity tier 1        |                                   |                            | Tangible net worth   |                                   |
|  |  | Fixed dollar (million) | Fixed dollar (million)            | Financial ratio             | Fixed dollar (million)            | Financial ratios           |  | Fixed dollar                      |
| U.S. SD (Financial Entity not using internal models).        | N/A  | \$20                   | 8% of the total amount of margin. | \$20                        | 8% of the total amount of margin. | 8% of risk weighted asset. | N/A .....  | N/A.                              |
| U.S. SD (Financial Entity using internal models).            | \$100  | \$20                   | 8% of the total amount of margin. | \$20                        | 8% of the total amount of margin. | 8% of risk weighted asset. | N/A .....  | N/A.                              |
| U.S. SD (Not predominantly engaged in financial activities). | N/A  | N/A                    | N/A .....                         | N/A                         | N/A .....                         | N/A .....                  | \$20 million plus credit risk charge and market risk charge. | 8% of the total amount of margin. |
| U.S. MSP .....   | N/A  | N/A                    | N/A .....                         | N/A                         | N/A .....                         | N/A .....                  | Positive .....   | N/A.                              |
| Non-U.S. SDs .....   | Substituted Compliance Eligible, Capital Comparability Determination Required. |                        |                                   |                             |                                   |                            |  |                                   |

3. Nonbank Subsidiaries of U.S. Bank Holding Companies (BHCs)

The Commission estimates that 12 SDs are nonbank subsidiaries of U.S. BHC. These SDs currently do not have any capital requirement, and the proposed capital requirement may increase cost to these SDs as it may have to retain earnings to capitalize to the required level. However, their parents are currently subject to Federal Reserve's capital requirements on a consolidated basis, including U.S. Basel III capital requirement and also are

participants of the Comprehensive Capital Analysis and Review (CCAR) and Dodd-Frank Act Stress Test (DFAST). CCAR evaluates the capital planning process and capital adequacy of the largest U.S.-based BHCs, including the firms' planned capital actions. The Dodd-Frank Act stress tests are a forward-looking component to help assess whether firms have sufficient capital to absorb losses and have the ability to lend to households and businesses even in times of financial and economic stress. The

parent BHCs of these nonbank SDs below are well capitalized due to these requirements, as indicated by their common equity tier 1 capital ratio at consolidated level is much higher than eight percent in the table below. Therefore, the additional cost from the Commission's proposed capital requirement may not be significant, as it may be possible for the consolidated entity to keep the same level of capital within the BHC, but just reallocate among its subsidiaries. In addition, the Commission recognizes that earnings

<sup>165</sup> Selected FCM Financial Data as of April 30, 2016. [http://www.cftc.gov/idc/groups/public/@](http://www.cftc.gov/idc/groups/public/@financialdataforfcms/documents/file/fcmdata0416.pdf)

[financialdataforfcms/documents/file/fcmdata0416.pdf](http://www.cftc.gov/idc/groups/public/@financialdataforfcms/documents/file/fcmdata0416.pdf).

will now have to retain in the SD and will no longer be available to be reallocated to fund other more profitable activities within the consolidated group or to be returned to shareholders. The Commission understands that capital is not additive, *i.e.*, the sum of capital at

individual subsidiary level may be more than the amount of capital required at the parent level for all its subsidiaries, due to the loss of netting benefits. The Commission requests comments on whether it is reasonable to assume that SDs would be able to comply with the

proposal while consolidated group of these SDs would not be able to keep the current level of capital. If not, please provide specific comments and estimates the additional cost of complying with the proposal.

TABLE 5—SD’S PARENT BHC’S COMMON EQUITY TIER 1 CAPITAL RATIO AS OF FIRST QUARTER 2016

| Name of swap dealers                                     | Common equity tier 1 capital ratio of parent BHC | SEC registered BD |
|--|--|-------------------|
| CITIGROUP ENERGY INC .....                               | Citigroup Inc. 12.3% <sup>166</sup> .....        | N                 |
| GOLDMAN SACHS FINANCIAL MARKETS LP .....                 | Goldman Sachs 13.4% <sup>167</sup> .....         | Y                 |
| GOLDMAN SACHS MITSUI MARINE DERIVATIVE PRODUCTS LP ..... | Goldman Sachs 13.4% .....                        | N                 |
| J ARON & COMPANY .....                                   | Goldman Sachs 13.4% .....                        | N                 |
| JP MORGAN VENTURES ENERGY CORPORATION .....              | JP Morgan Chase & Co. 11.7% <sup>168</sup> ..... | N                 |
| MERRILL LYNCH CAPITAL SERVICES INC .....                 | Bank of America 11% <sup>169</sup> .....         | N                 |
| MERRILL LYNCH COMMODITIES INC .....                      | Bank of America 11% .....                        | N                 |
| MERRILL LYNCH FINANCIAL MARKETS INC .....                | Bank of America 11% .....                        | Y                 |
| MORGAN STANLEY CAPITAL GROUP INC .....                   | Morgan Stanley 14.5% <sup>170</sup> .....        | N                 |
| MORGAN STANLEY CAPITAL SERVICES LLC .....                | Morgan Stanley 14.5% .....                       | N                 |
| MORGAN STANLEY DERIVATIVE PRODUCTS INC .....             | Morgan Stanley 14.5% .....                       | N                 |
| MORGAN STANLEY CAPITAL PRODUCTS LLC .....                | Morgan Stanley 14.5% .....                       | N                 |

As discussed above, the Commission expects all SDs would use models to calculate market risk and credit risk charges. Their parents BHCs most likely are already using their risk models to calculate capital for the positions of these wholly owned subsidiaries (including uncleared swaps) to measure the credit and market risk exposures of these positions.

4. U.S. SDs That Are Not Part of U.S. BHCs

The Commission estimates that there are 15 U.S. SDs not part of U.S. BHCs. These SDs currently do not have any capital requirement. However, out of these 15 SDs, six SDs are subsidiaries of foreign BHCs or a foreign financial holding company (FHC) which already comply with Basel III risk-based capital requirements and having common equity tier 1 capital ratio at consolidated level exceeding eight percent. Specifically, two SDs are wholly-owned

subsidiaries of Japanese BHCs, two SDs are subsidiaries of a Japanese Financial Holding Company, one SD is subsidiary of Netherlands BHC, and one SD is subsidiary of Australian investment bank. For the 9 SDs that are not subsidiaries of foreign holding companies that comply with Basel III, six SDs are part of groups that are subject to the CFTC’s or the SEC’s net capital requirements. Specifically, four SDs are subsidiaries of FCMs, and two SDs are also SEC registered BDs. These SDs’ consolidated group has excess net capital ranging from \$14.8 million to \$1.2 billion.<sup>171</sup> As it is possible for the consolidated entity to keep the same level of capital within the group, but just reallocate among its subsidiaries, the additional cost of complying with the Commission’s proposed capital requirement may not be too burdensome. However, for those SDs or their consolidated groups that currently have smaller amount of excess net

capital, they might need to raise additional capital and thus might incur significant cost to comply with this proposal. The Commission would like to request comments on (1) how much capital these SDs might need to raise? (2) Is it feasible for these SDs to raise capital? (3) If these SDs would raise capital through retained earnings, what would be the estimated ratio of required capital as percent of their current retained earnings?

The Commission estimates that three SDs do not belong to consolidated entities that have excess capital (either common equity tier 1 or net capital). The Commission, therefore, expects that these three SDs may incur significant additional costs to comply with this proposal and maintain their current business model. However, the Commission does not have data to precisely estimate the possible capital costs for these three SDs.

TABLE 6—CURRENT CAPITAL REQUIREMENT (COMMON EQUITY TIER 1 CAPITAL RATIO OR EXCESS NET CAPITAL) AT THE SD OR ITS PARENT LEVEL

| Name of swap dealers | Common equity tier 1 capital ratio at parent level | Excess net capital at entity or its parent level | SEC registered BD |
|----------------------|--|--|-------------------|
| BTIG LLC .....       | .....  | <sup>172</sup> 50,043,660                        | Y                 |
| GAIN GTX LLC .....   | .....  | <sup>173</sup> 14,821,951                        | N                 |

<sup>166</sup> <http://www.citigroup.com/citi/investor/data/ger116.pdf?ieNocache=23>.

<sup>167</sup> <http://www.goldmansachs.com/investor-relations/creditor-information/creditor-Website-presentation.pdf>

<sup>168</sup> [https://www.jpmorgan Chase.com/corporate/investor-relations/document/1Q16\\_Earnings\\_Presentation.pdf](https://www.jpmorgan Chase.com/corporate/investor-relations/document/1Q16_Earnings_Presentation.pdf)

<sup>169</sup> [http://investor.bankofamerica.com/phoenix.zhtml?c=71595&p=quarterly\\_earnings#fbid=ECX9ZgSZ-Oq](http://investor.bankofamerica.com/phoenix.zhtml?c=71595&p=quarterly_earnings#fbid=ECX9ZgSZ-Oq).

<sup>170</sup> <https://www.morganstanley.com/about-us-ir/shareholder/1q2016.pdf>.

<sup>171</sup> Selected FCM Financial Data as of April 30, 2016. <http://www.cftc.gov/idc/groups/public/@financialdataforfcm/documents/file/fcmdata0416.pdf>.

TABLE 6—CURRENT CAPITAL REQUIREMENT (COMMON EQUITY TIER 1 CAPITAL RATIO OR EXCESS NET CAPITAL) AT THE SD OR ITS PARENT LEVEL—Continued

| Name of swap dealers                   | Common equity tier 1 capital ratio at parent level | Excess net capital at entity or its parent level | SEC registered BD |
|--|--|--|-------------------|
| ING CAPITAL MARKETS LLC <sup>174</sup> | ING bank—11.6% <sup>175</sup>                      |  | N                 |
| INTL FCSTONE MARKETS LLC               |  | 60,582,006                                       | Y                 |
| JEFFERIES FINANCIAL PRODUCTS LLC       |  | <sup>176</sup> 1,204,270,344                     | N                 |
| MACQUARIE ENERGY LLC                   | Macquarie Bank—9.9% <sup>177</sup>                 |  | N                 |
| MIZUHO CAPITAL MARKETS CORPORATION     | Mizuho Financial Group—10.5% <sup>178</sup>        |  | N                 |
| NOMURA DERIVATIVE PRODUCTS INC         | Nomura Holdings, Inc.—15.1%                        |  | N                 |
| NOMURA GLOBAL FINANCIAL PRODUCTS INC   | Nomura Holdings, Inc.—15.1%                        |  | Y                 |
| SMBC CAPITAL MARKETS INC               | SMFG—11.81% <sup>179</sup>                         |  | N                 |
| JEFFERIES FINANCIAL SERVICES INC       |  | 1,204,270,344                                    | N                 |
| CANTOR FITZGERALD SECURITIES           |  | <sup>180</sup> 232,219,010                       | N                 |
| SHELL TRADING RISK MANAGEMENT LLC      |  |  | N                 |
| BP ENERGY COMPANY                      |  |  | N                 |
| CITADEL SECURITIES SWAP DEALER LLC     |  |  | N                 |

5. Non-Financial/Commercial SDs

This proposal would require Non-Financial/Commercial SDs to maintain tangible net worth in an amount equal to or in excess of the minimum capital level (\$20 million plus market risk charges and credit risk charges). Currently there is no capital requirement for commercial SDs. The Commission estimates that currently only one SD would be in this category, and believes that its tangible net worth greatly exceeds the Commission’s proposed requirement.<sup>181</sup> Therefore, the costs of this proposal are not expected to be material because it is not expected that this firm would have to alter its existing business practice in any substantial way to comply with minimum tangible net worth requirement.

6. Non-U.S. SDs Not Subject to a Prudential Regulator

The Commission is proposing to allow a “substituted compliance”

program for capital requirements for SDs that are: (1) Not organized under the laws of the U.S., and (2) not domiciled in the U.S. The Commission estimates that there are 17 non-U.S. provisionally registered SDs not subject to U.S. prudential regulators that would be eligible to apply for substituted compliance. Out of these 18 non-U.S. SDs, approximately 10 SDs are domiciled in the U.K., three SDs are domiciled in Japan, two SDs are domiciled in Mexico, one SD is domiciled in Singapore, and one SD is domiciled in Australia. The Commission would permit these non-U.S. SDs (or regulatory authorities in the non-U.S. SD’s home country jurisdictions) to petition the Commission to satisfy the Commission’s capital requirements through a program of substituted compliance with the SD’s home country capital requirements. U.K., Japan, Mexico, Singapore, and Australia are members of Basel Committee on Banking Supervision and

have adopted Basel III risk-based capital.<sup>182</sup> Thus, the Commission does not expect significant additional cost arising from this proposal for these entities.

Estimated Capital Requirement for IRS Positions of the SDs Subject to the Commission’s Capital Requirement

The Commission focuses its analysis on IRS as it covers the majority of swaps’ notional reported to SDRs. Table below shows that IRS positions reported to SDR on June 24, 2016 account for about \$312 trillion. Cleared IRS positions are roughly \$165 trillion, accounting for 53% of all IRS positions; while uncleared IRS positions are roughly \$147 trillion, accounting for the rest 47%. Of the \$147 trillion uncleared IRS positions, the Commission estimates that about 39% are inter-affiliate swaps<sup>183</sup> and 61% are outward-facing swaps.

TABLE 7—GROSS NOTIONAL OF IRS BILLION \$ REPORTED TO SDR ON POSITIONS [June 24, 2016]

|                               | Uncleared | Cleared | Total   |
|-------------------------------|-----------|---------|---------|
| Outward-facing <sup>184</sup> | 90,117    | 164,646 | 254,763 |

<sup>172</sup> <https://www.sec.gov/Archives/edgar/vpr/1600/16001826.pdf>.

<sup>173</sup> GAIN GTX LLC is a wholly owned subsidiary of GAIN Capital Holdings, Inc., a global provider of online trading services. GAIN Capital Group LLC (a CFTC registered FCM and RFD) is also subsidiary of GAIN Capital Holdings, Inc. and has excess net capital of 14,821,951.

<sup>174</sup> ING Bank was designated by the Basel Committee and the FSB as one of the global systemically important banks ‘G-SIBs’ and by the Dutch Central Bank and the Dutch Ministry of Finance as a domestic SIFI. See “ING Group Annual Report on Form 20-F 2015”.

<sup>175</sup> <http://www.ing.com/About-us/Profile-Fast-facts/Fast-facts.htm>.

<sup>176</sup> Excess net capital of Jefferies LLC, parent of Jefferies Derivative Products LLC, Jefferies Financial Products LLC, and Jefferies Financial Services LLC.

<sup>177</sup> <http://www.macquarie.com/us/about/newsroom/2015/agm-2015>.

<sup>178</sup> <http://www.mizuho-fg.co.jp/english/faq/kessan.html>.

<sup>179</sup> [http://www.smfg.co.jp/english/investor/financial/latest\\_statement/2016\\_3/h2803\\_e1\\_01.pdf](http://www.smfg.co.jp/english/investor/financial/latest_statement/2016_3/h2803_e1_01.pdf).

<sup>180</sup> Excess net capital at Cantor Fitzgerald & CO. (FCM and Broker-Dealer), which is owned by Cantor Fitzgerald Securities (94% ownership).

<sup>181</sup> <http://www.cargill.com/company/financial/five-year/index.jsp>.

<sup>182</sup> <http://www.bis.org/bcbs/publ/d338.pdf>.

<sup>183</sup> An inter-affiliate swap is identified if the ultimate parent of both counterparties is the same entity, using the Commission’s internal legal entity hierarchy database.

<sup>184</sup> These numbers are roughly the same numbers of CFTC Weekly Swap Report posted on <http://www.cftc.gov/MarketReports/SwapsReports/L1GrossExpCS>. The small discrepancies may be due to the fact that the table above is generated using the new automated weekly swaps report process.

TABLE 7—GROSS NOTIONAL OF IRS BILLION \$ REPORTED TO SDR ON POSITIONS—Continued  
[June 24, 2016]

|                       | Uncleared | Cleared | Total   |
|-----------------------|-----------|---------|---------|
| Inter-affiliate ..... | 57,222    | 2       | 57,224  |
| Total .....           | 147,339   | 164,648 | 311,987 |

For the purpose of capital estimates, we double the notional amounts listed above since both counterparties to a swap position may be subject to the capital rules and therefore need to hold capital. Table below shows that of roughly \$295 trillion uncleared IRS position on June 24, 2016 (double counting \$147 trillion of uncleared notional), the Commission estimates that about 46% of uncleared swaps are held by SDs that are subject to the prudential regulators' capital requirement and, therefore, are exempt from this proposal, 30% of uncleared swaps are held by SDs that are subject to the Commission's capital requirement, while the rest 24% are held by institutions not subject to prudential regulators or the Commission's capital requirement.<sup>185</sup> About 88 trillion of uncleared IRS positions (with double counting) are held by SDs subject to the Commission's

capital requirement. Of the 88 trillion uncleared IRS swap positions (double counting), 38% are outward-facing swaps while 62% are inter-affiliate swaps. The Commission assumes that these uncleared swaps will require margin of about 0.2% to two percent of gross notional amount.<sup>186</sup> The upper bound two percent margin rate based on average of table-based approach and is a conservative assumption because margin estimates from models tend to be on a much lower side. The initial margin amount required for these uncleared swaps (including inter-affiliate swaps) is 177 billion to 1.77 trillion. Assuming capital required is eight percent of margin amount, the capital required for the uncleared swaps held by SDs subject to CFTC's capital requirement would range from \$14 billion to \$140 billion. The Commission believes that most institutions, if not all institutions, will use models to calculate

initial margin amount. If that is the case, the estimated capital required may be close to the lower bound of \$14 billion. This estimated capital required here assumes that covered SDs currently do not hold capital for these swap positions. This is also a conservative assumption, because many SDs or their parent entities may already be holding capital against these uncleared swap positions. The Commission estimates that SDs may have significant amount of excess capital and in the case that SDs do not hold capital themselves, their parents may hold significant amount of excess capital. It may be possible for the consolidated entity (their parents) to keep the same level of capital within the group, but just reallocate among its subsidiaries and therefore, the additional cost of complying with the Commission's proposed capital requirement may not be too burdensome.

TABLE 8—GROSS NOTIONAL OF UNCLEARED IRS POSITIONS (BILLION \$) REPORTED TO SDR ON JUNE 24, 2016  
[Double counting as both Counterparties may need to hold capital]

| Gross notional in billion \$ for uncleared IRS position<br>(double counting) | Outward-facing | Inter-affiliate | Total   |
|--|----------------|-----------------|---------|
| Held by SDs subject to CFTC capital requirement .....                        | 33,627         | 54,742          | 88,369  |
| Held by SDs subject to Prudential Regulator (PR)'s capital requirement ..... | 89,062         | 46,689          | 135,751 |
| Held by institutions not subject to CFTC or PR capital requirement .....     | 57,546         | 13,013          | 70,558  |
| Total .....  | 180,234        | 114,443         | 294,677 |

The table below shows that of \$329 trillion cleared IRS position on June 24, 2016 (double counting \$216 trillion as both counterparties may need to hold capital against the same position), the Commission estimates that about 31% of cleared swaps are held by SDs that are already subject to prudential regulators' capital requirement and exempt from this proposal, nine percent of cleared swaps are held by SDs that are subject to the Commission's capital requirement, while the remaining 60% are held by institutions not subject to prudential regulators or the Commission's capital requirement.

Roughly \$29 trillion of outward-facing cleared IRS positions (with double counting) are held by SDs subject to the Commission's capital requirement. The Commission assumes that cleared swaps requires margin of about 0.14% (which is,  $0.2\%/\sqrt{2}$ ) to 1.4% ( $2\%/\sqrt{2}$ ) of gross notional, because margin period of risk is five days for cleared swaps compared to ten days for uncleared swaps. The initial margin required for cleared swaps held by SDs subject to CFTC requirement is about 40 billion to 400.6 billion. Assuming capital required is eight percent of initial margin, the capital required for the cleared swaps

held by SDs subject to CFTC's proposed capital requirement is about \$4.84 billion to \$48.4 billion. As discussed earlier, estimated capital required for covered SDs is most likely to be close to the lower bound of \$4.84 billion. Therefore, the total capital required for both cleared and uncleared IRS positions held by SDs subject to the Commission's proposed rule would range from \$18.84 billion to \$188.4 billion. As discussed earlier, the estimated capital for IRS swaps held by SDs subject to the Commission's requirement is most likely to be \$18.84 billion. As discussed earlier, many SDs

<sup>185</sup> These estimates are based on SDs registered with Commission on June 24, 2016. Since then, three SDs withdrew their registration with the Commission.

<sup>186</sup> The upper bound 2% is based on standardized approach, while the lower bound 0.2% is based on surveys that show model-based margin numbers

could be as low as 10% of standardized margin requirement.



already hold significant amount of excess capital. In the case that SDs do not hold capital themselves, their parents hold significant amount of

excess capital. It may be possible for the consolidated entity to keep the same level of capital within the group, but just reallocate among its subsidiaries

and therefore, the additional cost of complying with the Commission's proposed capital requirement may not be too burdensome.

TABLE 9—GROSS NOTIONAL OF CLEARED IRS POSITIONS (BILLION \$) REPORTED TO SDR ON JUNE 24, 2016

[Double counting as both Counterparties may need to hold capital]

| Gross notional in billion \$ for uncleared IRS position (double counting)    | Outward-facing | Inter-affiliate | Total          |
|--|----------------|-----------------|----------------|
| Held by SDs subject to CFTC capital requirement .....                        | 28,612         | 0               | 28,612         |
| Held by SDs subject to Prudential Regulator (PR)'s capital requirement ..... | 102,221        | 0               | 102,221        |
| Held by institutions not subject to CFTC or PR capital requirement .....     | 198,458        | 5               | 198,463        |
| <b>Total .....</b>   | <b>329,291</b> | <b>5</b>        | <b>329,296</b> |

Request for Comment

The Commission does not have sufficient financial information about these SDs to estimate precise costs of these proposed requirements and would welcome comments on how the proposed rule would impact the capital structure and the cost of doing business.

1. Would the minimum capital requirements represent a barrier to entry to firms that may otherwise seek to trade swaps as SDs? If so, which types of firms would be foreclosed?

2. Is it correct to assume that firms part of U.S. BHCs that are subject to Basel III and stress testing requirements would be readily able to meet the proposed capital requirement?

3. Is it correct to assume that ANC firms would be readily able to meet the proposed capital requirement?

4. Is it correct to assume that it would not be too costly for firms or their parents already subject to SEC current BD and/or proposed SBSD capital requirement or CFTC's current FCM capital requirement to comply with the capital requirement?

5. Is it correct to assume that proposed capital requirements would not be too burdensome for firms that are part of foreign BHCs subject to Basel?

6. Would it be too costly for the smaller SDs and SDs that are not subject to Basel or SEC or CFTC capital requirements to comply?

7. What restrictions would smaller firms be willing to accept for a lower capital requirement?

8. What alternative capital requirements might achieve the same policy goal?

ii. Margin vs. Capital

The Commission's proposal also would require an SD to include the initial margin for all swaps that would otherwise fall below the \$50 million initial margin threshold amount or the \$500,000 minimum transfer amount, as defined in Regulation 23.151, for

purposes of computing the uncleared swap margin amount. As such, the uncleared swap margin amount would be the amount that an SD would have to collect from a counterparty, assuming that the exclusions and exemptions for collecting initial margin for uncleared swaps set forth in Regulations 23.150–161 would not apply, and also assuming that the thresholds under which initial margin and/or variation margin would not need to be exchanged would not apply. Accordingly, swaps that are not subject to the margin requirement such as those executed prior to the compliance date for margin requirements ("legacy swaps"), inter-affiliate swaps, and swaps with counterparties that would qualify for the exception or exemption under section 2(h)(7)(A) would have to be taken into account in determining the capital requirement.

The Commission is proposing this approach as it believes that it would be appropriate to require an SD to maintain capital for uncollateralized swap exposures to counterparties to cover the "residual" risk of a counterparty's uncleared swaps positions. The Commission's proposed approach regarding the inclusion of uncollateralized swap exposures in the SD's capital requirements is consistent with the approach adopted by the prudential regulators in setting capital requirements for SDs subject to their jurisdiction and is consistent with the approach proposed by the SEC for SBSDs.

The Commission provides certain exemptions from initial margin requirements for uncleared trades between affiliates. However, for the proposed capital rule inter-affiliate swaps would require capital to be held against them. The Commission requests comments on how the proposed capital rule would impact the competitiveness between different SDs based on the legal entity structure of the firm. The

Commission understands that SDs may have different organizational structures due to various reasons. These reasons include, among others, centralized risk management for consolidation of balance-sheet, asset-liability and liquidity risk management; taxation benefits; funds transfer pricing; merger and acquisition; and subsidiaries in different jurisdictions. An arms-length swap may be offset by swap transaction with an affiliated SD because of any of the reasons listed above and possibly others. Centralization of risk within different entities of a firm in the same jurisdiction provides risk reduction benefits somewhat similar to the CCP and is encouraged.

As per the proposed rule, both parties to a swap transaction may be required to hold capital even if they both are part of the same parent institution. In that sense, there may be double (or more) counting of capital at the parent level for a given outward facing swap based on the legal structure of the entity. This may lead to an uneven playing field between SDs if for a given swap, different swap dealers are required to hold different amount of capital based on the number of inter-affiliate trades that they execute for the same client facing trade.

iii. Model vs. Table

The proposal would allow an SD to apply to the Commission or an RFA of which it is a member for approval to use internal models when calculating its market risk exposure and credit risk exposure. The proposal would also allow an FCM that is also an SD to apply in writing to the Commission or an RFA of which it is a member for approval to compute deductions for market risk and credit risk using internal models in lieu of the standardized deductions otherwise required.

As discussed above, there are approximately 107 SDs and no MSPs provisionally registered with the

Commission. Of these, the Commission estimates that approximately 55 SDs and no MSPs would be subject to the Commission’s capital rules as they are not subject to those of a prudential regulator. The Commission further estimates conservatively that most of these SDs and MSPs would seek to obtain Commission approval to use models for computing their market and credit risk capital charges. These entities would incur cost to develop, maintain, document, audit models, and seek model approval. The possibility of using models to calculate credit risk and market risk charges may allow SDs to more efficiently deploy capital in other parts of its operations, because models could reduce capital charges and thereby could make additional capital available. This reduced capital requirement due to model use could improve returns of SDs and make them more competitive.

Although the Commission expects that SDs would use models for calculating market risk and credit risk charges, it is possible that some entities, particularly potential new entrants, may not have the risk management capabilities of which the models are an integral part, and, therefore, have to rely on the standardized haircut approach.

The benefit of the standardized haircut approach for measuring market risk is its inherent simplicity. Therefore, this approach may improve customer protections and reduce systemic risk. In addition, a standardized haircut approach may reduce costs for the SD related to the risk of failing to observe or correct a problem with the use of models that could adversely impact the firm’s financial conditions, because the use of models would require the allocation by the SD of additional firm resources and personnel. Conversely, if the proposed standardized haircuts are too conservative, they could make conducting swap business too costly, preventing or impairing the ability of the firms to engage in swaps, increasing transaction costs, reducing liquidity, and reducing the availability of swaps for risk mitigation by end users.

Request for Comment

Does the proposed capital requirement reflect the increased risk associated with the use of models and trading in a portfolio of swaps?

*iv. Liquidity Requirement and Equity Withdrawal Restrictions*

The Commission proposes additional liquidity requirements and equity withdrawal restrictions on certain

eligible SDs. For SDs that elect a bank-based capital approach, the Commission is proposing to require the SD to maintain each day an amount of high quality liquid assets (“HQLAs”), that is no less than 100 percent of the SDs total net cash outflows over a prospective 30 calendar-day period. The HQLAs could be converted quickly into cash without reasonably expecting to incur losses in excess of the applicable haircuts during a stress period. Total net cash outflow amount are calculated by applying outflow and inflow rates, which reflect certain standardized stressed assumptions, against the balances of an SD’s funding sources, obligations, transactions, and assets over a prospective 30 day period.

For SDs that elect a net liquid assets capital approach, the Commission is proposing a liquidity stress test to be conducted by SDs that elect a net liquid assets capital approach at least monthly that takes into account certain assumed stressed conditions lasting for 30 consecutive days. The proposed minimum elements are designed to ensure that SDs employ a stress test that is severe enough to produce an estimate of a potential funding loss of a magnitude that might be expected in a severely stressed market.

TABLE 10—MINIMUM LIQUIDITY REQUIREMENT

|   | Liquidity reserve requirement  | Contingency funding plan                                  | Risk management  | Transferring approval  |
|---|--|---|--|--|
| SDs that elect a bank-based capital approach.       | Liquidity Coverage Ratio (LCR) $\geq 1$ ; HQLAs $\geq$ total net cash outflows over a prospective 30 calendar-day period.  | Strategies to address liquidity shortfalls in emergency.  | Review LCR quarterly by senior management overseeing risk management, annually by senior management. | Approval prior to transferring HQLAs if, after transferring, LCR $< 1$ . |
| SDs that elect a net liquid asset capital approach. | Liquidity Stress Test; Unencumbered cash + U.S. government securities $\geq$ a potential funding loss of a magnitude that might be expected in a severely stressed market for 30 consecutive days. | Strategies to address liquidity shortfalls in emergency.. | .....  |  |
| SDs that elect a tangible net worth approach.       | None   |   | .....  |  |

The benefit of the proposed liquidity requirement is an additional level of protection against disruptions in the ability to obtain funding for a firm. This requirement intends to increase the likelihood that a firm could withstand a general loss of confidence in the firm itself, or the markets more generally and stay solvent for up to 30 days, during which time it could either regain the ability to obtain funding in the ordinary

course or else better position itself for resolution, with less impact on other market participants and the financial system. Therefore, this requirement may reduce the likelihood and severity of a fire sale and thus mitigate spillover effects and lower systemic risk. This, in turn, may increase confidence in swap markets and may lead to an increase in the use of swaps.

However, this requirement would impose additional cost of capital and other costs directly related to the amount of the required liquidity reserve because an SD would be unable to deploy the assets that are maintained for the liquidity reserve in other, potentially more profitable ways. In addition, some firms may incur more implementation costs, because, firms (or their parent holding companies) that are

already complying with Basel III or SEC's liquidity requirements may already run stress tests, maintain liquidity reserves based on those tests, and/or have a written contingency funding plan.

#### Request for Comment

How much additional cost would SDs incur resulting from the proposed liquidity requirements given their current practice? The Commission requests that commenters quantify the extent of the additional cost the proposed minimum liquidity requirement would incur based on its portfolios and financials, and provide the Commission with such data. The Commission also requests comments on alternative approaches to liquidity requirements to achieve the same policy goal.

#### v. Other Considerations

The proposed requirements should reduce the risk of a failure of any major market participant in the swap market, which in turn reduces the possibility of a general market failure, and thus promotes confidence for market participants to transact in swaps for investment and hedging purposes. The proposed capital requirements are designed to promote confidence in SDs among customers, counterparties, and the entities that provide financing to SDs, thereby, lessen the potential that these market participants may seek to rapidly withdraw assets and financing from SDs during a time of market stress. This heightened confidence is expected to increase swap transactions and promote competition among dealers. A more competitive swap market may promote a more efficient capital allocation.

However, to the extent that costs associated with the proposed rules are high, they may negatively affect competition within the swap markets. This may, for example, lead smaller dealers or entities for whom dealing is not a core business to exit the market because compliance with the proposed minimum capital, liquidity, and reporting requirements is not feasible due to its cost. The same costs might also deter the entry of new SDs into the market, and if sufficiently high, increase concentration among SDs.

The proposals ultimately adopted could have a substantial impact on domestic and international commerce and the relative competitive position of SDs operating under different requirements of various jurisdictions. Specifically, SDs subject to a particular regulatory regime may be advantaged or disadvantaged if corresponding

requirements in other regimes are substantially more or less stringent. This could affect the ability of U.S. SDs to compete in the domestic and global markets, the ability of non-U.S. to compete in U.S. markets. Substantial differences between the U.S. and foreign jurisdictions in the costs of complying with these requirements for swaps between U.S. and foreign jurisdictions could reduce cross-border capital flows and hinder the ability of global firms to most efficiently allocate capital among legal entities to meet the demands of their customers/counterparties.

The willingness of end users to trade with an SD dealer will depend on their evaluation of the counterparty credit risks of trading with that particular SD compared to alternative SDs, and their ability to negotiate favorable price and other terms. The proposed capital, liquidity, and risk management requirements would in general reduce the likelihood of SDs' defaulting or failing, and therefore may increase the willingness of end users to trade with more SDs that have strong capital and liquidity reserves. End users of covered swaps are mostly made up of sophisticated participants such as hedge fund, asset management, other financial firms, and large commercial corporations. Many of these entities trade substantial volume of swaps and are relatively well-positioned to negotiate price and other terms with competing dealers. To the extent that the proposals result in increased competition, participants should be able to take advantage of this increased competition and negotiate improved terms. On the other hand, SDs may pass on additional capital, liquidity, and operational costs resulting from the proposal to end users in the form of higher fees or wider spreads. Thus end users may experience increased cost of using swaps for hedging and investing purposes.

In addition, benefits may arise when SDs consolidate with other affiliated SDs, FCMs, and/or broker-dealers. This may yield efficiencies for clients conducting business in swaps, including netting benefits, reduced number of account relationships, and reduced number of governing agreements. These potential benefits, however, may be offset by reduced competition from a smaller number of competing SDs. Further, the proposals would permit conducting swap business in an entity jointly registered as an FCM, or SBSB, or broker-dealer, which may offer the potential for these firms to offer portfolio margining for a variety of positions. From a holding company's perspective, aggregating swap business

in a single entity, could help simplify and streamline risk management, allow more efficient use of capital, as well as operational efficiencies, and avoid the need for multiple netting and other agreements.

The proposed rules may create the potential for regulatory arbitrage to the extent that they differ from corresponding rules other regulators adopt. Also, to the extent that the proposed requirements are overly stringent, they may prevent or discourage new entrants into swap markets and thereby may either increase spreads and trading costs or even reduce the availability of swaps. In these cases, end users would face higher cost or be forced to use less effective financial instruments to meet their business needs.

#### List of Subjects

##### 17 CFR Part 1

Brokers, Commodity futures, Reporting and recordkeeping requirements.

##### 17 CFR Part 23

Capital and margin requirements, Major swap participants, Swap dealers, Swaps.

##### 17 CFR Part 140

Authority delegations (Government agencies).

For the reasons discussed in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR chapter I as follows:

### PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

■ 1. The authority citation for part 1 is revised to read as follows:

**Authority:** 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b–1, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 9a, 12, 12a, 16, 18, 19, 21, and 23.

■ 2. In § 1.10, revise paragraph (f)(1) introductory text; paragraphs (f)(1)(i)(B), (f)(1)(ii)(B), and (g)(1); paragraph (g)(2) introductory text; and paragraph (h) to read as follows:

#### § 1.10 Financial reports of futures commission merchants and introducing brokers.

\* \* \* \* \*

(f) *Extension of time for filing uncertified reports.* (1) In the event a registrant finds that it cannot file its Form 1–FR, or, in accordance with paragraph (h) of this section, its Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, part II,

part IIA, part II CSE (FOCUS report), or a Form SBS, for any period within the time specified in paragraphs (b)(1)(i) or (b)(2)(i) of this section without substantial undue hardship, it may request approval for an extension of time, as follows:

(i) \* \* \*

(B) A futures commission merchant that is registered with the Securities and Exchange Commission as a securities broker or dealer may file with its designated self-regulatory organization a copy of any application that the registrant has filed with its designated examining authority, pursuant to § 240.17a-5(m) of this title, for an extension of time to file its FOCUS report or Form SBS. The registrant must also promptly file with the designated self-regulatory organization and the Commission copies of any notice it receives from its designated examining authority to approve or deny the requested extension of time. Upon receipt by the designated self-regulatory organization and the Commission of copies of any such notice of approval, the requested extension of time referenced in the notice shall be deemed approved under this paragraph (f)(1).

\* \* \* \* \*

(ii) \* \* \*

(B) An introducing broker that is registered with the Securities and Exchange Commission as a securities broker or dealer may file with the National Futures Association copies of any application that the registrant has filed with its designated examining authority, pursuant to § 240.17a-5(m) of this title, for an extension of time to file its FOCUS report or Form SBS. The registrant also must promptly file with the National Futures Association copies of any notice it receives from its designated examining authority to approve or deny the requested extension of time. Upon the receipt by the National Futures Association of a copy of any such notice of approval, the requested extension of time referenced in the notice shall be deemed approved under this paragraph (f)(1)(ii).

\* \* \* \* \*

(g) *Public availability of reports.* (1) Forms 1-FR filed pursuant to this section, and FOCUS reports or Forms SBS filed in lieu of Forms 1-FR pursuant to paragraph (h) of this section, will be treated as exempt from mandatory public disclosure for purposes of the Freedom of Information Act and the Government in the Sunshine Act and parts 145 and 147 of this chapter, except for the information described in paragraph (g)(2) of this section.

(2) The following information in Forms 1-FR, and the same or equivalent information in FOCUS reports or Forms SBS filed in lieu of Forms 1-FR, will be publicly available:

\* \* \* \* \*

(h) *Filing option available to a futures commission merchant or an introducing broker that is also a securities broker or dealer.* Any applicant or registrant which is registered with the Securities and Exchange Commission as a securities broker or dealer, a security-based swap dealer, or a major security-based market participant may comply with the requirements of this section by filing (in accordance with paragraphs (a), (b), (c), and (j) of this section) a copy, as applicable, of its Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II, Part IIA, or Part II CSE (FOCUS Report), or Form SBS, in lieu of Form 1-FR; *Provided, however,* That all information which is required to be furnished on and submitted with Form 1-FR is provided with such FOCUS Report or Form SBS; and *Provided, further,* That a certified FOCUS Report or Form SBS filed by an introducing broker or applicant for registration as an introducing broker in lieu of a certified Form 1-FR-IB must be filed according to National Futures Association rules, either in paper form or electronically, in accordance with procedures established by the National Futures Association, and if filed electronically, a paper copy of such filing with the original manually signed certification must be maintained by such introducing broker or applicant in accordance with § 1.31.

\* \* \* \* \*

■ 3. Amend § 1.12 as follows:

- a. Revise paragraph (a) introductory text and paragraphs (a)(1), (b)(3), and (b)(4); and
- b. Add paragraph (b)(5).

The revisions and addition to read as follows:

**§ 1.12 Maintenance of minimum financial requirements by futures commission merchants and introducing brokers.**

(a) Each person registered as a futures commission merchant or who files an application for registration as a futures commission merchant, and each person registered as an introducing broker or who files an application for registration as an introducing broker (except for an introducing broker or applicant for registration as an introducing broker operating pursuant to, or who has filed concurrently with its application for registration, a guarantee agreement and who is not also a securities broker or dealer), who knows or should have

known that its adjusted net capital at any time is less than the minimum required by § 1.17 or by the capital rule of any self-regulatory organization to which such person is subject, or the minimum net capital requirements of the Securities and Exchange Commission if the applicant or registrant is registered with the Securities and Exchange Commission, must:

(1) Give notice, as set forth in paragraph (n) of this section that the applicant's or registrant's capital is below the applicable minimum requirement. Such notice must be given immediately after the applicant or registrant knows or should have known that its adjusted net capital or net capital, as applicable, is less than minimum required amount; and

\* \* \* \* \*

(b) \* \* \*

(3) 150 percent of the amount of adjusted net capital required by a registered futures association of which it is a member, unless such amount has been determined by a margin-based capital computation set forth in the rules of the registered futures association, and such amount meets or exceeds the amount of adjusted net capital required under the margin-based capital computation set forth in § 1.17(a)(1)(i)(B), in which case the required percentage is 110 percent;

(4) For securities brokers or dealers, the amount of net capital specified in Rule 17a-11(b) of the Securities and Exchange Commission (§ 240.17a-11(b) of this title); or

(5) For security-based swap dealers or major security-based swap participants, the amount of net capital specified in Rule 18a-8(b) of the Securities and Exchange Commission (§ 240.18a-8(b) of this title), must file notice to that effect, as soon as possible and no later than twenty-four (24) hours of such event.

\* \* \* \* \*

■ 4. In § 1.16, revise paragraphs (f)(1)(i)(B) and (f)(1)(ii)(B) to read as follows:

**§ 1.16 Qualifications and reports of accountants.**

\* \* \* \* \*

(f)(1) \* \* \*

(i) \* \* \*

(B) A futures commission merchant that is registered with the Securities and Exchange Commission as a securities broker or dealer, a security-based swap dealer, or a major security-based swap participant, may file with its designated self-regulatory organization a copy of any application that the registrant has filed with its designated examining

authority, pursuant to § 240.17a-5(m) of this title, for an extension of time to file audited annual financial statements. The registrant must also promptly file with the designated self-regulatory organization and the Commission copies of any notice it receives from its designated examining authority to approve or deny the requested extension of time. Upon receipt by the designated self-regulatory organization and the Commission of copies of any such notice of approval, the requested extension of time referenced in the notice shall be deemed approved under this paragraph (f)(1)(i).

\* \* \* \* \*

(ii) \* \* \*

(B) An introducing broker that is registered with the Securities and Exchange Commission as a securities broker or dealer, a security-based swap dealer, or a major security-based swap participant may file with the National Futures Association copies of any application that the registrant has filed with its designated examining authority, pursuant to § 240.17a-5(m) of this title, for an extension of time to file audited annual financial statements. The registrant must also file promptly with the National Futures Association copies of any notice it receives from its designated examining authority to approve or deny the requested extension of time. Upon the receipt by the National Futures Association of a copy of any such notice of approval, the requested extension of time referenced in the notice shall be deemed approved under this paragraph (f)(1)(ii).

\* \* \* \* \*

■ 5. Amend § 1.17 as follows:

- a. Revise paragraphs (a)(1)(i)(A), (a)(1)(i)(B), (a)(1)(ii), (b)(9), and (b)(10);
- b. Add paragraph (b)(11);
- c. Revise paragraphs (c)(1)(i), (c)(2)(i), (c)(2)(ii)(B), and (c)(2)(ii)(D);
- d. Add paragraphs (c)(2)(ii)(G) and (c)(5)(iii);
- e. Revise paragraphs (c)(5)(viii), (c)(5)(ix), (c)(5)(x), and (c)(5)(xiv);
- f. Add paragraph (c)(5)(xv);
- g. Revise paragraph (c)(6) introductory text and paragraphs (c)(6)(i) and (c)(6)(iv)(A);
- h. Add paragraphs (c)(6)(v) and (c)(6)(vi); and
- i. Revise paragraph (g)(1).

The revisions and additions to read as follows:

**§ 1.17 Minimum financial requirements for futures commission merchants and introducing brokers.**

(a)(1)(i) \* \* \*

(A) \$1,000,000, *Provided, however*, that if the futures commission merchant

also is a swap dealer, the minimum amount shall be \$20,000,000;

(B) The futures commission merchant's risk-based capital requirement, computed as eight percent of the sum of:

(1) The total risk margin requirement (as defined in paragraph (b)(8) of this section) for positions carried by the futures commission merchant in customer accounts and noncustomer accounts;

(2) The total initial margin that the futures commission merchant is required to post with a clearing agency or broker for security-based swap positions carried in customer and noncustomer accounts;

(3) The total uncleared swaps margin, as that term is defined in § 23.100 of this chapter;

(4) The total initial margin that the futures commission merchant is required to post with a broker or clearing organization for all proprietary cleared swaps positions carried by the futures commission merchant;

(5) The total initial margin computed pursuant to Rule 18a-3(c)(1)(i)(B) (§ 240.18a-3(c)(1)(B) of this title) of the Securities and Exchange Commission for all uncleared security-based swap positions carried by the futures commission merchant without regard to any initial margin exemptions or exclusions that the rules of the Securities and Exchange Commission may provide to such security-based swap positions; and

(6) the total initial margin that the futures commission merchant is required to post with a broker or clearing agency for proprietary cleared security-based swaps;

\* \* \* \* \*

(ii) A futures commission merchant that is registered as a swap dealer and has received approval from the Commission, or from a registered futures association of which the futures commission merchant is a member, to use internal models to compute market risk and credit risk charges for uncleared swaps must maintain net capital equal to or in excess of \$100 million and adjusted net capital equal to or in excess of \$20 million.

\* \* \* \* \*

(b) \* \* \*

(9) *Cleared over the counter derivative positions* means a swap cleared by a derivatives clearing organization or a clearing organization exempted by the Commission from registering as a derivatives clearing organization, and further includes positions cleared by any organization permitted to clear such positions under the laws of the relevant jurisdiction.

(10) *Cleared over the counter customer* means any person that is not a proprietary person as defined in § 1.3(y) and for whom the futures commission merchant carries on its books one or more accounts for the cleared over the counter derivative positions of such person.

(11) *Uncleared swap margin*. This term means the amount of initial margin that would be required to be collected by a swap dealer, as set out in § 23.152(a) of this chapter for each outstanding swap (including the swaps that are exempt from the scope of § 23.152 of this chapter by § 23.150 of this chapter), exempt foreign exchange swaps or foreign exchange forwards, or netting set of swaps or foreign exchange swaps, for each counterparty, as if that counterparty was an unaffiliated swap dealer. In computing the uncleared swap margin amount, a swap dealer may not exclude the initial margin threshold amount or minimum transfer amount as such terms are defined in § 23.151 of this chapter.

(c) \* \* \*

(1) \* \* \*

(i) Unrealized profits shall be added and unrealized losses shall be deducted in the accounts of the applicant or registrant, including unrealized profits and losses on fixed price commitments, uncleared swaps, and forward contracts;

\* \* \* \* \*

(2) \* \* \*

(i) Exclude any unsecured commodity futures, options, cleared swaps, or other Commission regulated account containing a ledger balance and open trades, the combination of which liquidates to a deficit or containing a debit ledger balance only: *Provided, however*, deficits or debit ledger balances in unsecured customers', non-customers', and proprietary accounts, which are the subject of calls for margin or other required deposits may be included in current assets until the close of business on the business day following the date on which such deficit or debit ledger balance originated providing that the account had timely satisfied, through the deposit of new funds, the previous day's debit or deficits, if any, in its entirety.

(ii) \* \* \*

(B)(1) Interest receivable, floor brokerage receivable, commissions receivable from other brokers or dealers (other than syndicate profits), mutual fund concessions receivable and management fees receivable from registered investment companies and commodity pools that are not outstanding more than thirty (30) days from the date they are due;

(2) Dividends receivable that are not outstanding more than thirty (30) days from the payable date; and

(3) Commissions or fees receivable, including from other brokers or dealers, resulting from swap transactions that are not outstanding more than sixty (60) days from the month end accrual date provided they are billed promptly after the close of the month of their inception;

\* \* \* \* \*

(D) Receivables from registered futures commission merchants or brokers, resulting from commodity

futures, options, cleared swaps, foreign futures or foreign options transactions, except those specifically excluded under paragraph (c)(2)(i) of this section;

\* \* \* \* \*

(G) Receivables from third-party custodians that represent the futures commission merchant's initial margin deposits associated with uncleared swap transactions pursuant to § 23.158 of this chapter or uncleared security-based swap transactions under the rules of the Securities and Exchange Commission.

\* \* \* \* \*

(5) \* \* \*

(iii) Swaps—(A) *Uncleared swaps that are credit-default swaps referencing broad-based securities indices—(1) Short positions (selling protection).* In the case of an uncleared short credit default swap that references a broad-based securities index, deducting the percentage of the notional amount based upon the current basis point spread of the credit default swap and the maturity of the credit default swap in accordance with the following table:

| Length of time to maturity of CDS contract | Basis point spread (%) |         |         |         |         |             |
|--|------------------------|---------|---------|---------|---------|-------------|
|  | 100 or less            | 101–300 | 301–400 | 401–500 | 501–699 | 700 or more |
| 12 months or less .....                    | 0.67                   | 1.33    | 3.33    | 5.00    | 6.67    | 10.00       |
| 13 months to 24 months .....               | 1.00                   | 2.33    | 5.00    | 6.67    | 8.33    | 11.67       |
| 25 months to 36 months .....               | 1.33                   | 3.33    | 6.67    | 8.33    | 10.00   | 13.33       |
| 37 months to 48 months .....               | 2.00                   | 4.00    | 8.33    | 10.00   | 11.67   | 15.00       |
| 49 months to 60 months .....               | 2.67                   | 4.67    | 10.00   | 11.67   | 13.33   | 16.67       |
| 61 months to 72 months .....               | 3.67                   | 5.67    | 11.67   | 13.33   | 15.00   | 18.33       |
| 73 months to 84 months .....               | 4.67                   | 6.67    | 13.33   | 15.00   | 16.67   | 20.00       |
| 85 months to 120 months .....              | 5.67                   | 10.00   | 15.00   | 16.67   | 18.33   | 26.67       |
| 121 months and longer .....                | 6.67                   | 13.33   | 16.67   | 18.33   | 20.00   | 33.33       |

(2) *Long positions (purchasing protection).* In the case of an uncleared swap that is a long credit default swap referencing a broad-based securities index, deducting 50 percent of the deduction that would be required by paragraph (c)(5)(iii)(A)(1) of this section if the swap was a credit default swap.

(3) *Long and short positions—(i) Long and short uncleared credit default swaps referencing the same broad-based security index.* In the case of uncleared swaps that are long and short credit default swaps referencing the same broad-based security index, have the same credit events which would trigger payment by the seller of protection, have the same basket of obligations which would determine the amount of payment by the seller of protection upon the occurrence of a credit event, that are in the same or adjacent maturity spread category and have a maturity date within three months of the other maturity category, deducting the percentage of the notional amounts specified in the higher maturity category under paragraph (c)(5)(iii)(A)(1) or (c)(5)(iii)(A)(2) of this section on the excess of the long or short position.

(ii) *Long basket of obligors and uncleared long credit default swap referencing a broad-based securities index.* In the case of an uncleared swap that is a long credit default swap referencing a broad-based securities

index and the futures commission merchant is long a basket of debt securities comprising all of the components of the securities index, deducting 50 percent of the amount specified in § 240.15c3–1(c)(2)(vi) of this title for the component of securities, provided the futures commission merchant can deliver the component securities to satisfy the obligation of the futures commission merchant on the credit default swap.

(iii) *Short basket of obligors and uncleared short credit default swap referencing a broad-based securities index.* In the case of an uncleared swap that is a short credit default swap referencing a broad-based securities index and the futures commission merchant is short a basket of debt securities comprising all of the components of the securities index, deducting the amount specified in § 240.15c3–1(c)(2)(vi) of this title for the component securities.

(B) *Interest rate swaps.* In the case of an uncleared interest rate swap, deducting the percentage deduction specified in § 240.15c3–1(c)(2)(vi)(A) of this title based on the maturity of the interest rate swap, provided that the percentage deduction must be no less than 0.5 percent;

(C) *All other uncleared swaps.* (1) In the case of any uncleared swap that is not a credit default swap or interest rate

swap, deducting the amount calculated by multiplying the notional value of the swap by:

(i) The percentage specified in § 240.15c3–1 of this title applicable to the reference asset if § 240.15c3–1 of this title specifies a percentage deduction for the type of asset and this section does not specify a percentage deduction;

(ii) Six percent in the case of a currency swap that references euros, British pounds, Canadian dollars, Japanese yen, or Swiss francs, and twenty percent in the case of currency swaps that reference any other foreign currencies; or

(iii) In the case of over-the-counter swap transactions involving commodities, 20 percent of the market value of the amount of the underlying commodities; and

(iv) In the case of security-based swaps as defined in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)), the percentage as specified in § 240.15c3–1 of this title.

\* \* \* \* \*

(viii) In the case of a futures commission merchant, for undermargined customer accounts, the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or if there are no such maintenance margin requirements,

clearing organization margin requirements applicable to such positions, after application of calls for margin or other required deposits which are outstanding no more than one business day. If there are no such maintenance margin requirements or clearing organization margin requirements, then the amount of funds required to provide margin equal to the amount necessary, after application of calls for margin or other required deposits outstanding no more than one business day, to restore original margin when the original margin has been depleted by 50 percent or more:

*Provided*, to the extent a deficit is excluded from current assets in accordance with paragraph (c)(2)(i) of this section such amount shall not also be deducted under this paragraph. In the event that an owner of a customer account has deposited an asset other than cash to margin, guarantee or secure his account, the value attributable to such asset for purposes of this subparagraph shall be the lesser of:

(A) The value attributable to the asset pursuant to the margin rules of the applicable board of trade, or

(B) The market value of the asset after application of the percentage deductions specified in paragraph (c)(5) of this section;

(ix) In the case of a futures commission merchant, for undermargined noncustomer and omnibus accounts the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or if there are no such maintenance margin requirements, clearing organization margin requirements applicable to such positions, after application of calls for margin or other required deposits which are outstanding no more than one business day. If there are no such maintenance margin requirements or clearing organization margin requirements, then the amount of funds required to provide margin equal to the amount necessary after application of calls for margin or other required deposits outstanding no more than one business day to restore original margin when the original margin has been depleted by 50 percent or more:

*Provided*, to the extent a deficit is excluded from current assets in accordance with paragraph (c)(2)(i) of this section such amount shall not also be deducted under this paragraph. In the event that an owner of a noncustomer or omnibus account has deposited an asset other than cash to margin, guarantee or secure his account the value attributable to such asset for purposes of this paragraph shall be the

lesser of the value attributable to such asset pursuant to the margin rules of the applicable board of trade, or the market value of such asset after application of the percentage deductions specified in paragraph (c)(5) of this section;

(x) In the case of open futures contracts, cleared swaps, and granted (sold) commodity options held in proprietary accounts carried by the applicant or registrant which are not covered by a position held by the applicant or registrant or which are not the result of a "changer trade" made in accordance with the rules of a contract market:

(A) For an applicant or registrant which is a clearing member of a clearing organization for the positions cleared by such member, the applicable margin requirement of the applicable clearing organization;

(B) For an applicant or registrant which is a member of a self-regulatory organization, 150 percent of the applicable maintenance margin requirement of the applicable board of trade, or clearing organization, whichever is greater;

(C) For all other applicants or registrants, 200 percent of the applicable maintenance margin requirements of the applicable board of trade or clearing organization, whichever is greater; or

(D) For open contracts or granted (sold) commodity options for which there are no applicable maintenance margin requirements, 200 percent of the applicable initial margin requirement: *Provided*, the equity in any such proprietary account shall reduce the deduction required by this paragraph (c)(5)(x) if such equity is not otherwise includable in adjusted net capital;

\* \* \* \* \*

(xiv) For securities brokers and dealers, all other deductions specified in § 240.15c3-1 of this title;

(xv) In the case of a futures commission merchant, the amount of the uncleared swap margin that the futures commission merchant has not collected from a swap counterparty, less any amounts owed by the futures commission merchant to the swap counterparty for uncleared swap transactions.

(6)(i) *Election of alternative capital deductions that have received approval of Securities and Exchange Commission pursuant to § 240.15c3-1(a)(7) of this title.* Any futures commission merchant that is also registered with the Securities and Exchange Commission as a securities broker or dealer, and who also satisfies the other requirements of this paragraph (c)(6), may elect to compute its adjusted net capital using the

alternative capital deductions that, under § 240.15c3-1(a)(7) of this title, the Securities and Exchange Commission has approved by written order in lieu of the deductions that would otherwise be required under this section.

\* \* \* \* \*

(iv) \* \* \*

(A) Information that the futures commission merchant files on a monthly basis with its designated examining authority or the Securities and Exchange Commission, whether by way of schedules to its FOCUS reports or by other filings, in satisfaction of § 240.17a-5(a)(5) of this title;

\* \* \* \* \*

(v) *Election of alternative market risk and credit risk capital deductions for a futures commission merchant that is registered as a swap dealer and has received approval of the Commission or a registered futures association for which the futures commission merchant is a member.* For purposes of this paragraph (c)(6)(v) only, all references to futures commission merchant means a futures commission merchant that is also registered as a swap dealer.

(A) A futures commission merchant may apply in writing to the Commission or a registered futures association of which it is a member for approval to compute deductions for market risk and credit risk using internal models in lieu of the standardized deductions otherwise required under this section. The futures commission merchant must file the application in accordance with instructions approved by the Commission and specified on the Web site of the registered futures association.

(B) A futures commission merchant's application must include the information set forth in Appendix A to § 23.102 of this chapter and the market risk and credit risk charges must be computed in accordance with § 23.102 of this chapter.

(vi) A futures commission merchant that is also registered as a swap dealer must comply with the liquidity requirements in § 23.104(b)(1) of this chapter as though it were a swap dealer that elected to follow § 23.101(a)(1)(ii) of this chapter in computing its minimum capital requirement.

\* \* \* \* \*

(g)(1) The Commission may by order restrict, for a period of up to twenty business days, any withdrawal by a futures commission merchant of equity capital, or any unsecured advance or loan to a stockholder, partner, limited liability company member, sole proprietor, employee or affiliate if the Commission, based on the facts and information available, concludes that



any such withdrawal, advance or loan may be detrimental to the financial integrity of the futures commission merchant, or may unduly jeopardize its ability to meet customer obligations or other liabilities that may cause a significant impact on the markets.

\* \* \* \* \*

■ 6. In § 1.65, revise paragraph (b) introductory text and paragraphs (d) and (e) to read as follows:

**§ 1.65 Notice of bulk transfers and disclosure obligations to customers.**

\* \* \* \* \*

(b) *Notice to the Commission.* Each futures commission merchant or introducing broker shall file with the Commission, at least ten business days in advance of the transfer, notice of any transfer of customer accounts carried or introduced by such futures commission merchant or introducing broker that is not initiated at the request of the customer, where the transfer involves the lesser of:

\* \* \* \* \*

(d) The notice required by paragraph (b) of this section shall be considered filed when submitted to the Director of the Division of Swap Dealer and Intermediary Oversight, in electronic form using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instructions issued by or approved by the Commission.

(e) In the event that the notice required by paragraph (b) of this section cannot be filed with the Commission at least ten days prior to the account transfer, the Commission hereby delegates to the Director of the Division of Swap Dealer and Intermediary Oversight, or such other employee or employees as the Director may designate from time to time, the authority to accept a lesser time period for such notification at the Director's or designee's discretion. In any event, however, the transferee futures commission merchant or introducing broker shall file such notice as soon as practicable and no later than the day of the transfer. Such notice shall include a brief statement explaining the circumstances necessitating the delay in filing.

\* \* \* \* \*

**PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS**

■ 7. The authority citation for part 23 continues to read as follows:

**Authority:** 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b-1, 6c, 6p, 6r, 6s, 6t, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21.

Section 23.160 also issued under 7 U.S.C. 2(i); Sec. 721(b), Pub. L. 111-203, 124 Stat. 1641 (2010).

■ 8. Revise subpart E of part 23 to read as follows:

**Subpart E—Capital and Margin Requirements for Swap Dealers and Major Swap Participants**

Sec.

- 23.100 Definitions applicable to capital requirements.
- 23.101 Minimum financial requirements for swap dealers and major swap participants.
- 23.102 Calculation of market risk exposure requirement and credit risk exposure requirement using internal models.
- 23.103 Calculation of market risk exposure requirement and credit risk exposure requirement when models are not approved.
- 23.104 Liquidity requirements and equity withdrawal restrictions.
- 23.105 Financial recordkeeping, reporting and notification requirements for swap dealers and major swap participants.
- 23.106 Comparability determination for substituted compliance.
- 23.107–23.149 [Reserved]

**Subpart E—Capital and Margin Requirements for Swap Dealers and Major Swap Participants**

**§ 23.100 Definitions applicable to capital requirements.**

For purposes of §§ 23.101 through 23.108 of subpart E of this part, the following terms are defined as follows:

*Actual daily net trading profit and loss.* This term is used in assessing the performance of a swap dealer's VaR measure and refers to changes in the swap dealer's portfolio value that would have occurred were end-of-day positions to remain unchanged (therefore, excluding fees, commissions, reserves, net interest income, and intraday trading).

*Credit risk.* This term refers to the risk that the counterparty to an uncleared swap transaction could default before the final settlement of the transaction's cash flows.

*Credit risk exposure requirement.* This term refers to the amount that the swap dealer is required to compute under § 23.102 if approved to use internal credit risk models, or to compute under § 23.103 if not approved to use internal credit risk models.

*Exempt foreign exchange swaps and foreign exchange forwards* are those foreign exchange swaps and foreign exchange forwards that were exempted from the definition of a swap by the U.S. Department of the Treasury.

*Market risk exposure.* This term means the risk of loss in a position or portfolio of positions resulting from movements in market prices and other

factors. Market risk exposure is the sum of:

(1) General market risks including changes in the market value of a particular assets that result from broad market movements, such as a changes in market interest rates, foreign exchange rates, equity prices, and commodity prices;

(2) Specific risk, which includes risks that affect the market value of a specific instrument, such as the credit risk of the issuer of the particular instrument, but do not materially alter broad market conditions;

(3) Incremental risk, which means the risk of loss on a position that could result from the failure of an obligor to make timely payments of principal and interest; and

(4) Comprehensive risk, which is the measure of all material price risks of one or more portfolios of correlation trading positions.

*Market risk exposure requirement.* This term refers to the amount that the swap dealer is required to compute under § 23.102 if approved to use internal market risk models, or § 23.103 if not approved to use internal market risk models.

*Predominantly engaged in non-financial activities.* A swap dealer is predominantly engaged in non-financial activities if:

(1) The swap dealer's consolidated annual gross financial revenues in either of its two most recently completed fiscal years represents less than 15 percent of the swap dealer's consolidated gross revenue in that fiscal year ("15% revenue test"), and

(2) The consolidated total financial assets of the swap dealer at the end of its two most recently completed fiscal years represents less than 15 percent of the swap dealer's consolidated total assets as of the end of the fiscal year ("15% asset test"). For purpose of computing the 15% revenue test or the 15% asset test, a swap dealer's activities shall be deemed financial activities if such activities are defined as financial activities under 12 CFR 242.3 and Appendix A of 12 CFR part 242, including lending, investing for others, safeguarding money or securities for others, providing financial or investment advisory services, underwriting or making markets in securities, providing securities brokerage services, and engaging as principal in investing and trading activities; *provided, however*, a swap dealer may exclude from its financial activities accounts receivable resulting from non-financial activities.

*Prudential regulator.* This term has the same meaning as set forth in section

1a(39) of the Act, and includes the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency, as applicable to a swap dealer or major swap participant.

*Regulatory capital.* This term shall mean the amount of tier 1 capital or ratio based capital, tangible net worth, or calculated net capital of a swap dealer or major swap participant relevant to the associated applicable regulatory capital requirement.

*Regulatory capital requirement.* This term refers to each of the capital requirements that § 23.101 applies to a swap dealer or major swap participant.

*Tangible net worth.* This term means the net worth of a swap dealer or major swap participant as determined in accordance with generally accepted accounting principles in the United States, excluding goodwill and other intangible assets. In determining net worth, all long and short positions in swaps, security-based swaps and related positions must be marked to their market value. A swap dealer or major swap participant must include in its computation of tangible net worth all liabilities or obligations of a subsidiary or affiliate that the swap dealer or major swap participant guarantees, endorses, or assumes either directly or indirectly.

*Uncleared swap margin.* This term means the amount of initial margin, computed in accordance with § 23.154, that a swap dealer would be required to collect from each counterparty for each outstanding swap position of the swap dealer. A swap dealer must include all swap positions in the calculation of the uncleared margin amount, including swaps that are exempt from the scope of the Commission's margin for uncleared swaps rules pursuant to § 23.150, exempt foreign exchange swaps or foreign exchange forwards, or netting set of swaps or foreign exchange swaps, for each counterparty, as if that counterparty was an unaffiliated swap dealer. Furthermore, in computing the uncleared swap margin amount, a swap dealer may not exclude the *initial margin threshold amount* or *minimum transfer amount* as such terms are defined in § 23.151.

**§ 23.101 Minimum financial requirements for swap dealers and major swap participants.**

(a)(1) Except as provided in paragraphs (a)(2) through (a)(5) of this section, each swap dealer must elect to be subject to the minimum capital requirements set forth in either

paragraphs (a)(1)(i) or (a)(1)(ii) of this section:

(i) A swap dealer that elects to meet the capital requirements in this paragraph (a)(1)(i) must maintain regulatory capital that equals or exceeds the greatest of the following:

(A) \$20 million of common equity tier 1 capital, as defined under the bank holding company regulations in 12 CFR 217.20, as if the swap dealer itself were a bank holding company subject to 12 CFR part 217;

(B) Common equity tier 1 capital, as defined under the bank holding company regulations in 12 CFR 217.20, equal to or greater than eight percent of the swap dealer's risk-weighted assets computed under the bank holding company regulations in 12 CFR part 217, as if the swap dealer itself were a bank-holding company subject to 12 CFR part 217; *provided, however*, that the swap dealer must add to its risk-weighted assets market risk capital charges computed in accordance with § 1.17 of this chapter if the swap dealer has not obtained the approval of the Commission or of a registered futures association to use internal capital models under § 23.102;

(C) Common equity tier 1 capital, as defined under 12 CFR 217.20, equal to or greater than eight percent of the sum of:

(1) The amount of uncleared swap margin, as that term is defined in § 23.100, for each uncleared swap position open on the books of the swap dealer, computed on a counterparty by counterparty basis pursuant to § 23.154;

(2) The amount of initial margin that would be required for each uncleared security-based swap position open on the books of the swap dealer, computed on a counterparty by counterparty basis pursuant to § 240.18a-3(c)(1)(i)(B) of this title without regard to any initial margin exemptions or exclusions that the rules of the Securities and Exchange Commission may provide to such security-based swap positions; and

(3) The amount of initial margin required by clearing organizations for cleared proprietary futures, foreign futures, swaps, and security-based swaps positions open on the books of the swap dealer; or,

(D) The amount of capital required by a registered futures association of which the swap dealer is a member.

(ii) A swap dealer that elects to meet the capital requirements in this paragraph (a)(1)(ii) must maintain regulatory capital that equals or exceeds the greatest of the following:

(A) The amount of tentative net capital and net capital required by, and computed in accordance with,

§ 240.18a-1 of this title as if the swap dealer were a security-based swap dealer registered with the Securities and Exchange Commission and subject to § 240.18a-1 of this title; *Provided, however*, that the swap dealer's computation is subject to the following adjustments:

(1) In computing its minimum capital requirement, a swap dealer shall adjust the "risk margin amount" subject to the eight percent computation under § 240.18a-1(a)(1) and (2) of this title to be the sum of:

(i) The amount of uncleared swap margin, as that term is defined in § 23.100, for each uncleared swap position open on the books of the swap dealer, computed on a counterparty by counterparty basis pursuant to § 23.154;

(ii) The amount of initial margin that would be required for each uncleared security-based swap position open on the books of the swap dealer, computed on a counterparty by counterparty basis pursuant to § 240.18a-3(c)(1)(i)(B) of this title without regard to any initial margin exemptions or exclusions that the rules of the Securities and Exchange Commission may provide to such security-based swap positions;

(iii) The amount of risk margin, as defined in § 1.17(b)(8) of this chapter, required by a clearing organization for proprietary futures, swaps, and foreign futures positions open on the books of the swap dealer; and

(iv) The amount of initial margin required by a clearing organization for proprietary security-based swaps open on the books of the swap dealer;

(2) A swap dealer that uses internal models to compute market risk for its proprietary positions under § 240.18a-1(d) of this title must calculate the total market risk as the sum of the VaR measure, stressed VaR measure, specific risk measure, comprehensive risk measure, and incremental risk measure of the portfolio of proprietary positions in accordance with § 23.102 and Appendix A of § 23.102;

(3) A swap dealer that has obtained approval from the Commission or from a registered futures association of which it is a member to use internal models to compute credit risk capital charges for receivables resulting from uncleared swap and security-based swap transactions may use such models in computing the credit risk charge for receivables resulting from swap and security-based swap transactions under § 240.18a-1(d) of this title from all counterparties, including commercial end users as defined in § 240.18a-3(b)(2) of this title;

(4) A swap dealer may recognize as a current asset, receivables from third-

party custodians that maintain the swap dealer's initial margin deposits associated with uncleared swap transactions under § 23.152 and the swap dealer's initial margin deposits associated with uncleared security-based swap transactions under § 240.18a-1(c)(1) of this title; and

(5) A swap dealer may not deduct the margin difference as that term is defined in § 240.18a-1(c)(1)(viii) of this title for swap and security-based swap transactions in lieu of collecting margin on such transactions; or

(B) The amount of capital required by a registered futures association of which the swap dealer is a member.

(2)(i) A swap dealer that is "predominantly engaged in non-financial activities" as defined in § 23.100 may elect to meet the minimum capital requirements in this paragraph (a)(2) in lieu of the capital requirements in paragraph (a)(1) of this section.

(ii) A swap dealer that satisfies the requirements of paragraph (a)(2)(i) of this section and elects to meet the requirements of this paragraph (a)(2) must maintain tangible net worth, as defined in § 23.100, equal to or in excess of the greatest of the following:

(A) \$20 million plus the amount of the swap dealer's market risk exposure requirement (as defined in § 23.100) and its credit risk exposure requirement (as defined in § 23.100) associated with the swap dealer's swap and related hedge positions that are part of the swap dealer's swap dealing activities. The swap dealer shall compute its market risk exposure requirement and credit risk exposure requirement for its swap positions in accordance with § 23.102 if the swap dealer has obtained the approval of the Commission or a registered futures association of which it is a member to use internal capital models. The swap dealer shall compute its market risk exposure requirement and credit risk exposure requirement in accordance with the standardized approach of paragraphs (b)(1) and (c)(1) of § 23.103 if it has not been approved by the Commission or a registered futures association to use internal capital models;

(B) Eight percent of the sum of:

(1) The amount of uncleared swap margin, as that term is defined in § 23.100, for each uncleared swap positions open on the books of the swap dealer, computed on a counterparty by counterparty basis pursuant to § 23.154;

(2) The amount of initial margin that would be required for each uncleared security-based swap position open on the books of the swap dealer, computed on a counterparty by counterparty basis pursuant to § 240.18a-3(c)(1)(i)(B) of

this title without regard to any initial margin exemptions or exclusions that the rules of the Securities and Exchange Commission may provide to such security-based swap positions; and

(3) The amount of initial margin required by clearing organizations for cleared proprietary futures, foreign futures, swaps, security-based swaps positions on the books of the swap dealer; or,

(C) The amount of capital required by a registered futures association of which the swap dealer is a member.

(3) A swap dealer that is subject to minimum capital requirements established by the rules or regulations of a prudential regulator pursuant to section 4s(e) of the Act is not subject to the regulatory capital requirements set forth in paragraph (a)(1) or (2) of this section.

(4) A swap dealer that is a futures commission merchant is subject to the minimum capital requirements of § 1.17 of this chapter, and is not subject to the regulatory capital requirements set forth in paragraph (a)(1) or (2) of this section.

(5) A swap dealer that is organized and domiciled outside of the United States, including a swap dealer that is an affiliate of a person organized and domiciled in the United States, may satisfy its requirements for capital adequacy under paragraphs (a)(1) or (2) of this section by substituted compliance with the capital adequacy requirement of its home country jurisdiction. In order to qualify for substituted compliance, a swap dealer's home country jurisdiction must receive from the Commission a Capital Comparability Determination under § 23.106, and the swap dealer must obtain a confirmation to rely on the Capital Comparability Determination from a registered futures association as provided under § 23.106.

(6) A swap dealer that elects to meet the capital requirements of paragraph (a)(1)(i), (a)(1)(ii), or (a)(2) of this section may not subsequently change its election without the prior written approval of the Commission. A swap dealer that wishes to change its election must submit a written request to the Commission and must provide any additional information and documentation requested by the Commission.

(b)(1) Every major swap participant for which there is not a prudential regulator must at all time have and maintain positive tangible net worth.

(2) Notwithstanding paragraph (b)(1) of this section, each major swap participant for which there is no prudential regulator must meet the minimum capital requirements

established by a registered futures association of which the major swap participant is a member.

(c)(1) Before any applicant may be registered as a swap dealer or major swap participant, the applicant must demonstrate to the satisfaction of a registered futures association of which it is a member, or applying for membership, one of the following:

(i) That the applicant complies with the applicable regulatory capital requirements in paragraph (a)(1), (a)(2), (b)(1) or (b)(2) of this section;

(ii) That the applicant is a futures commission merchant that complies with § 1.17 of this chapter;

(iii) That the applicant is subject to minimum capital requirements established by the rules or regulations of a prudential regulator under paragraph (a)(3) of this section;

(iv) That the applicant is organized and domiciled in a non-U.S. jurisdiction and is regulated in a jurisdiction for which the Commission has issued a Capital Comparability Determination under § 23.106, and the non-U.S. person has obtained confirmation from a registered futures association of which it is a member that it may rely upon the Commission's Comparability Determination under § 23.106.

(2) Each swap dealer and major swap participant subject to the minimum capital requirements set forth in paragraphs (a) and (b) of this section must be in compliance with such requirements at all times, and must be able to demonstrate such compliance to the satisfaction of the Commission and to the registered futures association of which the swap dealer or major swap dealer is a member.

**§ 23.102 Calculation of market risk exposure requirement and credit risk exposure requirement using internal models.**

(a) A swap dealer may apply to the Commission, or to a registered futures association of which the swap dealer is a member, for approval to use internal models under terms and conditions required by the Commission and by these regulations, or under the terms and conditions required by the registered futures association of which the swap dealer is a member, when calculating the swap dealer's market risk exposure and credit risk exposure under § 23.101(a)(1)(i)(B), (a)(1)(ii)(A), or (a)(2)(ii)(A).

(b) The swap dealer's application to use internal models to compute market risk exposure and credit risk exposure must be in writing and must be filed with the Commission and with the registered futures association of which

the swap dealer is a member. The swap dealer must file the application in accordance with instructions established by the Commission and the registered futures association.

(c) A swap dealer's application must include the information set forth in Appendix A of this section.

(d) The Commission or the registered futures association may approve or deny the application, or approve an amendment to the application, in whole or in part, subject to any conditions or limitations the Commission or registered futures association may require, if the Commission or registered futures association finds the approval to be appropriate in the public interest, after determining, among other things, whether the applicant has met the requirements of this section, and the appendices to this section. A swap dealer that has received Commission or registered futures association approval to compute market risk exposure requirements and credit risk exposure requirements pursuant to internal models must compute such charges in accordance with Appendix A of this section.

(e) A swap dealer must cease using internal models to compute its market risk exposure requirement and credit risk exposure requirement, upon the occurrence of any of the following:

(1) The swap dealer has materially changed a mathematical model described in the application or materially changed its internal risk management control system without first submitting amendments identifying such changes and obtaining the approval of the Commission or the registered futures association for such changes;

(2) The Commission or the registered futures association of which the swap dealer is a member determines that the internal models are no longer sufficient for purposes of the capital calculations of the swap dealer as a result of changes in the operations of the swap dealer;

(3) The swap dealer fails to come into compliance with its requirements under this section, after having received from the Director of the Commission's Division of Swap Dealer and Intermediary Oversight, or from the registered futures association of which the swap dealer is a member, written notification that the swap dealer is not in compliance with its requirements, and must come into compliance by a date specified in the notice; or

(4) The Commission by written order finds that permitting the swap dealer to continue to use the internal models is no longer appropriate.

#### **Appendix A to § 23.102—Application for Internal Models To Compute Market Risk Exposure Requirement and Credit Risk Exposure Requirement**

(a) A swap dealer that is requesting the approval of the Commission, or the approval of a registered futures association of which the swap dealer is a member, to use internal models to compute its market risk exposure requirement and credit risk exposure requirement under § 23.102 must include the following information as part of its application:

(1) An executive summary of the information within its application and, if applicable, an identification of the ultimate holding company of the swap dealer;

(2) A list of the categories of positions that the swap dealer holds in its proprietary accounts and a brief description of the methods that the swap dealer will use to calculate deductions for market risk and credit risk on those categories of positions;

(3) A description of the mathematical models used by the swap dealer under this Appendix A to compute the VaR of the swap dealer's positions; the stressed VaR of the swap dealer's positions; the specific risk of the swap dealer's positions subject to specific risk; comprehensive risk of the swap dealer's positions; and the incremental risk of the swap dealer's positions, and deductions for credit risk exposure. The description should encompass the creation, use, and maintenance of the mathematical models; a description of the swap dealer's internal risk management controls over the models, including a description of each category of persons who may input data into the models; if a mathematical model incorporates empirical correlations across risk categories, a description of the process for measuring correlations; a description of the backtesting procedures the swap dealer will use to backtest the mathematical models; a description of how each mathematical model satisfies the applicable qualitative and quantitative requirements set forth in this Appendix A and a statement describing the extent to which each mathematical model used to compute deductions for market risk exposures and credit risk exposures will be used as part of the risk analyses and reports presented to senior management;

(4) If the swap dealer is applying to the Commission or a registered futures association for approval to use scenario analysis to calculate deductions for market risk for certain positions, a list of those types of positions, a description of how those deductions will be calculated using scenario analysis, and an explanation of why each scenario analysis is appropriate to calculate deductions for market risk on those types of positions;

(5) A description of how the swap dealer will calculate current exposure;

(6) A description of how the swap dealer will determine internal credit ratings of counterparties and internal credit risk weights of counterparties, if applicable;

(7) For each instance in which a mathematical model to be used by the swap dealer to calculate a deduction for market risk exposure or to calculate maximum

potential exposure for a particular product or counterparty differs from the mathematical model used by the swap dealer's ultimate holding company or the swap dealer's affiliates (if applicable) to calculate an allowance for market risk exposure or to calculate maximum potential exposure for that same product or counterparty, a description of the difference(s) between the mathematical models;

(8) A description of the swap dealer's process of re-estimating, re-evaluating, and updating internal models to ensure continued applicability and relevance; and

(9) Sample risk reports that are provided to management at the swap dealer who are responsible for managing the swap dealer's risk.

(b) The application of the swap dealer shall be supplemented by other information relating to the internal risk management control system, mathematical models, and financial position of the swap dealer that the Commission or a registered futures association may request to complete its review of the application.

(c) A person who files an application pursuant to this section for which it seeks confidential treatment may clearly mark each page or segregable portion of each page with the words "Confidential Treatment Requested." All information submitted in connection with the application will be accorded confidential treatment, to the extent permitted by law.

(d) If any of the information filed with the Commission or a registered futures association as part of the application of the swap dealer is found to be or becomes inaccurate before the Commission or a registered futures association approves the application, the swap dealer must notify the Commission or registered futures association promptly and provide the Commission or registered futures associations with a description of the circumstances in which the information was found to be or has become inaccurate along with updated, accurate information.

(e) The Commission or registered futures association may approve the application or an amendment to the application, in whole or in part, subject to any conditions or limitations the Commission or the registered futures association may require if the Commission or the registered futures association finds the approval to be appropriate in the public interest, after determining, among other things, whether the swap dealer has met all the requirements of this Appendix A.

(f) A swap dealer shall amend its application under this Appendix A and submit the amendment to the Commission and the registered futures association for approval before it may materially change a mathematical model used to calculate market risk exposure requirements or credit risk exposure requirements or before it may materially change its internal risk management control system with respect to such model.

(g) As a condition for a swap dealer to use internal models to compute deductions for market risk exposure and credit risk exposure under this Appendix A, the swap dealer agrees that:

(1) It will notify the Commission and registered futures association 45 days before it ceases to use internal models to compute deductions for market risk exposure and credit risk exposure under this Appendix A; and

(2) The Commission or the registered futures association may determine that the notice will become effective after a shorter or longer period of time if the swap dealer consents or if the Commission or the registered futures association determines that a shorter or longer period of time is appropriate in the public interest.

(h) The Commission may by written order, or the registered futures association by written notice, revoke a swap dealer's approval to use internal models to compute market risk exposures and credit risk exposures on certain credit exposures arising from transactions in derivatives instruments if the Commission or the registered futures association of which the swap dealer is a member finds that such approval is no longer appropriate in the public interest. In making its finding, the Commission or the registered futures association will consider the compliance history of the swap dealer related to its use of models and the swap dealer's compliance with its internal risk management controls. If the Commission or registered futures association withdraws all or part of a swap dealer's approval to use internal models, the swap dealer shall compute market risk exposure requirements and credit risk exposure requirements in accordance with § 23.103.

(i) *VaR models.* A value-at-risk ("VaR") model must meet the following minimum requirements in order to be approved:

(1) *Qualitative requirements.*

(i) The VaR model used to calculate market risk exposure or credit risk exposure for a position must be integrated into the daily internal risk management system of the swap dealer;

(ii) The VaR model must be reviewed both periodically and annually. The periodic review may be conducted by personnel of the swap dealer that are independent from the personnel that perform the VaR model calculations. The annual review must be conducted by a qualified third party service. The review must include:

(A) An evaluation of the conceptual soundness of, and empirical support for, the internal models;

(B) An ongoing monitoring process that includes verification of processes and the comparison of the swap dealer's model outputs with relevant internal and external data sources or estimation techniques; and

(C) An outcomes analysis process that includes backtesting. This process must include a comparison of the changes in the swap dealer's portfolio value that would have occurred were end-of-day positions to remain unchanged (therefore, excluding fees, commissions, reserves, net interest income, and intraday trading) with VaR-based measures during a sample period not used in model development.

(iii) For purposes of computing market risk, the swap dealer must determine the appropriate multiplication factor as follows:

(A) Beginning three months after the swap dealer begins using the VaR model to

calculate the market risk exposure, the swap dealer must conduct monthly backtesting of the model by comparing its actual daily net trading profit or loss with the corresponding VaR measure generated by the VaR model, using a 99 percent, one-tailed confidence level with price changes equivalent to a one business-day movement in rates and prices, for each of the past 250 business days, or other period as may be appropriate for the first year of its use;

(B) On the last business day of each quarter, the swap dealer must identify the number of backtesting exceptions of the VaR model using actual daily net trading profit and loss, as that term is defined in § 23.100. An exception has occurred when for a business day the actual net trading loss, if any, exceeds the corresponding VaR measure. The counting period shall be for the prior 250 business days except that during the first year of use of the model another appropriate period may be used; and

(C) The swap dealer must use the multiplication factor indicated in Table 1 of this Appendix A in determining its market risk until it obtains the next quarter's backtesting results;

TABLE 1—MULTIPLICATION FACTOR BASED ON THE NUMBER OF BACKTESTING EXCEPTIONS OF THE VaR MODEL

| Number of exceptions | Multiplication factor |
|----------------------|-----------------------|
| 4 or fewer .....     | 3.00                  |
| 5 .....              | 3.40                  |
| 6 .....              | 3.50                  |
| 7 .....              | 3.65                  |
| 8 .....              | 3.75                  |
| 9 .....              | 3.85                  |
| 10 or more .....     | 4.00                  |

(iv) For purposes of computing the credit equivalent amount of the swap dealer's exposures to a counterparty, the swap dealer must determine the appropriate multiplication factor as follows:

(A) Beginning three months after it begins using the VaR model to calculate maximum potential exposure, the swap dealer must conduct backtesting of the model by comparing, for at least 80 counterparties (or the actual number of counterparties if the swap dealer does not have 80 counterparties) with widely varying types and sizes of positions with the firm, the ten business day change in its current exposure to the counterparty based on its positions held at the beginning of the ten-business day period with the corresponding ten-business day maximum potential exposure for the counterparty generated by the VaR model;

(B) As of the last business day of each quarter, the swap dealer must identify the number of backtesting exceptions of the VaR model, that is, the number of ten-business day periods in the past 250 business days, or other period as may be appropriate for the first year of its use, for which the change in current exposure to a counterparty, assuming the portfolio remains static for the ten-business day period, exceeds the

corresponding maximum potential exposure; and

(C) The swap dealer will propose, as part of its application, a schedule of multiplication factors, which must be approved by the Commission, or a registered futures association of which the swap dealer is a member, based on the number of backtesting exceptions of the VaR model. The swap dealer must use the multiplication factor indicated in the approved schedule in determining the credit equivalent amount of its exposures to a counterparty until it obtains the next quarter's backtesting results, unless the Commission or the registered futures association determines, based on, among other relevant factors, a review of the swap dealer's internal risk management control system, including a review of the VaR model, that a different adjustment or other action is appropriate.

(2) *Quantitative requirements.* (i) For purposes of determining market risk exposure, the VaR model must use a 99 percent, one-tailed confidence level with price changes equivalent to a ten business-day movement in rates and prices;

(ii) For purposes of determining maximum potential exposure, the VaR model must use a 99 percent, one-tailed confidence level with price changes equivalent to a one-year movement in rates and prices; or based on a review of the swap dealer's procedures for managing collateral and if the collateral is marked to market daily and the swap dealer has the ability to call for additional collateral daily, the Commission, or the registered futures association of which the swap dealer is a member, may approve a time horizon of not less than ten business days;

(iii) The VaR model must use an effective historical observation period of at least one year. The swap dealer must consider the effects of market stress in its construction of the model. Historical data sets must be updated at least monthly and reassessed whenever market prices or volatilities change significantly or portfolio composition warrant; and

(iv) The VaR model must take into account and incorporate all significant, identifiable market risk factors applicable to positions in the accounts of the swap dealer, including:

(A) Risks arising from the non-linear price characteristics of derivatives and the sensitivity of the fair value of those positions to changes in the volatility of the derivatives' underlying rates, prices, or other material risk factors. A swap dealer with a large or complex portfolio with non-linear derivatives (such as options or positions with embedded optionality) must measure the volatility of these positions at different maturities and/or strike prices, where material;

(B) Empirical correlations within and across risk factors provided that the swap dealer validates and demonstrates the reasonableness of its process for measuring correlations, if the VaR-based measure does not incorporate empirical correlations across risk categories, the swap dealer must add the separate measures from its internal models used to calculate the VaR-based measure for the appropriate risk categories (interest rate risk, credit spread risk, equity price risk, foreign exchange rate risk, and/or commodity

price risk) to determine its aggregate VaR-based measure, or, alternatively, risk factors sufficient to cover all the market risk inherent in the positions in the proprietary or other trading accounts of the swap dealer, including interest rate risk, equity price risk, foreign exchange risk, and commodity price risk; and

(C) Spread risk, where applicable, and segments of the yield curve sufficient to capture differences in volatility and imperfect correlation of rates along the yield curve for securities and derivatives that are sensitive to different interest rates. For material positions in major currencies and markets, modeling techniques must incorporate enough segments of the yield curve—in no case less than six—to capture differences in volatility and less than perfect correlation of rates along the yield curve.

(j) *Stressed VaR-based Measure.* A stressed VaR model must meet the following minimum requirements in order to be approved:

(1) *Requirements for stressed VaR-based measure.* (i) A swap dealer must calculate a stressed VaR-based measure for its positions using the same model(s) used to calculate the VaR-based measure under paragraph (i) of this appendix, subject to the same confidence level and holding period applicable to the VaR-based measure, but with model inputs calibrated to historical data from a continuous 12-month period that reflects a period of significant financial stress appropriate to the swap dealer's current portfolio.

(ii) The stressed VaR-based measure must be calculated at least weekly and be no less than the swap dealer's VaR-based measure.

(iii) A swap dealer must have policies and procedures that describe how it determines the period of significant financial stress used to calculate the swap dealer's stressed VaR-based measure under this section and must be able to provide empirical support for the period used. The swap dealer must obtain the prior approval of the Commission, or a registered futures association of which the swap dealer is a member, if the swap dealer makes any material changes to these policies and procedures. The policies and procedures must address:

(A) How the swap dealer links the period of significant financial stress used to calculate the stressed VaR-based measure to the composition and directional bias of its current portfolio; and

(B) The swap dealer's process for selecting, reviewing, and updating the period of significant financial stress used to calculate the stressed VaR-based measure and for monitoring the appropriateness of the period to the swap dealer's current portfolio.

(iv) Nothing in this appendix prevents the Commission or the registered futures association of which the swap dealer is a member from requiring a swap dealer to use a different period of significant financial stress in the calculation of the stressed VaR-based measure.

(k) *Specific Risk.* A specific risk model must meet the following minimum requirements in order to be approved:

(1) *General requirement.* A swap dealer must use one of the methods in this

paragraph (k) to measure the specific risk for each of its debt, equity, and securitization positions with specific risk.

(2) *Modeled specific risk.* A swap dealer may use models to measure the specific risk of its proprietary positions. A swap dealer must use models to measure the specific risk of correlation trading positions that are modeled under paragraph (m) of this appendix.

(i) *Requirements for specific risk modeling.*

(A) If a swap dealer uses internal models to measure the specific risk of a portfolio, the internal models must:

(1) Explain the historical price variation in the portfolio;

(2) Be responsive to changes in market conditions;

(3) Be robust to an adverse environment, including signaling rising risk in an adverse environment; and

(4) Capture all material components of specific risk for the debt and equity positions in the portfolio. Specifically, the internal models must:

(i) Capture name-related basis risk;

(ii) Capture event risk and idiosyncratic risk; and

(iii) Capture and demonstrate sensitivity to material differences between positions that are similar but not identical and to changes in portfolio composition and concentrations.

(B) If a swap dealer calculates an incremental risk measure for a portfolio of debt or equity positions under paragraph (l) of this appendix, the swap dealer is not required to capture default and credit migration risks in its internal models used to measure the specific risk of those portfolios.

(C) A swap dealer shall validate a specific risk model through backtesting.

(ii) *Specific risk fully modeled for one or more portfolios.* If the swap dealer's VaR-based measure captures all material aspects of specific risk for one or more of its portfolios of debt, equity, or correlation trading positions, the swap dealer has no specific risk add-on for those portfolios.

(3) *Specific risk not modeled.*

(i) If the swap dealer's VaR-based measure does not capture all material aspects of specific risk for a portfolio of debt, equity, or correlation trading positions, the swap dealer must calculate a specific-risk add-on for the portfolio under the standardized measurement method as described in 12 CFR 217.210.

(ii) A swap dealer must calculate a specific risk add-on under the standardized measurement method as described in 12 CFR 217.200 for all of its securitization positions that are not modeled under this paragraph (k).

(l) *Incremental Risk.* An incremental risk model must meet the following minimum requirements in order to be approved:

(1) *General requirement.* A swap dealer that measures the specific risk of a portfolio of debt positions under paragraph (k) of this appendix using internal models must calculate at least weekly an incremental risk measure for that portfolio according to the requirements in this section. The incremental risk measure is the swap dealer's measure of potential losses due to incremental risk over a one-year time horizon at a one-tail, 99.9

percent confidence level, either under the assumption of a constant level of risk, or under the assumption of constant positions. With the prior approval of the Commission or a registered futures association of which the swap dealer is a member, a swap dealer may choose to include portfolios of equity positions in its incremental risk model, provided that it consistently includes such equity positions in a manner that is consistent with how the swap dealer internally measures and manages the incremental risk of such positions at the portfolio level. If equity positions are included in the model, for modeling purposes default is considered to have occurred upon the default of any debt of the issuer of the equity position. A swap dealer may not include correlation trading positions or securitization positions in its incremental risk measure.

(2) *Requirements for incremental risk modeling.* For purposes of calculating the incremental risk measure, the incremental risk model must:

(i) Measure incremental risk over a one-year time horizon and at a one-tail, 99.9 percent confidence level, either under the assumption of a constant level of risk, or under the assumption of constant positions.

(A) A constant level of risk assumption means that the swap dealer rebalances, or rolls over, the swap dealer's trading positions at the beginning of each liquidity horizon over the one-year horizon in a manner that maintains the swap dealer's initial risk level. The swap dealer must determine the frequency of rebalancing in a manner consistent with the liquidity horizons of the positions in the portfolio. The liquidity horizon of a position or set of positions is the time required for a swap dealer to reduce its exposure to, or hedge all of its material risks of, the position(s) in a stressed market. The liquidity horizon for a position or set of positions may not be less than the shorter of three months or the contractual maturity of the position.

(B) A constant position assumption means that the swap dealer maintains the same set of positions throughout the one-year horizon. If a swap dealer uses this assumption, it must do so consistently across all portfolios.

(C) A swap dealer's selection of a constant position or a constant risk assumption must be consistent between the swap dealer's incremental risk model and its comprehensive risk model described in paragraph (m) of this appendix, if applicable.

(D) A swap dealer's treatment of liquidity horizons must be consistent between the swap dealer's incremental risk model and its comprehensive risk model described in paragraph (m) of this appendix, if applicable.

(ii) Recognize the impact of correlations between default and migration events among obligors.

(iii) Reflect the effect of issuer and market concentrations, as well as concentrations that can arise within and across product classes during stressed conditions.

(iv) Reflect netting only of long and short positions that reference the same financial instrument.

(v) Reflect any material mismatch between a position and its hedge.

(vi) Recognize the effect that liquidity horizons have on dynamic hedging strategies. In such cases, a swap dealer must:

(A) Choose to model the rebalancing of the hedge consistently over the relevant set of trading positions;

(B) Demonstrate that the inclusion of rebalancing results in a more appropriate risk measurement;

(C) Demonstrate that the market for the hedge is sufficiently liquid to permit rebalancing during periods of stress; and

(D) Capture in the incremental risk model any residual risks arising from such hedging strategies.

(vii) Reflect the nonlinear impact of options and other positions with material nonlinear behavior with respect to default and migration changes.

(viii) Maintain consistency with the swap dealer's internal risk management methodologies for identifying, measuring, and managing risk.

(m) *Comprehensive Risk.* A comprehensive risk model must meet the following minimum requirements in order to be approved:

(1) *General requirement.*

(i) Subject to the prior approval of the Commission or a registered futures association of which the swap dealer is a member, a swap dealer may use the method in this paragraph to measure comprehensive risk, that is, all price risk, for one or more portfolios of correlation trading positions.

(ii) A swap dealer that measures the price risk of a portfolio of correlation trading positions using internal models must calculate at least weekly a comprehensive risk measure that captures all price risk according to the requirements of this paragraph (m). The comprehensive risk measure is either:

(A) The sum of:

(1) The swap dealer's modeled measure of all price risk determined according to the requirements in paragraph (m)(2) of this appendix; and

(2) A surcharge for the swap dealer's modeled correlation trading positions equal to the total specific risk add-on for such positions as calculated under paragraph (k) of this appendix multiplied by 8.0 percent; or

(B) With approval of the Commission, or the registered futures association of which the swap dealer is member, and provided the swap dealer has met the requirements of this paragraph (m) for a period of at least one year and can demonstrate the effectiveness of the model through the results of ongoing model validation efforts including robust benchmarking, the greater of:

(1) The swap dealer's modeled measure of all price risk determined according to the requirements in paragraph (b) of this appendix; or

(2) The total specific risk add-on that would apply to the swap dealer's modeled correlation trading positions as calculated under paragraph (k) of this appendix multiplied by 8.0 percent.

(2) *Requirements for modeling all price risk.* If a swap dealer uses an internal model to measure the price risk of a portfolio of correlation trading positions:

(i) The internal model must measure comprehensive risk over a one-year time

horizon at a one-tail, 99.9 percent confidence level, either under the assumption of a constant level of risk, or under the assumption of constant positions.

(ii) The model must capture all material price risk, including but not limited to the following:

(A) The risks associated with the contractual structure of cash flows of the position, its issuer, and its underlying exposures;

(B) Credit spread risk, including nonlinear price risks;

(C) The volatility of implied correlations, including nonlinear price risks such as the cross-effect between spreads and correlations;

(D) Basis risk;

(E) Recovery rate volatility as it relates to the propensity for recovery rates to affect tranche prices; and

(F) To the extent the comprehensive risk measure incorporates the benefits of dynamic hedging, the static nature of the hedge over the liquidity horizon must be recognized. In such cases, a swap dealer must:

(1) Choose to model the rebalancing of the hedge consistently over the relevant set of trading positions;

(2) Demonstrate that the inclusion of rebalancing results in a more appropriate risk measurement;

(3) Demonstrate that the market for the hedge is sufficiently liquid to permit rebalancing during periods of stress; and

(4) Capture in the comprehensive risk model any residual risks arising from such hedging strategies;

(iii) The swap dealer must use market data that are relevant in representing the risk profile of the swap dealer's correlation trading positions in order to ensure that the swap dealer fully captures the material risks of the correlation trading positions in its comprehensive risk measure in accordance with this section; and

(iv) The swap dealer must be able to demonstrate that its model is an appropriate representation of comprehensive risk in light of the historical price variation of its correlation trading positions.

(3) *Requirements for stress testing.*

(i) A swap dealer must at least weekly apply specific, supervisory stress scenarios to its portfolio of correlation trading positions that capture changes in:

(A) Default rates;

(B) Recovery rates;

(C) Credit spreads;

(D) Correlations of underlying exposures; and

(E) Correlations of a correlation trading position and its hedge.

(ii) *Other requirements.* (A) A swap dealer must retain and make available to the Commission and to the registered futures association of which the swap dealer is a member the results and all assumptions and parameters of the supervisory stress testing, including comparisons with the capital requirements generated by the swap dealer's comprehensive risk model.

(B) A swap dealer must report promptly to the Commission and to the registered futures association of which it is a member promptly any instances where the stress tests indicate

any material deficiencies in the comprehensive risk model.

(n) *Securitization Exposures.* (1) To use the simplified supervisory formula approach (SSFA) to determine the specific risk-weighting factor for a securitization position, a swap dealer must have data that enables it to assign accurately the parameters described in paragraph (n)(2) of this appendix. Data used to assign the parameters described in paragraph (n)(2) of this appendix must be the most currently available data; if the contracts governing the underlying exposures of the securitization require payments on a monthly or quarterly basis, the data used to assign the parameters described in paragraph (n)(2) of this appendix must be no more than 91 calendar days old. A swap dealer that does not have the appropriate data to assign the parameters described in paragraph (n)(2) of this appendix must assign a specific risk-weighting of 100 percent to the position.

(2) *SSFA parameters.* To calculate the specific risk-weighting factor for a securitization position using the SSFA, a swap dealer must have accurate information on the five inputs to the SSFA calculation described in paragraphs (n)(2)(i) through (n)(2)(v) of this appendix.

(i)  $K_G$  is the weighted-average (with unpaid principal used as the weight for each exposure) total capital requirement of the underlying exposures calculated for a swap dealer's credit risk.  $K_G$  is expressed as a decimal value between zero and one (that is, an average risk weight of 100 percent presents a value of  $K_G$  equal to 0.08).

(ii) Parameter  $W$  is expressed as a decimal value between zero and one. Parameter  $W$  is the ratio of the sum of the dollar amounts of any underlying exposures of the securitization that meet any of the criteria as set forth in paragraphs (n)(2)(ii)(A) through (F) of this appendix to the balance, measured in dollars, of underlying exposures:

(A) Ninety days or more past due;

(B) Subject to a bankruptcy or insolvency proceeding;

(C) In the process of foreclosure;

(D) Held as real estate owned;

(E) Has contractually deferred payments for 90 days or more, other than principal or interest payments deferred on;

(1) Federally-guaranteed student loans, in accordance with the terms of those guarantee programs; or

(2) Consumer loans, including non-federally guaranteed student loans, provided that such payments are deferred pursuant to provisions included in the contract at the time funds are disbursed that provide for period(s) of deferral that are not initiated based on changes in the creditworthiness of the borrower; or

(F) Is in default.

(iii) Parameter  $A$  is the attachment point for the position, which represents the threshold at which credit losses will first be allocated to the position. Except as provided in 12 CFR 217.210(b)(2)(vii)(D) for  $n^{\text{th}}$  to default derivatives, parameter  $A$  equals the ratio of the current dollar amount of underlying exposures that are subordinated to the position of the swap dealer to the current dollar amount of underlying exposures. Any reserve account funded by



the accumulated cash flows from the underlying exposures that is subordinated to the position that contains the swap dealer's securitization exposure may be included in the calculation of parameter A to the extent that cash is present in the account. Parameter A is expressed as a decimal value between zero and one.

(iv) Parameter D is the detachment point for the position, which represents the threshold at which credit losses of principal allocated to the position would result in a total loss of principal. Except as provided in 12 CFR 217.210(b)(2)(vii)(D) for n<sup>th</sup>-to-default credit derivatives, parameter D equals parameter A plus the ratio of the current dollar amount of the securitization positions that are pari passu with the position (that is, have equal seniority with respect to credit

risk) to the current dollar amount of the underlying exposures. Parameter D is expressed as a decimal value between zero and one.

(v) A supervisory calibration parameter, p, is equal to 0.5 for securitization positions that are not resecuritization positions and equal to 1.5 for resecuritization positions.

(3) *Mechanics of the SSFA.*  $K_G$  and  $W$  are used to calculate  $K_A$ , the augmented value of  $K_G$ , which reflects the observed credit quality of the underlying exposures.  $K_A$  is defined in paragraph (n)(4) of this section. The values of parameters A and D, relative to  $K_A$  determine the specific risk-weighting factor assigned to a securitization position, or portion of a position, as appropriate, is the larger of the specific risk-weighting factor determined in accordance with paragraphs (n)(3) and (n)(4)

of this appendix, and a specific risk-weighting factor of 1.6 percent.

(i) When the detachment point, parameter D, for a securitization position is less than or equal to  $K_A$ , the position must be assigned a specific risk-weighting factor of 100 percent.

(ii) When the attachment point, parameter A, for a securitization position is greater than or equal to  $K_A$ , the swap dealer must calculate the specific risk-weighting factor in accordance with paragraph (n)(4) of this section.

(iii) When A is less than  $K_A$  and D is greater than  $K_A$ , the specific risk-weighting factor is a weighted-average of 1.00 and  $K_{SSFA}$  calculated under paragraphs (n)(3)(iii)(A) and (3)(iii)(B) of this appendix. For the purpose of this calculation:

(A) The weight assigned to 1.00 equals

(B) The weight assigned to  $K_{SSFA}$  equals  $\frac{D-K_A}{D-A}$ . The specific risk-weighting factor

is equal to:  $SRWF = 100 \cdot [(\frac{K_A-A}{D-A}) \cdot 1.00] + [(\frac{D-K_A}{D-A}) \cdot K_{SSFA}]$

#### (4) SSFA equation.

(i) The swap dealer must define the following parameters:

$$K_A = (1 - W) \cdot K_G + (0.5 \cdot W)$$

$$a = -\frac{1}{p \cdot K_A}$$

$$u = D - K_A$$

$$l = \max(A - K_A, 0)$$

$$e = 2.71828, \text{ the base of the natural logarithms}$$

(ii) Then the swap dealer must calculate  $K_{SSFA}$  according to the following formula:

$$K_{SSFA} = \frac{e^{a \cdot u} - e^{a \cdot l}}{a \cdot (u - l)}$$

(iii) The specific risk-weighting factor for the position (expressed as a percent) is

equal to  $K_{SSFA} \times 100$ .

(o) *Additional conditions.* As a condition for the swap dealer to use this Appendix A to calculate certain of its capital charges, the Commission, or registered futures association of which the swap dealer is a member, may impose additional conditions on the swap dealer, which may include, but are not limited to restricting the swap dealer's business on a product-specific, category-

specific, or general basis; submitting to the Commission or registered futures association a plan to increase the swap dealer's regulatory capital; filing more frequent reports with the Commission or registered futures association; modifying the swap dealer's internal risk management control procedures; or computing the swap dealer's deductions for market and credit risk in

accordance with § 23.102 as appropriate. If the Commission or registered futures association finds it is necessary or appropriate in the public interest, the Commission or registered futures association may impose additional conditions on the swap dealer, if:

(1) The swap dealer is required to provide notice to the Commission or a registered

futures association that the swap dealer's regulatory capital is less than \$100 million;

(2) The swap dealer fails to meet the reporting requirements set forth in § 23.105;

(3) Any event specified in § 23.105 occurs;

(4) There is a material deficiency in the internal risk management control system or in the mathematical models used to price securities or to calculate deductions for market and credit risk or allowances for market and credit risk, as applicable, of the swap dealer;

(5) The swap dealer fails to comply with this Appendix A; or

(6) The Commission finds that imposition of other conditions is necessary or appropriate in the public interest.

**§ 23.103 Calculation of market risk exposure requirement and credit risk requirement when models are not approved.**

(a) *Non-model approach.* A swap dealer that has not received approval from the Commission, or from a registered futures association of which the swap dealer is a member, to compute its market risk exposure requirement and/or credit risk exposure requirement pursuant to internal models under § 23.102, or a swap dealer that has had its approval to compute its market risk exposure requirement and/or credit risk exposure requirement pursuant to internal models under § 23.102 revoked by the Commission or the registered futures association, must compute its market risk exposure requirements and/or credit risk exposure requirements pursuant to paragraphs (b) and (c) of this section.

(b) *Market risk exposure requirements.* (1) A swap dealer that computes its regulatory capital under § 23.101(a)(1)(i), (a)(1)(ii), or (a)(2) shall compute a market risk capital charge for the positions that the swap dealer holds in its proprietary accounts using the applicable standardized market risk charges set forth in § 240.18a-1 of this title and § 1.17 of this chapter for such positions.

(2) In computing its regulatory capital under § 23.101(a)(1)(i), a swap dealer shall increase its risk-weighted assets by an amount equal to 1250 percent of the sum of the market risk capital charges computed under paragraph (b)(1) of this section.

(3) In computing its net capital under § 23.101(a)(1)(ii), a swap dealer shall deduct from its tentative net capital the sum of the market risk capital charges computed under paragraph (b)(1) of this section.

(4) In computing its minimum capital requirement under § 23.101(a)(2), a swap dealer must add the amount of the market risk capital charge computed under this section to the \$20 million minimum capital requirement.

(c) *Credit risk charges.* (1) A swap dealer that computes its regulatory capital under § 23.101(a)(1)(i) shall compute counterparty credit risk capital charges in accordance with subpart D of 12 CFR part 217. A swap dealer that computes regulatory capital under § 23.101(a)(1)(ii) shall compute counterparty credit risk capital charges using the applicable standardized credit risk charges set forth in § 240.18a-1 of this title and § 1.17 of this chapter for such positions; *Provided, however,* that a swap dealer may reduce the counterparty credit risk for a particular counterparty by the amount of margin deposited by such counterparty for its uncleared swap positions that is maintained with a third party custodian in accordance with § 23.157 and by the amount of margin deposited by such counterparty for its uncleared security-based swap positions that is maintained with a third party custodian in accordance with § 240.18a-3 of this title.

(2) In computing its regulatory capital under § 23.101(a)(1)(i), a swap dealer shall increase its risk-weighted assets by the sum of the counterparty credit risk capital charges computed under paragraph (c)(1) of this section.

(3) In computing its net capital under § 23.101(a)(1)(ii), a swap dealer shall reduce its tentative net capital by the sum of the counterparty credit risk capital charges computed under paragraph (c)(1) of this section.

(4) In computing its minimum capital requirement under § 23.101(a)(2), a swap dealer must add the amount of the credit risk capital charge computed under this section to the \$20 million minimum capital requirement.

**§ 23.104 Liquidity requirements and equity withdrawal restrictions.**

(a)(1) *Liquidity coverage ratio.* A swap dealer that is subject to the minimum capital requirements of § 23.101(a)(1)(i) must meet the liquidity coverage ratio as defined in 12 CFR part 249 as if the swap dealer were regulated by the Federal Reserve Board and subject to the provisions of 12 CFR part 249; *Provided, however,* that a swap dealer may include cash deposited with banks that is readily available for withdrawal as level 1 assets under 12 CFR 249.20, and a swap dealer organized and domiciled outside of the U.S. may include high quality liquid assets maintained in its home country jurisdiction, in meeting its minimum liquidity coverage ratio.

(2) *Notification of senior management.* The senior management of the swap dealer that is responsible for risk management must be promptly informed if the swap dealer's liquidity

coverage ratio falls below 1.0. In addition, the assumptions underlying the calculation of the liquidity coverage ratio must be reviewed at least quarterly by senior management of the swap dealer that is responsible for risk management, and at least annually by the full senior management of the swap dealer.

(3) *Restrictions on the disposition or transfer of high quality liquid assets.* A swap dealer may not dispose of, or transfer to an affiliate, a high quality liquid asset (as that term is defined in 12 CFR 249.20) without prior notice to and approval by the Commission if such disposition or transfer would result in the swap dealer failing to meet the liquidity coverage ratio in paragraph (a)(1) of this section.

(4) *Contingency funding plan.* The swap dealer must have a written contingency funding plan that addresses the swap dealer's policies and the roles and responsibilities of relevant personnel for meeting the liquidity needs of the swap dealer and communications with the public and other market participants during a liquidity stress event.

(b)(1) *Liquidity stress test.* A swap dealer that computes regulatory capital under paragraph (a)(1)(ii) of § 23.101 must perform a liquidity stress test at least monthly, the results of which must be provided within ten business days to senior management that has responsibility to oversee risk management at the swap dealer. The assumptions underlying the liquidity stress test must be reviewed at least quarterly by senior management that has responsibility to oversee risk management at the swap dealer and at least annually by senior management of the swap dealer. The liquidity stress test must include, at a minimum, the following assumed conditions lasting for 30 consecutive days:

(i) A stress event includes a decline in creditworthiness of the swap dealer severe enough to trigger contractual credit-related commitment provisions of counterparty agreements;

(ii) The loss of all existing unsecured funding at the earlier of its maturity or put date and an inability to acquire a material amount of new unsecured funding, including intercompany advances and unfunded committed lines of credit;

(iii) The potential for a material net loss of secured funding;

(iv) The loss of the ability to procure repurchase agreement financing for less liquid assets;

(v) The illiquidity of collateral required by and on deposit at clearing agencies or other entities which is not

deducted from net worth or which is not funded by customer assets;

(vi) A material increase in collateral required to be maintained at registered clearing agencies of which it is a member; and

(vii) The potential for a material loss of liquidity caused by market participants exercising contractual rights and/or refusing to enter into transactions with respect to the various businesses, positions, and commitments of the swap dealer.

(2) *Stress test of consolidated entity.* If applicable, the swap dealer must justify and document any differences in the assumptions used in the liquidity stress test of the swap dealer from those used in the liquidity stress test of the consolidated entity of which the swap dealer is a part.

(3) *Liquidity reserves.* The swap dealer must maintain at all times liquidity reserves based on the results of the liquidity stress test. The liquidity reserves used to satisfy the liquidity stress test must be:

(i) Cash, obligations of the United States, or obligations fully guaranteed as to principal and interest by the United States; and

(ii) Unencumbered and free of any liens at all times.

(4) *Contingency funding plan.* The swap dealer must have a written contingency funding plan that addresses the swap dealer's policies and the roles and responsibilities of relevant personnel for meeting the liquidity needs of the swap dealer and communications with the public and other market participants during a liquidity stress event.

(c) *Equity withdrawal restrictions.* The capital of a swap dealer, including the capital of any affiliate or subsidiary whose liabilities or obligations are guaranteed, endorsed, or assumed by the swap dealer may not be withdrawn by action of the swap dealer or its equity holders, or by redemption of shares of stock by the swap dealer or by such affiliates or subsidiaries, or through the payment of dividends or any similar distribution, nor may any unsecured advance or loan be made to an equity holder or employee if, after giving effect thereto and to any other such withdrawals, advances, or loans which are scheduled to occur within six months following such withdrawal, advance or loan, the swap dealer's regulatory capital is less than 120 percent of the minimum regulatory capital required under § 23.101. The equity withdrawal restrictions, however, do not preclude a swap dealer from making required tax payments or from paying reasonable compensation to

equity holders. The Commission may, upon application by the swap dealer, grant relief from this paragraph (c) if the Commission deems such relief to be in the public interest.

(d) *Temporary equity withdrawal restrictions by Commission order.* (1) The Commission may by order restrict, for a period of up to twenty business days, any withdrawal by a swap dealer of capital or any unsecured loan or advance to a stockholder, partner, member, employee or affiliate under such terms and conditions as the Commission deems appropriate in the public interest if the Commission, based on the information available, concludes that such withdrawal, loan or advance may be detrimental to the financial integrity of the swap dealer, or may unduly jeopardize the swap dealer's ability to meet its financial obligations to counterparties or to pay other liabilities which may cause a significant impact on the markets or expose the counterparties and creditors of the swap dealer to loss.

(2) An order temporarily prohibiting the withdrawal of capital shall be rescinded if the Commission determines that the restriction on capital withdrawal should not remain in effect. A hearing on an order temporarily prohibiting withdrawal of capital will be held within two business days from the date of the request in writing by the swap dealer.

**§ 23.105 Financial recordkeeping, reporting and notification requirements for swap dealers and major swap participants.**

(a) *Scope.* (1) Except as provided in paragraphs (a)(2) and (a)(3) of this section, a swap dealer or major swap participant must comply with the applicable requirements set forth in paragraphs (b) through (q) of this section.

(2) The requirements in paragraphs (b) through (o) of this section do not apply to any swap dealer or major swap participant that is subject to the capital requirements of a prudential regulator.

(3) The requirements in paragraph (p) of this section do not apply to any swap dealer or major swap participant that is subject to the capital requirements of the Commission.

(4) The requirements of paragraph (q) of this section apply to swap dealers or major swap participants that are subject to the capital requirements of the Commission or of a prudential regulator.

(b) *Current books and records.* A swap dealer or major swap participant shall prepare and keep current ledgers or other similar records which show or summarize, with appropriate references to supporting documents, each

transaction affecting its asset, liability, income, expense and capital accounts, and in which all its asset, liability and capital accounts are classified in accordance with U.S. generally accepted accounting principles, and as otherwise may be necessary for the capital calculations required under § 23.101: *Provided, however,* that a swap dealer or major swap participant that is not organized under the laws of a state or other jurisdiction in the United States, and is not otherwise required to prepare financial statements in accordance with U.S. generally accepted accounting principles, may prepare and keep records required by this section in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board. Such records must be maintained in accordance with § 1.31 of this chapter.

(c) *Notices.* (1) A swap dealer or major swap participant subject to minimum regulatory capital requirements under § 23.101 and who knows or should have known that its regulatory capital at any time is less than the minimum required by § 23.101, must:

(i) Provide immediate written notice that the swap dealer's or major swap participant's regulatory capital is less than that required by § 23.101; and

(ii) Provide together with such notice, documentation in such form as necessary to adequately reflect the swap dealer's or major swap participant's regulatory capital condition as of any date such person's regulatory capital is less than the minimum required. The swap dealer or major swap participant must provide similar documentation for other days as the Commission may request.

(2) A swap dealer or major swap participant who is subject to the minimum regulatory capital requirements under § 23.101 and who knows or should have known that its regulatory capital at any time is less than 120 percent of its minimum regulatory capital requirement as determined under § 23.101, must provide written notice to that effect within 24 hours of such event.

(3) If a swap dealer or major swap participant at any time fails to make or to keep current the books and records required by these regulations, such swap dealer or major swap participant must, on the same day such event occurs, provide notice of such fact, specifying the books and records which have not been made or which are not current, and within 48 hours after giving such notice file a written report stating what steps have been and are being taken to correct the situation.

(4) Each swap dealer that fails to comply with the liquidity requirements set forth in § 23.104 must file written notice within 24 hours of when it knows or should have known that the swap dealer is not in compliance.

(5) A swap dealer or major swap participant must provide notice of a substantial reduction in capital as compared to that last reported in a financial report filed with the Commission pursuant to this section. The notice shall be provided if the swap dealer or major swap participant experiences a 30 percent or more decrease in the amount of capital that the swap dealer or major swap participant holds in excess of its regulatory capital requirement as computed under § 23.101.

(6) A swap dealer must provide the Commission with notice two business days prior to the withdrawal of capital by action of the equity holders of the swap dealer where the withdrawal exceeds 30 percent of the swap dealer's excess regulatory capital as computed under § 23.101.

(7) A swap dealer or major swap participant that is registered with the Securities and Exchange Commission as a security-based swap dealer or as a major security based swap participant and files a notice with the Securities and Exchange Commission under § 240.18a-8 of this title, must file a copy of such notice with the Commission at the time the swap dealer or major security-based swap participant files the notice with the Securities and Exchange Commission.

(8) A swap dealer or major swap participant must submit a notice to the Commission within 24 hours of the occurrence of any of the following events:

(i) A single counterparty or group of counterparties that are under common ownership or control fails to post initial margin or pay variation margin to the swap dealer or major swap participant for swap positions in compliance with § 23.152 and security-based swap positions in compliance with proposed § 240.18a-3(c)(1)(i)(b) of this title and such initial margin and variation margin, in the aggregate, is equal to or greater than 25 percent of the swap dealer's minimum capital requirement or 25 percent of the major swap participant's tangible net worth;

(ii) Counterparties fail to post initial margin or pay variation margin to the swap dealer or major swap participant for swap positions in compliance with § 23.152 and security-based swap positions in compliance with proposed § 240.18a-3(c)(1)(i)(B) in an amount that, in the aggregate, exceeds 50

percent of the swap dealer's minimum capital requirement or 50 percent of the major swap participant's tangible net worth;

(iii) A swap dealer or major swap participant fails to post initial margin or pay variation margin to a single counterparty or group of counterparties under common ownership and control for swap positions in compliance with § 23.152 and security-based swap positions in compliance with proposed § 240.18a-3(c)(1)(i)(B) of this title and such initial margin and variation margin, in the aggregate, exceeds 25 percent of the swap dealer's minimum capital requirement or 25 percent of the major swap participant's tangible net worth; or

(iv) A swap dealer or major swap participant fails to post initial margin or pay variation margin to counterparties for swap positions in compliance with § 23.152 and security-based swap positions in compliance with proposed § 240.18a-3(c)(1)(i)(B) in an amount that, in the aggregate, exceeds 50 percent of the swap dealer's minimum capital requirement or 50 percent of the major swap participants tangible net worth.

(d) *Monthly unaudited financial reports.* (1) A swap dealer or major swap participant shall file monthly financial reports meeting the requirements in paragraph (d)(2) of this section as of the close of business each month. Such financial reports must be filed no later than 17 business days after the date for which the report is made.

(2) The monthly financial reports must be prepared in the English language and be denominated in United States dollars. The monthly financial reports shall include a statement of financial condition, a statement of income/loss, a statement of cash flows, a statement of changes in ownership equity, a statement demonstrating compliance with and calculation of the applicable regulatory capital requirement under § 23.101, and such further material information as may be necessary to make the required statements not misleading. The monthly report and schedules must be prepared in accordance with generally accepted accounting principles as established in the United States: *Provided, however*, that a swap dealer or major swap participant that is not organized under the laws of a state or other jurisdiction in the United States, and does not otherwise prepare financial statements in accordance with U.S. generally accepted accounting principles, may prepare the monthly report and schedules required by this section in accordance with International Financial

Reporting Standards issued by the International Accounting Standards Board.

(3) A swap dealer or major swap participant that is also registered with the Securities and Exchange Commission as a security-based swap dealer or a major security-based swap participant and files a monthly Form SBS with the Securities and Exchange Commission pursuant to § 240.18a-7 of this title, may file such Form SBS with the Commission in lieu of the financial reports required under paragraphs (d)(1) and (2) of this section. The swap dealer or major swap participant must file the Form SBS with the Commission when it files the Form SBS with the Securities and Exchange Commission, *provided, however*, that the swap dealer or major swap participant must file the Form SBS with the Commission no later than 17 business days from the date the report is made.

(4) A swap dealer or major swap participant that is also registered with the Commission as a futures commission merchant may file a Form 1-FR-FCM in lieu of the monthly financial reports required under paragraphs (d)(1) and (2) of this section.

(e) *Annual audited financial reports.*

(1) A swap dealer and major swap participant shall file an annual audited financial report as of the close of its fiscal year, certified in accordance with paragraph (e)(2) of this section, and including the information specified in paragraph (e)(3) of this section no later than 60 days after the close of the swap dealer's and major swap participant's fiscal year-end.

(2) The annual certified financial report shall be audited and reported upon with an opinion expressed by an independent certified public accountant or independent licensed accountant that is in good standing in the accountant's home jurisdiction.

(3) The annual audited financial reports shall be prepared in accordance with generally accepted accounting principles as established in the United States, be prepared in the English language, and denominated in United States dollars: *Provided, however*, that a swap dealer or major swap participant that is not organized under the laws of a state or other jurisdiction in the United States, and does not otherwise prepare financial statements in accordance with U.S. generally accepted accounting principles, may prepare the annual audited financial reports required by this section in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board.

(4) The annual audited financial report must include the following:

(i) A statement of financial condition as of the date for which the report is made;

(ii) Statements of income (loss), cash flows, and changes in ownership equity for the period between the date of the most recent certified statement of financial condition filed with the Commission and the date for which the report is made;

(iii) Appropriate footnote disclosures;

(iv) A statement demonstrating the swap dealer's or major swap participant's compliance with and calculation of the applicable regulatory capital requirement under § 23.101;

(v) A reconciliation of any material differences from the monthly unaudited financial report prepared as of the swap dealer's or major swap participant's year-end date and the swap dealer's or major swap participant's annual financial report prepared under this paragraph (e); and

(vi) Such further material information as may be necessary to make the required statements not misleading.

(5) A swap dealer or major swap participant that is also registered with the Securities and Exchange Commission as a security-based swap dealer or a major security-based swap participant and files an annual financial report with the Securities and Exchange Commission pursuant to § 240.18a-7 of this title, may file such annual report with the Commission in lieu of the annual financial report required under this paragraph (e). The swap dealer or major swap participant must file its annual report with the Commission at the same time that it files the annual report with the Securities and Exchange Commission, provided that the annual report is filed with the Commission no later than 60 days from the swap dealer's or major swap participant's fiscal year-end date.

(6) A swap dealer or major swap participant that is also registered with the Commission as a futures commission merchant may file an audited Form 1-FR-FCM in lieu of the annual financial reports required under this paragraph (e).

(f) *Oath or affirmation.* Attached to each financial report, or other filing made pursuant to this section, must be an oath or affirmation that to the best knowledge and belief of the individual making such oath or affirmation the information contained in the financial report is true and correct. The individual making such oath or affirmation must be: If the swap dealer or major swap participant is a sole proprietorship, the proprietor; if a

partnership, any general partner; if a corporation, the chief executive officer or chief financial officer; and, if a limited liability company or limited liability partnership, the chief executive officer, the chief financial officer, the manager, the managing member, or those members vested with the management authority for the limited liability company or limited liability partnership.

(g) *Change of fiscal year-end.* A swap dealer or major swap participant may not change the date of its fiscal year-end from that used in its most recent annual report filed under paragraph (e) of this section unless the swap dealer or major swap participant has requested and received written approval for the change from a registered futures association of which it is a member.

(h) *Additional information requirements.* From time to time the Commission may, by written notice, require any swap dealer or major swap participant to file financial or operational information on a daily basis or at such other times as may be specified by the Commission. Such information must be furnished in accordance with the requirements included in the written Commission notice.

(i) *Public disclosure and nonpublic treatment of reports.* (1) A swap dealer or major swap participant must no less than quarterly make publicly available on its Web site the following information:

(i) The statement of financial condition; and

(ii) A statement disclosing the amount of the swap dealer's or major swap participant's regulatory capital as of the end of the quarter and the amount of its minimum regulatory capital requirement, computed in accordance with § 23.101.

(2) A swap dealer or major swap participant must no less than annually make publicly available on its Web site the following information:

(i) The statement of financial condition from the swap dealer or major swap participant's audited financial statements including applicable footnotes; and

(ii) A statement disclosing the amount of the swap dealer's or major swap participant's regulatory capital as of the fiscal year end and its minimum regulatory capital requirement, computed in accordance with § 23.101.

(3) Financial information required to be made publicly available pursuant to this section must be posted within 10 business days after the firm is required to file applicable financial reports with

the Commission pursuant to paragraph (d) or (e) of this section.

(4) Financial information required to be filed pursuant to this section, and not otherwise publicly available, will be treated as exempt from mandatory public disclosure for purposes of the Freedom of Information Act and the Government in the Sunshine Act and parts 145 and 147 of this chapter; *Provided, however,* that all information that is exempt from mandatory public disclosure will be available for official use by any official or employee of the United States or any State, by the National Futures Association and by any other person to whom the Commission believes disclosure of such information is in the public interest.

(j) *Extension of time to file financial reports.* A swap dealer or major swap participant may file a request with the registered futures association of which it is a member for an extension of time to file a monthly unaudited financial report or an annual audited financial report required under paragraphs (d) and (e) of this section. Such request will be approved, conditionally or unconditionally, or disapproved by the registered futures association.

(k) *Additional reporting requirements for swap dealers approved to use models to calculate market risk and credit risk for computing capital requirements.* (1) A swap dealer that has received approval under § 23.102(d) from the Commission, or from a registered futures association of which the swap dealer is a member, to use internal models to compute its market risk exposure requirement and credit risk exposure requirement in computing its regulatory capital under § 23.101 must file with the Commission and with the registered futures association of which the swap dealer is a member the following information within 17 business days of the end of each month:

(i) For each product for which the swap dealer calculates a deduction for market risk other than in accordance with a model approved pursuant to § 23.102(d), the product category and the amount of the deduction for market risk;

(ii) A graph reflecting, for each business line, the daily intra-month VaR;

(iii) The aggregate VaR for the swap dealer;

(iv) For each product for which the swap dealer uses scenario analysis, the product category and the deduction for market risk;

(v) Credit risk information on swap, mixed swap and security-based swap exposures including:

(A) Overall current exposure;

(B) Current exposure (including commitments) listed by counterparty for the 15 largest exposures;

(C) The 10 largest commitments listed by counterparty;

(D) The swap dealer's maximum potential exposure listed by counterparty for the 15 largest exposures;

(E) The swap dealer's aggregate maximum potential exposure;

(F) A summary report reflecting the swap dealer's current and maximum potential exposures by credit rating category; and

(G) A summary report reflecting the swap dealer's current exposure for each of the top ten countries to which the swap dealer is exposed (by residence of the main operating group of the counterparty); and

(vi) The results of the liquidity stress test required by § 23.104.

(2) A swap dealer that has received approval under § 23.102(d) from the Commission or from a registered futures association of which the swap dealer is a member to use internal models to compute its market risk exposure requirement and credit risk exposure requirement in computing its regulatory capital under § 23.101 must file with the Commission and with the registered futures association of which the swap dealer is member the following information within 17 business days of the end of each calendar quarter:

(i) A report identifying the number of business days for which the actual daily net trading loss exceeded the corresponding daily VaR; and

(ii) The results of backtesting of all internal models used to compute allowable capital, including VaR, and credit risk models, indicating the number of backtesting exceptions.

(l) *Additional position and counterparty reporting requirements.* A swap dealer or major swap participant must provide on a monthly basis to the Commission and to the registered futures association of which the swap dealer or major swap participant is a member the specific information required in Appendix A to this section.

(m) *Margin reporting.* A swap dealer or major swap participant must file with the Commission and with the registered futures association of which the swap dealer or major swap participant is member the following information as of the end of each month within 17 business days of the end of each month:

(1) The name and address of each custodian holding initial margin or variation margin collected by the swap dealer or major swap participant for uncleared swap transactions pursuant to §§ 23.152 and 23.153;

(2) The amount of initial margin and variation margin collected by the swap dealer or major swap participant that is held by each custodian listed in paragraph (m)(1) of this section;

(3) The aggregate amount of initial margin that the swap dealer or major swap participant is required to collect from swap counterparties pursuant to § 23.152(a);

(4) The name and address of each custodian holding initial margin or variation margin posted by the swap dealer or major swap participant for uncleared swap transaction pursuant to §§ 23.152 and 23.153;

(5) The amount of initial margin and variation margin posted by the swap dealer or major swap participant that is held by each custodian listed in paragraph (m)(4) of this section; and

(6) The aggregate amount of initial margin that the swap dealer or major swap participant is required to post to its swap counterparties pursuant to § 23.152(b).

(n) *Electronic filing.* All filings of financial reports, notices and other information required to be submitted to the Commission under paragraphs (b) through (m) of this section must be filed in electronic form using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instructions issued by or approved by the Commission. A swap dealer or major swap participant must provide the Commission with the means necessary to read and to process the information contained in such report. Any such electronic submission must clearly indicate the swap dealer or major swap participant on whose behalf such filing is made and the use of such user authentication in submitting such filing will constitute and become a substitute for the manual signature of the authorized signer. In the case of a financial report required under paragraphs (d), (e), or (h) of this section and filed via electronic transmission in accordance with procedures established by or approved by the Commission, such transmission must be accompanied by the user authentication assigned to the authorized signer under such procedures, and the use of such user authentication will constitute and become a substitute for the manual signature of the authorized signer for the purpose of making the oath or affirmation referred to in paragraph (f) of this section.

(o) *Comparability determination for certain financial reporting.* A swap dealer or major swap participant that is subject to the monthly financial

reporting requirements of paragraph (d) of this section and the annual financial reporting requirements of paragraph (e) of this section may petition the Commission for a Comparability Determination under § 23.106 to file monthly financial reports and/or annual financial reports prepared in accordance with the rules a foreign regulatory authority in lieu of the requirements contained in this section.

(p) *Quarterly financial reporting and notification provisions for swap dealers and major swap participants that are subject to the capital requirements of a prudential regulator.*

(1) *Scope.* A swap dealer or major swap participant that is subject to the capital requirements of a prudential regulator must comply with the requirements of this paragraph.

(2) *Financial report and position information.* A swap dealer or major swap participant that is subject to the capital requirements of a prudential regulator shall file on a quarterly basis with the Commission the financial reports and specific position information set forth in Appendix B of this section. The swap dealer or major swap participant must file Appendix B with the Commission within 17 business days of the date of the end of the swap dealer's fiscal quarter.

(3) *Notices.* A swap dealer or major swap participant that is subject to the capital requirements of a prudential regulator must comply with the following notice provisions:

(i) A swap dealer or major swap participant that files a notice of adjustment of its reported capital category with the Federal Reserve Board, the Office of the Comptroller of the Currency, or the Federal Deposit Insurance Corporation, or files a similar notice with its home country supervisor(s), must give notice of this fact that same day by transmitting a copy of the notice of the adjustment of reported capital category, or the similar notice provided to its home country supervisor(s), to the Commission.

(ii) A swap dealer or major swap participant must provide immediate written notice that the swap dealer's or major swap participant's regulatory capital is less than the applicable minimum capital requirements set forth in 12 CFR 217.10, 12 CFR 3.10, or 12 CFR 324.10, or the minimum capital requirements established by its home country supervisor(s).

(iii) A swap dealer or major swap participant must submit a notice to the Commission within 24 hours of the occurrence of any of the following events:

(A) A single counterparty or group of counterparties that are under common ownership or control fails to post initial margin or pay variation margin to the swap dealer for swap positions and security-based swap positions and such initial margin and variation margin, in the aggregate, is equal to or greater than 25 percent of the swap dealer's minimum capital requirement;

(B) Counterparties fail to post initial margin or pay variation margin to the swap dealer for swap positions and security-based swap positions in an amount that, in the aggregate, exceeds 50 percent of the swap dealer's minimum capital requirement;

(C) A swap dealer fails to post initial margin or pay variation margin to a single counterparty or group of counterparties under common ownership and control for swap positions and security-based swap positions and such initial margin and variation margin, in the aggregate, exceeds 25 percent of the swap dealer's minimum capital requirement; or

(D) A swap dealer fails to post initial margin or pay variation margin to counterparties for swap positions and security-based swap positions in an amount that, in the aggregate, exceeds 50 percent of the swap dealer's minimum capital requirement.

(iv) If a swap dealer or major swap participant at any time fails to make or to keep current the books and records required by these regulations, such swap dealer or major swap participant must, on the same day such event occurs, provide notice of such fact, specifying the books and records which have not been made or which are not current, and within 48 hours after giving such notice file a written report stating what steps have been and are being taken to correct the situation.

(4) *Additional information.* From time to time the Commission may, by written notice, require a swap dealer or major swap participant that is subject to the capital rules of a prudential regulator to file financial or operational information on a daily basis or at such other times as may be specified by the Commission. Such information must be furnished in accordance with the requirements included in the written Commission notice.

(5) *Oath or affirmation.* Attached to each financial report, notice filing, or other filing made pursuant to this paragraph (p) must be an oath or affirmation that to the best knowledge and belief of the individual making such oath or affirmation the information contained in the filing is true and correct. With respect to financial reports, the individual making such

oath or affirmation must be: If the swap dealer or major swap participant is a sole proprietorship, the proprietor; if a partnership, any general partner; if a corporation, the chief executive officer or chief financial officer; and, if a limited liability company or limited liability partnership, the chief executive officer, the chief financial officer, the manager, the managing member, or those members vested with the management authority for the limited liability company or limited liability partnership.

(6) *Electronic filing.* All filings of financial reports, notices, and other information made pursuant to this paragraph (p) must be submitted to the Commission in electronic form using a form of user authentication assigned in accordance with procedures established by or approved by the Commission, and otherwise in accordance with instructions issued by or approved by the Commission. Each swap dealer and major swap participant must provide the Commission with the means necessary to read and to process the information contained in such report. Any such electronic submission must clearly indicate the swap dealer or major swap participant on whose behalf such filing is made and the use of such user authentication in submitting such filing will constitute and become a substitute for the manual signature of the authorized signer. In the case of a financial report required under this paragraph (p) and filed via electronic transmission in accordance with procedures established by or approved by the Commission, such transmission must be accompanied by the user authentication assigned to the authorized signer under such procedures, and the use of such user authentication will constitute and become a substitute for the manual signature of the authorized signer for the purpose of making the oath or affirmation referred to in paragraph (p)(5) of this section. Every notice or report required to be transmitted to the Commission pursuant to this paragraph (p) must also be filed with the Securities and Exchange Commission if the swap dealer or major swap participant also is registered with the Securities and Exchange Commission.

(7) *Public disclosure and nonpublic treatment of reports.* (i) A swap dealer or major swap participant that is subject to the capital requirements of a prudential regulator must no less than quarterly make publicly available on its Web site the following information:

(A) The statement of financial condition; and

(B) A statement disclosing the amount of the swap dealer's or major swap participant's regulatory capital as of the end of the quarter and the amount of its minimum regulatory capital requirement.

(ii) Financial information required to be made publicly available pursuant to this section must be posted within 10 business days after the firm is required to file applicable financial reports with the Commission pursuant to paragraph (p)(2) of this section.

(iii) Financial information required to be filed pursuant to this section, and not otherwise publicly available, will be treated as exempt from mandatory public disclosure for purposes of the Freedom of Information Act and the Government in the Sunshine Act and parts 145 and 147 of this chapter; *Provided, however,* that all information that is exempt from mandatory public disclosure will be available for official use by any official or employee of the United States or any State, by the National Futures Association and by any other person to whom the Commission believes disclosure of such information is in the public interest.

(q) *Weekly position and margin reporting—(1) Positions.* On the first business day of every week, a swap dealer or major swap participant shall file with the Commission a report showing, in a format specified by the Commission, all open uncleared swap positions as of the close of business on the last business day of the previous week, sorted as follows:

(i) By counterparty, and

(ii) For each counterparty, by the following asset classes—commodity, credit, equity, and foreign exchange or interest rate.

(2) *Margin.* On the first business day of every week, a swap dealer or major swap participant shall file with the Commission a report showing, in a format specified by the Commission, for open uncleared swap positions as of the close of business on the last business day of the previous week:

(i) The total initial margin posted by the swap dealer or major swap participant with each counterparty;

(ii) The total initial margin collected by the swap dealer or major swap participant from each counterparty; and

(iii) The net variation margin paid or collected over the previous week with each counterparty.

#### **Appendix A to § 23.105—Swap Dealer and Major Swap Participant Position Information**



Reg. 23.105(l)

SCHEDULE 1 - AGGREGATE SECURITIES, COMMODITIES, AND SWAPS POSITIONS

Appendix A

Items on this page to be Reported by: Swap Dealers  
Major Swap Participants

| Aggregate Securities, Commodities, Swaps Positions   | LONG     | SHORT    |
|--|----------|----------|
| 1. U.S. treasury securities.....   | \$ _____ | \$ _____ |
| 2. U.S. government agency and U.S. government-sponsored enterprises.....                                       | \$ _____ | \$ _____ |
| A. Mortgage-backed securities issued by U.S. government agency and U.S. government-sponsored enterprises ..... | \$ _____ | \$ _____ |
| B. Debt securities issued by U.S. government agency and U.S. government-sponsored enterprises .....            | \$ _____ | \$ _____ |
| 3. Securities issued by states and political subdivisions in the U.S .....                                     | \$ _____ | \$ _____ |
| 4. Foreign securities  |          |          |
| A. Debt securities.....  | \$ _____ | \$ _____ |
| B. Equity securities .....   | \$ _____ | \$ _____ |
| 5. Money market instruments.....   | \$ _____ | \$ _____ |
| 6. Private label mortgage backed securities.....   | \$ _____ | \$ _____ |
| 7. Other asset-backed securities .....   | \$ _____ | \$ _____ |
| 8. Corporate obligations.....  | \$ _____ | \$ _____ |
| 9. Stocks and warrants (other than arbitrage positions).....   | \$ _____ | \$ _____ |
| 10. Arbitrage.....   | \$ _____ | \$ _____ |
| 11. Spot commodities .....   | \$ _____ | \$ _____ |
| 12. Security-based swaps   |          |          |
| A. Debt security-based swaps (other than credit default swaps)   |          |          |
| 1. Cleared.....  | \$ _____ | \$ _____ |
| 2. Non-cleared .....   | \$ _____ | \$ _____ |
| B. Equity security-based swaps   |          |          |
| 1. Cleared.....  | \$ _____ | \$ _____ |
| 2. Non-cleared .....   | \$ _____ | \$ _____ |
| C. Credit default security-based swaps   |          |          |
| 1. Cleared.....  | \$ _____ | \$ _____ |
| 2. Non-cleared .....   | \$ _____ | \$ _____ |
| D. Other security-based swaps  |          |          |
| 1. Cleared.....  | \$ _____ | \$ _____ |
| 2. Non-cleared .....   | \$ _____ | \$ _____ |
| 13. Mixed swaps  |          |          |
| 1. Cleared.....  | \$ _____ | \$ _____ |
| 2. Non-cleared.....  | \$ _____ | \$ _____ |

Reg. 23.105(l)

SCHEDULE 1 (cont'd) - AGGREGATE SECURITIES, COMMODITIES, AND SWAPS POSITIONS

Appendix A

Items on this page to be Reported by: Swap Dealers  
Major Swap Participants

|   | <u>LONG</u> | <u>SHORT</u> |
|---|-------------|--------------|
| 14. Swaps   |             |              |
| A. Interest rate swaps                                |             |              |
| 1. Cleared.....                                       | \$ _____    | \$ _____     |
| 2. Non-cleared.....                                   | \$ _____    | \$ _____     |
| B. Foreign exchange swaps                             |             |              |
| 1. Cleared.....                                       | \$ _____    | \$ _____     |
| 2. Non-cleared.....                                   | \$ _____    | \$ _____     |
| C. Commodity swaps                                    |             |              |
| 1. Cleared.....                                       | \$ _____    | \$ _____     |
| 2. Non-cleared.....                                   | \$ _____    | \$ _____     |
| D. Debt index swaps (other than credit default swaps) |             |              |
| 1. Cleared.....                                       | \$ _____    | \$ _____     |
| 2. Non-cleared.....                                   | \$ _____    | \$ _____     |
| E. Equity index swaps                                 |             |              |
| 1. Cleared.....                                       | \$ _____    | \$ _____     |
| 2. Non-cleared.....                                   | \$ _____    | \$ _____     |
| F. Credit default swaps                               |             |              |
| 1. Cleared.....                                       | \$ _____    | \$ _____     |
| 2. Non-cleared.....                                   | \$ _____    | \$ _____     |
| G. Other swaps  |             |              |
| 1. Cleared.....                                       | \$ _____    | \$ _____     |
| 2. Non-cleared.....                                   | \$ _____    | \$ _____     |
| 15. Other derivatives and options.....                | \$ _____    | \$ _____     |
| 16. Securities with no ready market                   |             |              |
| A. Equity.....  | \$ _____    | \$ _____     |
| B. Debt.....  | \$ _____    | \$ _____     |
| C. Other (include limited partnership interests)..... | \$ _____    | \$ _____     |
| 17. Other securities and commodities.....             | \$ _____    | \$ _____     |
| 18. Total (sum of Lines 1-17).....                    | \$ _____    | \$ _____     |

Reg. 23.105(l)

SCHEDULE 2 – CREDIT CONCENTRATION REPORT FOR FIFTEEN LARGEST EXPOSURES IN DERIVATIVES

Appendix A

Items on this page to be Reported by: Swap Dealers  
Major Swap Participants

**I. By Current Net Exposure**

| Counterparty Identifier  | Internal Credit Rating | Gross Replacement Value |                      | Net Replacement Value | Current Net Exposure | Total Exposure | Margin Collected |
|--------------------------|------------------------|-------------------------|----------------------|-----------------------|----------------------|----------------|------------------|
|                          |                        | Receivable (Gross Gain) | Payable (Gross Loss) |                       |                      |                |                  |
| 1.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 2.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 3.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 4.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 5.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 6.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 7.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 8.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 9.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 10.                      | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 11.                      | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 12.                      | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 13.                      | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 14.                      | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 15.                      | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| All other counterparties |                        | N/A                     | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| Totals:                  |                        | \$                      |                      |                       |                      |                |                  |

**II. By Total Exposure**

| Counterparty Identifier  | Internal Credit Rating | Gross Replacement Value |                      | Net Replacement Value | Current Net Exposure | Total Exposure | Margin Collected |
|--------------------------|------------------------|-------------------------|----------------------|-----------------------|----------------------|----------------|------------------|
|                          |                        | Receivable (Gross Gain) | Payable (Gross Loss) |                       |                      |                |                  |
| 1.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 2.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 3.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 4.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 5.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 6.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 7.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 8.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 9.                       | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 10.                      | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 11.                      | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 12.                      | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 13.                      | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 14.                      | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| 15.                      | 9999                   | 9999                    | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| All other counterparties |                        | N/A                     | 9999                 | 9999                  | 9999                 | 9999           | 9999             |
| Totals:                  |                        | \$                      |                      |                       |                      |                |                  |

Reg. 23.105(l)

SCHEDULE 3 – PORTFOLIO SUMMARY OF DERIVATIVES EXPOSURES BY INTERNAL CREDIT RATING

Appendix A

Items on this page to be Reported by: Swap Dealers  
Major Swap Participants

| Internal Credit Rating | Gross Replacement Value |         | Net Replacement Value |         | Current Net Exposure | Total Exposure | Margin Collected |
|------------------------|-------------------------|---------|-----------------------|---------|----------------------|----------------|------------------|
|                        | Receivable              | Payable |                       |         |                      |                |                  |
| 1.                     | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 2.                     | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 3.                     | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 4.                     | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 5.                     | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 6.                     | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 7.                     | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 8.                     | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 9.                     | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 10.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 11.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 12.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 13.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 14.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 15.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 16.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 17.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 18.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 19.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 20.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 21.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 22.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 23.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 24.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 25.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 26.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 27.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 28.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 29.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 30.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 31.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 32.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 33.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 34.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 35.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| 36.                    | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| Unrated.               | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |
| Totals.                | 9999                    | \$ 9999 | 9999                  | \$ 9999 | 9999                 | \$ 9999        | 9999             |

Reg. 23.105(l)

SCHEDULE 4 – GEOGRAPHIC DISTRIBUTION OF DERIVATIVES EXPOSURES FOR TEN LARGEST COUNTRIES

Appendix A

Items on this page to be Reported by: Swap Dealers  
Major Swap Participants

I. By Current Net Exposure

| Country | Gross Replacement Value |         | Net Replacement Value | Current Net Exposure | Total Exposure | Margin Collected |
|---------|-------------------------|---------|-----------------------|----------------------|----------------|------------------|
|         | Receivable              | Payable |                       |                      |                |                  |
| 1.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 2.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 3.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 4.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 5.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 6.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 7.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 8.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 9.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 10.     | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| Totals. | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |

II. By Total Exposure

| Country | Gross Replacement Value |         | Net Replacement Value | Current Net Exposure | Total Exposure | Margin Collected |
|---------|-------------------------|---------|-----------------------|----------------------|----------------|------------------|
|         | Receivable              | Payable |                       |                      |                |                  |
| 1.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 2.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 3.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 4.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 5.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 6.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 7.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 8.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 9.      | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| 10.     | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |
| Totals. | 9999                    | \$ 9999 | \$ 9999               | \$ 9999              | \$ 9999        | \$ 9999          |

**Appendix B to § 23.105 – Financial Reports and Specific Position Information for Swap Dealers  
and Major Swap Participants Subject to the Capital Requirements of a Prudential Regulator**

Reg.23.105(o)

BALANCE SHEET

Appendix B

Items on this page to be reported by a: Bank SD  
Bank MSP

**Assets**

**Totals**

|   |    |       |
|---|----|-------|
| 1. Cash and balances due from depository institutions                       |    |       |
| A. Noninterest-bearing balances and currency and coin .....                 | \$ | _____ |
| B. Interest-bearing balances .....  | \$ | _____ |
| 2. Securities   |    |       |
| A. Held-to-maturity securities .....  | \$ | _____ |
| B. Available-for-sale securities .....                                      | \$ | _____ |
| 3. Federal funds sold and securities purchased under agreements to resell   |    |       |
| A. Federal funds sold in domestic offices .....                             | \$ | _____ |
| B. Securities purchased under agreements to resell .....                    | \$ | _____ |
| 4. Loans and lease financing receivables                                    |    |       |
| A. Loans and leases held for sale .....                                     | \$ | _____ |
| B. Loans and leases, net of unearned income .....                           | \$ | _____ |
| C. LESS: Allowance for loan and lease losses .....                          | \$ | _____ |
| D. Loans and leases, net of unearned income and allowance .....             | \$ | _____ |
| 5. Trading Assets .....   | \$ | _____ |
| 6. Premises and fixed assets (including capitalized leases) .....           | \$ | _____ |
| 7. Other real estate owned .....  | \$ | _____ |
| 8. Investment in unconsolidated subsidiaries and associated companies ..... | \$ | _____ |
| 9. Direct and indirect investments in real estate ventures .....            | \$ | _____ |
| 10. Intangible assets   |    |       |
| A. Goodwill .....   | \$ | _____ |
| B. Other intangible assets .....  | \$ | _____ |
| 11. Other assets .....  | \$ | _____ |
| 12. Total assets (sum of Lines 1 through 11) .....                          | \$ | _____ |

Reg.23.105(o)

## BALANCE SHEET

Appendix B

Items on this page to be reported by a: Bank SD  
Bank MSP

| <u>Liabilities</u>  | <u>Totals</u> |
|---|---------------|
| 13 Deposits   |               |
| A. In domestic offices .....  | \$ _____      |
| 1. Noninterest-bearing .....  | \$ _____      |
| 2. Interest-bearing .....   | \$ _____      |
| B. In foreign offices, Edge and Agreement subsidiaries, and IBFs .....                                  | \$ _____      |
| 1. Noninterest-bearing .....  | \$ _____      |
| 2. Interest-bearing .....   | \$ _____      |
| 14 Federal funds purchased and securities sold under agreements to repurchase                           |               |
| A. Federal funds purchased in domestic offices .....  | \$ _____      |
| B. Securities sold under agreements to repurchase .....   | \$ _____      |
| 15 Trading liabilities .....  | \$ _____      |
| 16 Other borrowed money (includes mortgage indebtedness and obligations under capitalized leases) ..... | \$ _____      |
| 17 Subordinated notes and debentures .....  | \$ _____      |
| 18 Other liabilities .....  | \$ _____      |
| 19 Total liabilities .....  | \$ _____      |
| <b><u>Equity Capital</u></b>  |               |
| 20 Perpetual preferred stock and related surplus .....  | \$ _____      |
| 21 Common stock .....   | \$ _____      |
| 22 Surplus (exclude all surplus related to preferred stock) .....                                       | \$ _____      |
| 23 A. Retained earnings .....   | \$ _____      |
| B. Accumulated other comprehensive income .....   | \$ _____      |
| C. Other equity capital components .....  | \$ _____      |
| 24 A. Total bank equity capital (sum of Lines 20 through 23.C) .....                                    | \$ _____      |
| B. Non-controlling (minority) interests in consolidated subsidiaries .....                              | \$ _____      |
| 25 Total equity capital (sum of Lines 24A and 24B) .....  | \$ _____      |
| 26 Total liabilities and equity capital (sum of Lines 19 and 25) .....                                  | \$ _____      |



Reg.23.105(o)

REGULATORY CAPITAL

Appendix B

Items on this page to be reported by a: Bank SD Bank MSP

Capital

Totals

|   |          |
|---|----------|
| 1. Total bank equity capital .....                  | \$ _____ |
| 2. Tier 1 capital .....                             | \$ _____ |
| 3. Tier 2 capital .....                             | \$ _____ |
| 4. Tier 3 capital allocated for market risk .....   | \$ _____ |
| 5. Total risk-based capital .....                   | \$ _____ |
| 6. Total risk-weighted assets .....                 | \$ _____ |
| 7. Total assets for leverage capital purposes ..... | \$ _____ |

Capital Ratios (Column B is to be completed by all banks. Column A is to be completed by banks with financial subsidiaries.)

Column A

Column B

|  |          |          |
|--|----------|----------|
| 8. Tier 1 Leverage ratio .....           | \$ _____ | \$ _____ |
| 9. Tier 1 risk-based capital ratio ..... | \$ _____ | \$ _____ |
| 10. Total risk-based capital ratio ..... | \$ _____ | \$ _____ |

Reg.23.105(o)

SCHEDULE 1 – AGGREGATE SWAP POSITIONS

Appendix B

Items to be Reported by: Bank SDs  
Bank MSPs

| <u>Aggregate Positions</u>                                     | <u>LONG</u> | <u>SHORT</u> |
|--|-------------|--------------|
| 1. Security-based swaps  |             |              |
| A. Debt security-based swaps (other than credit default swaps) |             |              |
| 1. Cleared.....  | \$ _____    | \$ _____     |
| 2. Non-cleared.....  | \$ _____    | \$ _____     |
| B. Equity security-based swaps                                 |             |              |
| 1. Cleared.....  | \$ _____    | \$ _____     |
| 2. Non-cleared.....  | \$ _____    | \$ _____     |
| C. Credit default security-based swaps                         |             |              |
| 1. Cleared.....  | \$ _____    | \$ _____     |
| 2. Non-cleared.....  | \$ _____    | \$ _____     |
| D. Other security-based swaps                                  |             |              |
| 1. Cleared.....  | \$ _____    | \$ _____     |
| 2. Non-cleared.....  | \$ _____    | \$ _____     |
| 2. Mixed swaps   |             |              |
| A. Cleared .....   | \$ _____    | \$ _____     |
| B. Non-cleared .....   | \$ _____    | \$ _____     |
| 3. Swaps   |             |              |
| A. Interest rate swaps   |             |              |
| 1. Cleared.....  | \$ _____    | \$ _____     |
| 2. Non-cleared.....  | \$ _____    | \$ _____     |
| B. Foreign exchange swaps                                      |             |              |
| 1. Cleared.....  | \$ _____    | \$ _____     |
| 2. Non-cleared.....  | \$ _____    | \$ _____     |
| C. Commodity swaps   |             |              |
| 1. Cleared.....  | \$ _____    | \$ _____     |
| 2. Non-cleared.....  | \$ _____    | \$ _____     |
| D. Debt index swaps (other than credit default swaps)          |             |              |
| 1. Cleared.....  | \$ _____    | \$ _____     |
| 2. Non-cleared.....  | \$ _____    | \$ _____     |
| E. Equity index swaps  |             |              |
| 1. Cleared.....  | \$ _____    | \$ _____     |
| 2. Non-cleared.....  | \$ _____    | \$ _____     |
| F. Credit default swaps  |             |              |
| 1. Cleared.....  | \$ _____    | \$ _____     |
| 2. Non-cleared.....  | \$ _____    | \$ _____     |

Reg.23.105(o)

SCHEDULE 1 (cont'd) – AGGREGATE SWAP POSITIONS

Appendix B

Items to be Reported by: Bank SDs  
Bank MSPs

G. Other swaps

|                                  |          |          |
|----------------------------------|----------|----------|
| 1. Cleared.....                  | \$ _____ | \$ _____ |
| 2. Non-cleared.....              | \$ _____ | \$ _____ |
| 3. Other derivatives.....        | \$ _____ | \$ _____ |
| 4. Total (sum of Lines 1-3)..... | \$ _____ | \$ _____ |

BILLING CODE 6351-01-C

**§ 23.106 Comparability determination for substituted compliance.**

(a)(1) *Eligibility requirements.* The following persons may, either individually or collectively, request a Capital Comparability Determination with respect to the Commission’s capital adequacy and financial reporting requirements for swap dealers or major swap participants:

(i) A swap dealer or major swap participant that is eligible for substituted compliance under § 23.101; or

(ii) A foreign regulatory authority that has direct supervisory authority over one or more swap dealers or major swap participants that are eligible for substituted compliance under § 23.101, and such foreign regulatory authority is responsible for administering the relevant foreign jurisdiction’s capital adequacy and financial reporting requirements over the swap dealer or major swap participant.

(2) *Submission requirements.* A person requesting a Capital Comparability Determination must electronically submit to the Commission:

(i) A description of the objectives of the relevant foreign jurisdiction’s capital adequacy and financial reporting requirements over entities that are subject to the Commission’s capital adequacy and financial reporting requirements in this part;

(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 Commission’s capital adequacy and financial reporting requirements for swap dealers and major swap participants, including, at a minimum, the methodologies for establishing and calculating capital adequacy requirements and whether such

methodologies comport with any international standards, including Basel-based capital requirements for banking institutions; and

(iii) A description of 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. Such description should discuss the powers of the foreign regulatory authority or authorities to supervise, investigate, and discipline entities for compliance with capital adequacy and financial reporting requirements, and the ongoing efforts of the regulatory authority or authorities to detect and deter violations, and ensure compliance with capital adequacy and financial reporting requirements. The description should address how foreign authorities and foreign laws and regulations address situations where a swap dealer or major swap participant is unable to comply with the foreign jurisdictions capital adequacy or financial reporting requirements.

(iv) Upon request, such other information and documentation that the Commission deems necessary to evaluate the comparability of the capital adequacy and financial reporting requirements of the foreign jurisdiction.

(v) All supplied documents shall be provided in English, or provided translated to the English language, with currency amounts stated in or converted to USD (conversions to be noted with applicable date).

(3) *Standard of Review.* The Commission will issue a Capital Comparability Determination to the extent that it determines that some or all of the relevant foreign jurisdiction’s capital adequacy and financial reporting requirements and related financial recordkeeping and reporting requirements for swap dealing financial intermediaries are comparable to the Commission’s corresponding capital

adequacy and financial recordkeeping and reporting requirements. In determining whether the requirements are comparable, the Commission will consider all relevant factors, including:

(i) The scope and objectives of the foreign jurisdiction’s capital adequacy and financial reporting requirements;

(ii) How and whether the relevant foreign jurisdiction’s capital adequacy requirements compare to international Basel capital standards for banking institutions or to other standards such as those used for securities brokers or dealers;

(iii) 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 swap dealers and major swap participants;

(iv) The ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction’s capital adequacy and financial reporting requirements; and

(v) Any other facts or circumstances the Commission deems relevant.

(4) *Reliance.* (i) A swap dealer or major swap participant that is subject to the supervision of a foreign jurisdiction that has received a Capital Comparability Determination from the Commission must file a notice of its intent to comply with the capital adequacy and financial reporting requirements of the foreign jurisdiction with the registered futures association of which the swap dealer or major swap participant is a member. The registered futures association will determine the information that the swap dealer or major swap participant must include in the notice. A swap dealer or major swap participant must obtain a confirmation from the registered futures association that it may comply with the capital

adequacy and financial reporting requirements of the foreign jurisdiction in lieu of some or all of the capital adequacy and financial reporting requirements in the part.

(ii) Any swap dealer or major swap participant that has obtained a confirmation from a registered futures association and, in accordance with a Capital Comparability Determination, complies with a foreign jurisdiction's capital adequacy and financial reporting requirements will be deemed to be in compliance with the Commission's corresponding capital adequacy and financial reporting requirements.

Accordingly, the failure of such a swap dealer or major swap participant to comply with the foreign jurisdictions capital adequacy and financial reporting requirements may constitute a violation of the Commission's capital adequacy and financial reporting requirements. All swaps dealer and major swap participants, regardless of whether they rely on a Capital Comparability Determination, remain subject to the Commission's examination and enforcement authority.

(5) *Conditions*. 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 or major swap participants. The violation of such terms and conditions may constitute a violation of the Commission's capital adequacy or financial reporting requirements and/or result in the modification or revocation of the Capital Comparability Determination.

(6) *Modifications*. The Commission reserves the right to further condition, modify, suspend or terminate or otherwise restrict a Capital Comparability Determination in the Commission's discretion.

#### §§ 23.107–23.149 [Reserved]

### PART 140—ORGANIZATION, FUNCTIONS, AND PROCEDURES OF THE COMMISSION

■ 9. The authority citation for part 140 continues to read as follows:

**Authority:** 7 U.S.C. 2(a)(12), 12a, 13(c), 13(d), 13(e), and 16(b).

■ 10. Amend § 140.91 as follows:

■ a. Redesignate paragraph (a)(12) as paragraph (a)(13);

■ b. Redesignate paragraph (a)(11) as paragraph (a)(12);

■ c. Add new paragraph (a)(11).

The addition to read as follows:

#### § 140.91 Delegation of authority to the Director of the Division of Clearing and Risk and to the Director of the Division of Swap Dealer and Intermediary Oversight.

(a) \* \* \*

(11) All functions reserved to the Commission in §§ 23.100 through 23.107 of this chapter, except for those related to the revocation of a swap dealer's or major swap participant's approval to use internal models to compute capital requirements under § 23.102 of this chapter, and the issuance of Capital Comparability Determinations under § 23.106 of this chapter.

\* \* \* \* \*

Issued in Washington, DC, on December 2, 2016, by the Commission.

**Christopher J. Kirkpatrick,**  
*Secretary of the Commission.*

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

#### Appendices to Capital Requirements of Swap Dealers and Major Swap Participants—Commission Voting Summary, Chairman's Statement, and Commissioner's Statement

##### Appendix 1—Commission Voting Summary

On this matter, Chairman Massad and Commissioners Bowen and Giancarlo voted in the affirmative. No Commissioner voted in the negative.

##### Appendix 2—Statement of Chairman Timothy G. Massad

I support the proposed rulemaking the Commission unanimously approved today.

Capital requirements for swap dealers are among the most important reforms of the over-the-counter swap market agreed to by the leaders of the G20 nations in 2009. They complement margin requirements for uncleared swaps, which the Commission finalized earlier this year. While margin is the front line defense against a default, adequate capital is critical to the ability of swap dealers to absorb losses.

One of my priorities this year has been to issue a reproposal of our rule setting these capital requirements. Our original proposal was issued at a time when margin requirements for uncleared swaps had not yet been established and bank capital rules were still being finalized. It is important that our rules are harmonized with prudential requirements, which is why it was appropriate to update and repropose our rule.

As with margin, the law provides that swap dealers for which there is a prudential regulator shall comply with the capital rules of the prudential regulators, and the CFTC must adopt capital rules for all others. Because capital requirements are entity-wide, and not specific to transactions, I believe the requirements should take into account the fact that there are different types of firms that act as swap dealers—such as bank affiliates, broker-dealers, futures commission

merchants and others primarily engaged in non-financial activities. Requiring all firms to follow one approach could favor one business model over another, and cause even greater concentration in the industry.

The reproposal we have approved today recognizes this diversity. It supports competition as well as safety and soundness, by providing three different approaches. First, for swap dealers that are affiliates of prudentially regulated firms, the proposal permits them to use a method based on that of our banking regulators. Swap dealers that are also broker-dealers can use an approach that is based on the Securities and Exchange Commission's net liquid assets approach. And for those dealers that are engaged primarily in non-financial activities, we have proposed a third approach based on net worth. And we have harmonized these requirements, where appropriate, with the capital rules of our prudential regulators and the Securities and Exchange Commission.

I thank the CFTC's hardworking staff for the significant time and effort they have devoted to this rule. I thank my fellow Commissioners for their support of this measure. And I encourage public comment on this proposal.

##### Appendix 3—Statement of Commissioner J. Christopher Giancarlo

For some time now, I have been asking whether the amount of capital which regulators have caused financial institutions to take out of trading markets is at all calibrated to the amount of capital which is needed to be kept in global markets to support the health and durability of the global financial system. I have called on the Financial Stability Oversight Council and domestic and foreign financial regulators to conduct a thorough analysis in this regard. Those calls have been largely ignored. So, I hope that commenters to this capital proposal can help provide some insight into my question.

Along those lines, I have included several questions in this proposal that ask for feedback on whether the capital requirements under the different capital approaches are appropriate. I thank staff of the Division of Swap Dealer and Intermediary Oversight for including my questions in the proposal. I am particularly interested in how the proposed capital requirements will affect smaller swap dealers and how much additional capital they may have to raise to comply with the proposal. I have included several questions in the cost-benefit section in this regard. I am also interested in the impact of the proposed rule on any potential new registrants if the swap dealer *de minimis* level falls to \$3 billion.

I have also included several questions about the scope of the proposal. For example, the proposed minimum capital requirement is based upon eight percent of the margin required on the swap dealer's cleared and uncleared swaps and security-based swaps and the margin required on the swap dealer's futures and foreign futures. However, Commodity Exchange Act section 4s(e)(3)(A) only cites the risk of uncleared swaps in

setting standards for capital.<sup>1</sup> Additionally, in the Commission's final swap dealer definition rule, it said it will "in connection with promulgation of final rules relating to capital requirements for swap dealers and major swap participants, consider institution of reduced capital requirements for entities or individuals that fall within the swap dealer definition and that execute swaps only on exchanges, using only proprietary funds."<sup>2</sup> Given these pronouncements, I welcome commenters' views on the broad scope of the proposed capital requirements.

<sup>1</sup> 7 U.S.C. 6s(e)(3)(A).

<sup>2</sup> 77 FR 30596, 30610 fn. 199 (May 23, 2012).

Finally, I am concerned about the proposed capital model review and approval process. The proposal states that the Commission expects that a prudential regulator's or foreign regulator's review and approval of capital models that are used in the corporate family of a swap dealer would be a significant factor in the National Futures Association's (NFA) determination of the scope of its review, provided that appropriate information sharing agreements are in place. Given the large number of models that will need to be reviewed, the complexity of those models and the practical resource constraints at the NFA, I am concerned that the proposed process will be unworkable. We have already

seen the challenges in the model approval process for initial margin under tight implementation timelines, and in that case there was a standard initial margin model. We should learn from that lesson. So, I am interested to hear commenters' views on alternative model approval processes, such as automatic or temporary approval of capital models that have been previously approved by a prudential or foreign regulator.

I look forward to reviewing thoughtful and well-considered comments.

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