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October 5, 2023

Mr. Thomas Smith
Deputy Director
Market Participants Division
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: CFTC Staff Questions Regarding Substituted Compliance Application for UK Swap Dealers from CEA Sections 4s(e)–(f) and Rules 23.101 and 23.105(d)–(e), (p)(2)

Dear Mr. Smith:

Thank you for your letter dated October 4, 2023. Please find attached our answers to your questions related to the May 4, 2021 application submitted by the Institute of International Bankers, International Swaps and Derivatives Association and Securities Industry and Financial Markets Association requesting that the Commission determine that the capital and financial reporting laws and regulations of the United Kingdom ("UK") applicable to CFTC-registered swap dealers organized and domiciled in the UK provide sufficient bases for an affirmative finding of comparability with respect to the Commission's swap dealer capital and financial reporting requirements adopted under the Commodity Exchange Act.

If you have questions or would like additional information, please contact the undersigned at (212) 313-1280.

Very truly yours,

Kyle L Brandon
Managing Director, Head of Derivatives Policy
SIFMA

U.S. COMMODITY FUTURES TRADING COMMISSION

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Market Participants Division

October 4, 2023

Kyle Brandon
Managing Director, Head of Derivatives Policy
Securities Industry and Financial Markets Association

Re: CFTC Staff Questions Regarding Substituted Compliance Application for UK Swap Dealers from CEA Sections 4s(e)–(f) and Rules 23.101 and 23.105(d)–(e), (p)(2)

Dear Ms. Brandon:

The U.S. Commodity Futures Trading Commission's ("**Commission**" or "**CFTC**") Market Participants Division has received the application submitted by the Institute of International Bankers ("**IIB**"), International Swaps and Derivatives Association ("**ISDA**") and Securities Industry and Financial Markets Association ("**SIFMA**", and together with IIB and ISDA, the "**Applicants**") on May 4, 2021 requesting that the Commission determine that the capital and financial reporting laws and regulations of the United Kingdom ("**UK**") applicable to CFTC-registered swap dealers organized and domiciled in the UK provide sufficient bases for an affirmative finding of comparability with respect to the Commission's swap dealer capital and financial reporting requirements adopted under the Commodity Exchange Act ("**UK Application**").

As part of our review of the UK Application, we have identified several topics and statements for which we need further clarification from the Applicants. To that end, below please find a list of questions to your attention:

I. Scope of the UK Application and Related Questions

We understand that swap dealers registered and domiciled in the UK may be subject to two different prudential regulatory regimes depending on whether the swap dealer is licensed as an investment firm that is designated for prudential supervision by the UK Prudential Regulation Authority ("**PRA**") ("**PRA-designated UK nonbank SD**") or the swap dealer is licensed as an investment firm that is prudentially regulated by the UK Financial Conduct Authority ("**FCA**") ("**FCA-regulated UK nonbank SD**"). The questions below relate to PRA-designated UK

nonbank SDs. Due to the differences in the regulatory regimes, Commission staff plan to address the comparability of the capital and financial reporting rules applicable to FCA-regulated UK nonbank SDs separately.

There are currently six PRA-designated UK nonbank SDs registered with the Commission:

- Citigroup Global Markets Limited ("**CGML**"),
- Goldman Sachs International ("**GSI**"),
- Merrill Lynch International ("**MLI**"),
- Morgan Stanley & Co. International Plc ("**MSIP**"),
- MUFG Securities EMEA Plc ("**MSEP**"), and
- Nomura International Plc ("**NIP**").

To the extent any of the questions below relates to a regulatory requirement that is firm-specific, please indicate if and how the requirement applies to each of the PRA-designated UK nonbank SDs listed above.

II. Regulatory Framework

We understand that following the UK's withdrawal from European Union ("**EU**") membership, directly applicable EU law, such as the Capital Requirements Regulation ("**Regulation (EU) 575/2013"** or "**CRR**"), was converted into domestic UK law and UK legislation implementing EU directives, such as the Capital Requirements Directive ("**2013/36/EU**" or "**CRD**"), was preserved.[1] We also understand that subsequently, the UK adopted additional changes, generally consistent with amendments introduced by the EU to CRR, CRD and other relevant EU provisions, and incorporated certain CRR provisions in the PRA Rulebook.

1. Please confirm or correct.

   Confirmed.

2. To the extent not covered by the specific questions listed below, please describe relevant regulatory changes to the UK capital and financial reporting framework applicable to PRA-designated UK nonbank SDs that were adopted after May 4, 2021 (*i.e.*, the date of the UK Application).

   There have been some changes implemented via Policy Statement 21/21 and Policy Statement 22/21, e.g., LE and CCR requirements, as part of the UK's ongoing adoption of Basel III capital standard.

[1] We refer to the version of the Capital Requirements Regulation (Regulation (EU) 575/2013) applicable in the UK as the "UK CRR."

III. Minimum Capital, Capital Buffers and Leverage Ratio Requirements

3. We understand that PRA-designated UK nonbank SDs are subject to a minimum fixed-amount capital requirement of GBP 750,000. Please indicate in what form of qualifying capital (*e.g.*, common equity tier 1) must the requirement be met. Please cite the relevant regulatory provision imposing the form of capital.

   The 'Definition of Capital' Part of the PRA Rulebook confirms, by rule 12.1, a Base Capital Resources Requirement of GBP 750,000 for a designated investment firm. This Base Capital Resources Requirement establishes the amount of initial capital required at the time of authorisation for Article 93(1) UK CRR. The relationship between the PRA rule and the article is as follows:

   Article 93(1) states: "The *own funds* of an institution may not fall below the amount of *initial capital* required at the time of its authorisation". The definition of 'initial capital' at Article 4.1(51) of the CRR then links Article 93(1) CRR and the PRA rule by denoting initial capital as "the amount and types of own funds specified in rule 12.1 of the Definition of Capital Part of the PRA rulebook".[2]

   There are currently no "types of own funds" specified in rule 12.1.[3] However, under article 4.1(118) of the CRR 'own funds' means the sum of Tier 1 capital and Tier 2 capital.[4]

4. Are any of the six PRA-designated UK nonbank SDs subject to a systemic risk buffer ("**SRB**") requirement? More generally, does the SRB requirement apply to PRA-designated investment firms?

   No, the systemic risk buffer does not apply to PRA-designated investment firms.

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[2] Previously the definition of initial capital stated that it "means the amount and types of own funds specified in Article 12 of Directive 2013/36/EU [the CRD] for credit institutions and in Title IV of that Directive for investment firms". As regards the types of own funds, article 12(2) stated "2. Initial capital shall comprise only one or more of the items referred to in Article 26(1)(a) to (e) of Regulation (EU) No 575/2013". Title IV for investment firms (pursuant to art 28(1)) was to the same effect. In turn, the relevant provisions of art 26(1) CRR were:
"1. Common Equity Tier 1 items of institutions consist[ing] of the following:
(a) capital instruments, provided that the conditions laid down in Art 28 or, where applicable, Art 29 are met;
(b) share premium accounts related to the instruments referred to in point (a);
(c) retained earnings;
(d) accumulated other comprehensive income;
(e) other reserves;"

[3] This is consistent with the FCA's parallel new prudential regime for other investment firms. FCA MIFIDPRU 3.2.3R now states that "a firm's initial capital must be made up of own funds". Chapter 2 of PRA Supervisory Statement SS7/13 Definition of capital (CRR firms) sets out expectations regarding quality and composition of capital.

[4] Article 25 of the CRR defines Tier 1 capital as follows: "The Tier 1 capital of an institution consists of the sum of the Common Equity Tier 1 capital and Additional Tier 1 capital of the institution". Article 71 defines Tier 2 capital in the following terms: "The Tier 2 capital of an institution shall consist of the Tier 2 items of the institution [see article 62] after the deductions referred to in Article 66 and the application of Article 79".

5. In addition to the capital conservation buffer requirement, the institution-specific countercyclical capital buffer requirement, and (potentially) the systemic risk buffer requirement, is there another buffer requirement that PRA-designated UK nonbank SDs must meet?

   There are two firm-specific buffers that can be applied at the discretion of the PRA to systemically important banks or to address systemic risks. These are the global systemically important institutions ("**G-SII**") and other systemically important institutions ("**O-SII**") buffers.

   The PRA has designated fifteen firms as O-SIIs, including Citigroup Global Markets Limited and Merrill Lynch International. The official list of these firms is published here. Under reg 34ZA(1) of The Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014, the PRA may require an O-SII to maintain Common Equity Tier 1 capital. The O-SII buffer, however, can only be applied to ring-fenced banks and building societies, and therefore is not relevant to the six firms.

   There are no relevant G-SIIs (see the official list here), and therefore the G-SII buffer is not currently relevant.

   The PRA may also set a firm-specific buffer for individual institutions. This is referred to as the PRA buffer or Pillar 2B buffer; it is set at the discretion of the PRA and is confidential between the firm and the PRA.[5]

6. Are any of the six PRA-designated UK nonbank SDs subject to a leverage ratio floor requirement?

   Yes, all six are subject to a leverage ratio floor requirement.

IV. MREL and TLAC Requirements

7. Please confirm that each of the six PRA-designated UK nonbank SDs is subject to a minimum requirement for own funds and eligible liabilities ("**MREL**") pursuant to the Banking Act 2009 and its secondary legislation. Please cite the relevant UK law provisions that impose the requirement for each SD.

   Confirmed.

   Firm-specific internal MREL requirements are set by the Bank of England, specifically the Bank of England's MREL Policy, which states "[t]his document contains the Bank of England's policy for exercising its power to direct relevant persons to maintain a minimum requirement for own funds and eligible liabilities (MREL) under section 3A(4) and (4B) of the Banking Act 2009" (page 2).

[5] Chapter 9 ('The PRA Buffer') of the PRA's Statement of Policy: The PRA's methodologies for setting Pillar 2 capital provides further detail on this buffer, and sets out in diagram form the PRA's capital framework as a whole.

8. Please indicate whether any of the PRA-designated UK nonbank SDs has been designated as a resolution entity.
   None of the six firms have been designated as a resolution entity.

9. Are any of the six PRA-designated UK nonbank SDs subject to a total loss absorbing capacity ("**TLAC**") requirement?
   Currently, four of the firms are subject to TLAC requirements based on CRR Article 92b; two are not but are subject to the Bank of England's MREL policy (see further discussion in answer to 9.a. below).
   a. If yes, on the basis of which specific regulatory provision (please specify for each PRA-designated UK nonbank SD)?
   As stated above, four firms are currently subject to TLAC requirements based on CRR Art 92b. Following publication of a secondary instrument amending the Financial Services and Markets Act 2023, Article 92(b) under UK CRR is to be deleted, from 1 Jan. 2024. This allows the Bank of England to set MREL Requirements in line with their existing policy, without applying the TLAC backstop within the CRR (Reg 5(b)(i) of the Financial Services and Markets Act 2023 (Commencement No. 1) Regulations 2023). So, from 1 Jan. 2024, all six firms will be subject to the Bank of England MREL policy.
   b. For each PRA-designated UK nonbank SD, please indicate the applicable category of entities subject to a TLAC requirement in which the PRA-designated UK nonbank SD falls (*e.g.*, G-SII entity that is a resolution entity; material subsidiary of a non-UK G-SII that is not a resolution entity).
   The four firms currently subject to TLAC under Article 92b are in the category "material subsidiary of a non-UK G-SII that is not a resolution entity."
   The designation is not applicable to the other two firms.

V. Financial Reporting

10. The PRA Rulebook contains two parts covering financial reporting requirements for "CRR firms": (i) Reporting (CRR) Part and (ii) Regulatory Reporting Part. Please describe the scope of applicability of each part (*i.e.*, to what categories of firms does each part apply).

    (i) Reporting (CRR) Part applies to all banks and designated investments firms that are subject to capital requirements under the CRR. It provides details of all common reporting requirements that pre-Brexit applied to institutions subject to the CRR in the EU that the PRA continued post-Brexit.
    (ii) Regulatory Report Part applies to all firms that are supervised by the PRA. This therefore includes all firms that are subject to (i). It includes additional national only reporting requirements that pre-Brexit only applied to UK entities. Within this section specific reporting requirements are set based on the permitted activities of each firm. To the extent certain reporting requirements are already addressed in (i) then they are not required under this section to avoid duplication.

11. In addition to the two parts of the PRA Rulebook listed immediately above, is there another source of the financial reporting requirements (in the PRA Rulebook or another regulatory instrument) applicable to PRA-designated UK nonbank SDs?

    No.

12. Please confirm that all six PRA-designated UK nonbank SDs are subject to the requirement to submit COREP reports to the PRA.
    Confirmed.

13. Article 430, Rule 3 of the Reporting (CRR) Part of the PRA Rulebook indicates that only institutions that are "subject to section 403(1) Companies Act 2006" are required to submit financial information reporting. In that regard:

    a. We understand that section 403(1) of the Companies Act 2006 applies to entities that report on a consolidated basis using UK-adopted international accounting standards and that issue securities admitted to trading on a UK-regulated market. Please confirm or correct our understanding of the scope of section 403(1).

       Correct – where the entity is a 'parent company', meaning a company that is a 'parent undertaking' (see Section 1162 Companies Act).

    b. Is there another UK law/PRA Rulebook provision that mandates financial information/FINREP reporting for firms that are not subject to section 403(1) of the Companies Act 2006?

       Yes. Financial reporting requirements for firms that are not subject to 403(1) of the Companies Act of 2006 [6] are set in in accordance with the Regulatory Reporting Part of the PRA Rulebook (as referenced in (ii) in response to Q10 above) based on the firm's regulatory activity group ("**RAG**") designation. The six firms are designated RAG 3 and are required to report balance sheet, profit and loss data, and comprehensive income, *i.e.*, a subset of FINREP reports (templates 1- 3).

14. Please indicate if each of the six PRA-designated UK nonbank SDs are subject to a requirement to submit FINREP reports to the PRA.
    As described above the six firms are designated RAG 3 under the Regulatory Reporting Part of the PRA Rulebook and are required to submit a subset of FINREP reports (templates 1- 3) to the PRA.

[6] Full FINREP is only required when Article 403(1) applies, and Article 401(1) only applies to entities that report on a consolidated basis and issue securities on a UK regulated market.

a. If yes, on the basis of what regulatory provision (please indicate for each of the six firms)?
Rule 9.2 of the Regulatory Reporting Part of the PRA Rulebook.

b. If yes, are all six PRA-designated UK nonbank SDs required to submit FINREP template 10 (Derivatives – Trading and economic hedges)?
As described above, the six firms are required to submit a subset of FINREP templates (templates 1 -3). The subset does not include template 10.[7]

15. If any of the PRA-designated UK nonbank SD is not subject to the requirement to submit FINREP and/or COREP reports, please describe the financial reporting requirements that apply to that firm and provide citation to the relevant source.

Please see answers to Q14 and Q12, respectively, regarding FINREP and COREP reporting requirements.

16. With respect to the annual audited accounts and strategic report required under Parts 15 and 16 of the Companies Act 2006, please confirm/respond to the following and provide a citation to the relevant provisions imposing each requirement:

a. Please confirm that all PRA-designated UK nonbank SD are required to prepare annual audited accounts and a strategic report pursuant to Parts 15 and 16 of the Companies Act 2006 (*i.e.*, please confirm that none of the firms falls into an exempt category).
Confirmed.

b. Are PRA-designated UK nonbank SDs required to file the accounts and strategic report with the PRA? If yes, under what timeframe?

Yes, within 80 business days of the accounting reference date (year-end) as specified in Rule 9.1 of the Regulatory Reporting part of the PRA Rulebook.

c. Are PRA-designated UK nonbank SDs required to file the accounts and strategic report with another regulatory body/register? If yes, under what timeframe?

Yes, the six firms are required to file the accounts and strategic report with the U.S. Securities and Exchange Commission ("**SEC**") at the same time as submitting them to the PRA as SEC-registered Security-based Swap Dealers relying on substituted compliance for SEC capital and financial reporting requirements[8].

[7] One of the firms used to be, but is no longer, subject to Article 403(1). According, while it has in the past submitted template 10, it is not currently required to do so.

[8] See Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the United Kingdom [Release No. 34-92529; File No. S7-04-21, condition (f)(3)(iv)(B), page 227].

Also, the six firms are required to submit the accounts and strategic report to the UK Registrar of Companies ("**Companies House**") (see s.441 of the UK Companies Act 2006 ("**CA06**"). Three of the firms are required to make the filing within nine months of the firm' accounting reference date (see s.442 CA06) and three firms are required to make the filing within six months of the relevant accounting reference period, as a category of 'public company'. (see Part 15 CA06).

d. Are PRA-designated UK nonbank SDs required to publish the accounts and report?
Yes.
If yes, where (on their website? another location?) and under what timeframe?
Companies House makes it available to the public free of charge and online. See above reply to Q16.c on timeframe.

Does the requirement apply to all PRA-designated investment firms or does it depend on specific criteria that a firm meets?
The requirement to submit accounts to Companies House is a generally applicable company law requirement. The deadline to submit accounts and report to Companies House depends on the category of the firm (see answer to Q16.c., above).

e. Are the auditors assigned to conduct the audit of annual accounts and strategic report subject to specific requirements? Do the auditors need to obtain approval to conduct audits of PRA-designated UK nonbank SDs?
The PRA's requirements with respect to Auditors are set out in the following rulebook: https://www.prarulebook.co.uk/rulebook/Content/Part/211454/16-08-2023.

While approval is not required from the PRA to appoint an Auditor, notification must be provided to the PRA via a PRA notification form as specified in SUP 15 Annex 3R – Notifications under SUP 16.10. Auditors are not required to obtain approval by the regulators, but are required to be engaged for the statutory audit of the entity in accordance with the Companies Act 2006 Part 16.

The Auditor must have the required skill, resources and experience to perform its duties based on the complexity of the firm.
Audit partners/directors obtain responsible individuals' status from the ICAEW (Institute of Chartered Accountants in England and Wales) to sign accounts in the UK.

VI. Notice Requirements and Supervision

17. Please confirm that Supervisory Statement SS6/14 Implementing Capital Buffers, Prudential Regulatory Authority, January 2021 is still applicable to PRA-designated UK nonbank SDs. If the supervisory statement has been superseded by a more recent statement, please provide the currently applicable statement.

    Confirmed. The post-transition period version of SS6/14 effective from 1 January 2021 is still applicable.

18. In connection with the capital conservation plan required under PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 4 Capital Conservation Measures, Rule 4.4, the UK Application indicates that if the PRA does not approve the capital conservation plan, the PRA may impose requirements for the PRA-designated UK nonbank SD to increase its capital to specified levels within a specified time or the PRA may impose more restrictions on distributions. Please provide a reference to the relevant provision/source that confers such powers to the PRA.

    The Capital Buffers part of the PRA Rulebook does not directly grant the PRA powers to set additional requirements should they reject a capital conservation plan. The direct impact is limited to the continued prohibition on certain capital depleting actions specified in that part of the rulebook.

    However, per SS6/14 a rejection of a capital conservation plan would occur if the proposed plan would not "be reasonably likely to conserve or raise sufficient capital to enable the firm to meet its combined buffer within a period which the PRA considers appropriate" which would give rise to the PRA's general supervisory powers, S 55M(2) etc..[9]

    As regards general supervisory powers, s 55M(2), (3) and (4) of the Financial Services and Markets Act 2000 ("**FSMA**") (Imposition of requirements by PRA) set out the PRA's "own-initiative requirement power". Section 55P(4) of FSMA illustrates the wide scope of this power.[10] See also sections 192C and 192D in respect of the power to direct a qualifying parent undertaking of an investment firm.

19. Please confirm that the document titled "PRA, The Prudential Regulation Authority's approach to banking supervision" cited in the UK Application is still effective.

    Correct, please see here for the updated document.

[9] Please see SS6/14 'Implementing capital buffers' - January 2021 (bankofengland.co.uk), which outlines the PRA approach for capital conservation plans including when they will approve.

[10] See also paragraph 2.4 of PRA Supervisory Statement SS16/16.

20. The UK Application indicates that the PRA may impose administrative penalties or other administrative measures, including prudential charges, if a PRA-designated nonbank SD's liquidity position falls below the liquidity and stable funding requirements. Please provide a reference for this statement.

A breach of PRA rules made under FSMA may result in administrative penalties or other sanctions pursuant to Part 14 (Disciplinary measures) of the Act. PRA liquidity and stable funding requirements are imposed by CRR rules made pursuant to Part 9D of FSMA. Relevant disciplinary consequences under FSMA may therefore result from their breach.

The measures we describe in our answer to question 18 above may also be employed in relation to such a breach. In relation to the supervisory powers under Reg 35B of The Capital Requirements Regulations, this is because a breach of CRR rules (widely defined by way of by Reg 2 of the Regulations, in s 144A of FSMA) may engage those powers.

21. The UK Application indicates that if MREL is breached, the PRA make take early measures to intervene. Please provide a reference for this statement. The UK Application refers to the Recovery and Resolution (No. 2) Order 2014, Part 8 but does not provide a reference to a specific section. Section 107 of the order lists possible early intervention measures but does not specify what conditions (e.g., breach of MREL?) may trigger such early intervention. It appears that the conditions may be determined by technical standards adopted by the PRA. If such standards exist, please provide them and refer to the relevant provisions.

The "conditions for early intervention" referred to in Part 8 are defined in Article 2 of the Order. They include that an institution is likely in the near future to infringe requirements of the CRR rules, or provisions derived from CRD, due, amongst other things, to a rapidly deteriorating financial condition. Part 8 essentially lays down procedures to be followed by the appropriate regulator for determining whether measures for early intervention should be taken under FSMA. Article 107 of the Order defines "measures for early intervention" as "relevant measures" under FSMA powers (which would include, for example, measures under Section 55M of FSMA) including requiring changes to the institution's business strategy or to the legal or operational structures of the institution.

22. The UK Application notes that the PRA may also impose other requirements in case of non-compliance with regulatory requirements, including:

    a. maintaining additional capital in excess of the minimum requirements, if certain conditions are met: Reg 35B(1)(g) of The Capital Requirements Regulations 2013 (the "**2013 Regulations**").
    b. requiring that the PRA-designated UK nonbank SD submit a plan to restore compliance with applicable capital or liquidity thresholds: Reg 35B(1)(b) of the 2013 Regulations.
    c. imposing restrictions on the business or operations of the PRA-designated UK nonbank SD: Reg 35B(1)(d) of the 2013 Regulations.
    d. imposing restrictions or prohibitions on distributions or interest payments to shareholders or holders of additional tier 1 capital instruments: Reg 35B(1)(h) of the 2013 Regulations.
    e. requiring additional or more frequent reporting requirements: Reg 35B(1)(i) of the 2013 Regulations. and
    f. imposing additional specific liquidity requirements: Reg 35B(1)(j) of the 2013 Regulations.

    In support of this statement, the UK Application refers broadly to Parts 4A and 12A of FSMA and the Capital Requirements Regulations 2013. Please provide more specific references addressing each of the listed PRA powers.

    Please see the response to question 18 above and references provided to the requirements listed above.

If you have any questions concerning this letter, please feel free to contact Lily Bozhanova, Special Counsel, Market Participants Division, at (202) 418-6232.

Sincerely,

Thomas Smith
Deputy Director
Market Participants Division