

## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Chapter I

#### Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Subject to Capital and Financial Reporting Requirements of the United Kingdom and Regulated by the United Kingdom Prudential Regulation Authority

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Proposed order and request for comment.

**SUMMARY:** The Commodity Futures Trading Commission is soliciting public comment on an application submitted by the Institute of International Bankers, International Swaps and Derivatives Association, and Securities Industry and Financial Markets Association requesting that the Commission determine that the capital and financial reporting laws and regulations of the United Kingdom applicable to CFTC-registered swap dealers organized and domiciled in the United Kingdom, which are licensed under the United Kingdom Financial Services and Markets Act 2000 as investment firms and designated for prudential supervision by the United Kingdom Prudential Regulation Authority, provide sufficient bases for an affirmative finding of comparability with respect to the Commission's swap dealer capital and financial reporting requirements adopted under the Commodity Exchange Act. The Commission is also soliciting public comment on a proposed order providing for the conditional availability of substituted compliance in connection with the application.

**DATES:** Comments must be received on or before March 24, 2024.

**ADDRESSES:** You may submit comments, identified by "UK-PRA Swap Dealer Capital Comparability Determination," by any of the following methods:

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

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

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <https://comments.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act ("FOIA"), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in Commission Regulation 145.9.<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 <https://comments.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the proposed determination and order will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the FOIA.

**FOR FURTHER INFORMATION CONTACT:**

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**SUPPLEMENTARY INFORMATION:** The Commodity Futures Trading Commission ("Commission" or "CFTC") is soliciting public comment on an application dated May 4, 2021 (the "UK Application") submitted by the Institute of International Bankers, International Swaps and Derivatives Association, and Securities Industry and Financial Markets Association (together,

the "Applicants").<sup>2</sup> The Applicants request that the Commission determine that registered nonbank swap dealers<sup>3</sup> ("nonbank SDs") organized and domiciled within the United Kingdom ("UK"), which are licensed as investment firms and designated for prudential supervision by the UK Prudential Regulation Authority ("PRA") ("PRA-designated UK nonbank SDs"), may satisfy certain capital and financial reporting requirements under the Commodity Exchange Act ("CEA")<sup>4</sup> by being subject to, and complying with, comparable capital and financial reporting requirements under UK laws and regulations.<sup>5</sup> The Commission also is soliciting public comment on a proposed order under which PRA-designated UK nonbank SDs would be able, subject to defined conditions, to comply with certain CFTC nonbank SD capital and financial reporting requirements in the manner set forth in the proposed order.

### I. Introduction

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

Section 4s(e) of the CEA<sup>6</sup> directs the Commission and "prudential regulators"<sup>7</sup> to impose capital

<sup>2</sup> See Letter dated May 4, 2021 from Stephanie Webster, General Counsel, Institute of International Bankers, Steven Kennedy, Global Head of Public Policy, International Swaps and Derivatives Association, and Kyle Brandon, Managing Director, Head of Derivatives Policy, Securities Industry and Financial Markets Association. The UK Application is available on the Commission's website at: <https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm>.

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

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

<sup>5</sup> The Applicants also requested that the Commission determine that nonbank SDs licensed as investment firms and prudentially regulated by the UK Financial Conduct Authority ("FCA") ("FCA-regulated UK nonbank SDs") may satisfy certain capital and financial reporting requirements under the CEA by being subject to, and complying with, comparable capital and financial reporting requirements under UK laws and regulations. Due to the differences between the capital and financial reporting regimes applicable to PRA-designated UK nonbank SD and FCA-regulated UK nonbank SDs, the Commission anticipates assessing the comparability of the rules applicable to FCA-regulated UK nonbank SDs through a separate capital comparability determination.

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

<sup>7</sup> The term "prudential regulator" is defined in the CEA to mean the Board of Governors of the Federal Reserve System ("Federal Reserve Board"); the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Farm

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

requirements on all SDs and major swap participants (“MSPs”) registered with the Commission.<sup>8</sup> Section 4s(e) of the CEA also directs the Commission and prudential regulators to adopt regulations imposing initial and variation margin requirements on swaps entered into by SDs and MSPs that are not cleared by a registered derivatives clearing organization (“uncleared swaps”).

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

The prudential regulators implemented Section 4s(e) in 2015 by amending existing capital requirements applicable to bank SDs and bank MSPs to incorporate swap transactions into their respective bank capital frameworks, and by adopting rules imposing initial and variation margin requirements on bank SDs and bank MSPs that engage in uncleared swap

transactions.<sup>11</sup> The Commission adopted final rules imposing initial and variation margin obligations on nonbank SDs and nonbank MSPs for uncleared swap transactions on January 6, 2016.<sup>12</sup> The Commission also approved final capital requirements for nonbank SDs and nonbank MSPs on July 24, 2020, which were published in the **Federal Register** on September 15, 2020 with a compliance date of October 6, 2021 (“CFTC Capital Rules”).<sup>13</sup>

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

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

Commission Regulation 23.106 establishes a substituted compliance framework whereby the Commission may determine that compliance by a non-U.S. domiciled nonbank SD or non-U.S. domiciled nonbank MSP with its home country’s capital and financial reporting requirements will satisfy all or parts of the CFTC Capital Rules and all or parts of the CFTC Financial Reporting Rules (such a determination referred to as a “Capital Comparability Determination”).<sup>17</sup> The availability of

such substituted compliance is conditioned upon the Commission issuing a determination that the relevant foreign jurisdiction’s capital adequacy and financial reporting requirements, and related financial recordkeeping requirements, for non-U.S. nonbank SDs and/or non-U.S. nonbank MSPs are comparable to the corresponding CFTC Capital Rules and CFTC Financial Reporting Rules. The Commission will issue a Capital Comparability Determination in the form of a Commission order (“Capital Comparability Determination Order”).<sup>18</sup>

The Commission’s approach for conducting a Capital Comparability Determination with respect to the CFTC Capital Rules and the CFTC Financial Reporting Rules is a principles-based, holistic approach that focuses on whether the applicable foreign jurisdiction’s capital and financial reporting requirements achieve comparable outcomes to the corresponding CFTC requirements.<sup>19</sup> In this regard, the approach is not a line-by-line assessment or comparison of a foreign jurisdiction’s regulatory requirements with the Commission’s requirements.<sup>20</sup> In performing the analysis, the Commission recognizes that jurisdictions may adopt differing approaches to achieving comparable outcomes, and the Commission will focus on whether the foreign

Commission regulations provide that any non-U.S. nonbank SD or non-U.S. nonbank MSP that is dually-registered with the Commission as a futures commission merchant (“FCM”) is subject to the capital requirements of Commission Regulation 1.17 (17 CFR 1.17) and may not petition the Commission for a Capital Comparability Determination. *See* 17 CFR 23.101(a)(5) and (b)(4), respectively. Furthermore, non-U.S. bank SDs and non-U.S. bank MSPs may not petition the Commission for a Capital Comparability Determination with respect to their respective financial reporting requirements under Commission Regulation 23.105(p) (17 CFR 23.105(p)). Commission staff has issued, however, a time-limited no-action letter stating that the Market Participants Division will not recommend enforcement action against a non-U.S. bank SD that files with the Commission certain financial information that is provided to its home country regulator in lieu of certain financial reports required by Commission Regulation 23.105(p). *See* CFTC Staff Letter 21–18, issued on August 31, 2021, and CFTC Staff Letter 23–11, issued on July 10, 2023 (extending the expiration of CFTC Staff Letter 21–18 until the earlier of October 6, 2025 or the adoption of any revised financial reporting requirements applicable to bank SDs under Regulation 23.105(p)). On December 15, 2023, the Commission issued for public comment proposed amendments to Regulation 23.105(p) addressing the financial reporting requirements applicable to bank SDs in a manner consistent with the position taken in CFTC Letters 21–18 and 23–11. *See* CFTC Press Release 8836–23 issued on December 15, 2023, available at [cftc.gov](https://www.cftc.gov).

<sup>18</sup> 17 CFR 23.106(a)(3).

<sup>19</sup> *See* 85 FR 57462 at 57521.

<sup>20</sup> *Id.*

Credit Administration; and the Federal Housing Finance Agency. *See* 7 U.S.C. 1a(39).

<sup>8</sup> Subject to certain exceptions, the term “swap dealer” is generally defined as any person that: (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps. *See* 7 U.S.C. 1a(49). The term “major swap participant” is generally defined as any person who is not an SD, and: (i) subject to certain exclusions, maintains a substantial position in swaps for any of the major swap categories as determined by the Commission; (ii) whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or (iii) maintains a substantial position in outstanding swaps in any major swap category as determined by the Commission. *See* 7 U.S.C. 1a(33).

<sup>9</sup> 7 U.S.C. 6s(e)(2).

<sup>10</sup> 7 U.S.C. 6s(e)(1) and (2).

<sup>11</sup> *See Margin and Capital Requirements for Covered Swap Entities*, 80 FR 74840 (Nov. 30, 2015).

<sup>12</sup> *See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 FR 636 (Jan. 6, 2016).

<sup>13</sup> *See Capital Requirements of Swap Dealers and Major Swap Participants*, 85 FR 57462 (Sept. 15, 2020).

<sup>14</sup> 7 U.S.C. 6s(f).

<sup>15</sup> 7 U.S.C. 6s(f)(1)(A).

<sup>16</sup> *See* 85 FR 57462.

<sup>17</sup> 17 CFR 23.106. Commission Regulation 23.106(a)(1) provides that a request for a Capital Comparability Determination may be submitted by a non-U.S. nonbank SD or a non-U.S. nonbank MSP, a trade association or other similar group on behalf of its SD or MSP members, or a foreign regulatory authority that has direct supervisory authority over one or more non-U.S. nonbank SDs or non-U.S. nonbank MSPs. In addition,

jurisdiction's capital and financial reporting requirements are comparable to the Commission's in purpose and effect, and not whether they are comparable in every aspect or contain identical elements.

A person requesting a Capital Comparability Determination is required to submit an application to the Commission containing: (i) a description of the objectives of the relevant foreign jurisdiction's capital adequacy and financial reporting requirements applicable to entities that are subject to the CFTC Capital Rules and the CFTC Financial Reporting Rules; (ii) a description (including specific legal and regulatory provisions) of how the relevant foreign jurisdiction's capital adequacy and financial reporting requirements address the elements of the CFTC Capital Rules and CFTC Financial Reporting Rules, including, at a minimum, the methodologies for establishing and calculating capital adequacy requirements and whether such methodologies comport with any international standards; and (iii) a description of the ability of the relevant foreign regulatory authority to supervise and enforce compliance with the relevant foreign jurisdiction's capital adequacy and financial reporting requirements. The applicant must also submit, upon request, such other information and documentation as the Commission deems necessary to evaluate the comparability of the capital adequacy and financial reporting requirements of the foreign jurisdiction.<sup>21</sup>

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

would facilitate supervisory cooperation.<sup>22</sup>

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

In performing the comparability assessment for foreign nonbank MSPs,<sup>23</sup> the Commission's review will include the extent to which the foreign jurisdiction's requirements address: (i) the process of establishing minimum capital requirements for a nonbank MSP and how such process establishes a minimum level of capital to ensure the safety and soundness of the nonbank MSP; (ii) the financial reports and other financial information submitted by a nonbank MSP to its relevant regulatory authority and whether such information provides the regulatory authority with the means necessary to effectively monitor the financial condition of the nonbank MSP; and (iii) the regulatory notices and other communications between a nonbank MSP and its foreign regulatory authority that address

potential adverse financial or operational issues that may impact the firm. With respect to the ability of the relevant foreign regulatory authority to supervise and enforce compliance with the foreign jurisdiction's capital adequacy and financial reporting requirements, the Commission's review will include a review of the foreign jurisdiction's surveillance program for monitoring nonbank MSPs' compliance with such capital adequacy and financial reporting requirements, and the disciplinary process imposed on firms that fail to comply with such requirements.

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

The Commission's capital adequacy and financial reporting requirements are designed to address and manage risks that arise from a firm's operation as a SD or MSP. Given their functions, both sets of requirements and rules must be applied on an entity-level basis (meaning that the rules apply on a firm-wide basis, irrespective of the type of transactions involved) to effectively address risk to the firm as a whole. Therefore, in order to rely on a Capital Comparability Determination, a nonbank SD or nonbank MSP domiciled in the foreign jurisdiction and subject to supervision by the relevant regulatory authority (or authorities) in the foreign jurisdiction must file a notice with the Commission of its intent to comply with the applicable capital adequacy and financial reporting requirements of the foreign jurisdiction set forth in the Capital Comparability Determination in lieu of all or parts of the CFTC Capital Rules and/or CFTC Financial Reporting Rules.<sup>25</sup> Notices must be filed electronically with the Commission's

<sup>22</sup> See 17 CFR 23.106(a)(3) and 85 FR 57520–57522.

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

<sup>24</sup> See 17 CFR 23.106(a)(5).

<sup>25</sup> 17 CFR 23.106(a)(4).

<sup>21</sup> 17 CFR 23.106(a)(2).

Market Participants Division (“MPD”).<sup>26</sup> The filing of a notice by a non-U.S. nonbank SD or non-U.S. nonbank MSP provides MPD staff, acting pursuant to authority delegated by the Commission,<sup>27</sup> with the opportunity to engage with the firm and to obtain representations that it is subject to, and complies with, the laws and regulations cited in the Capital Comparability Determination and that it will comply with any listed conditions. MPD will issue a letter under its delegated authority from the Commission confirming that the non-U.S. nonbank SD or non-U.S. nonbank MSP may comply with foreign laws and regulations cited in the Capital Comparability Determination in lieu of complying with the CFTC Capital Rules and the CFTC Financial Reporting Rules upon MPD’s determination that the firm is subject to and complies with the applicable foreign laws and regulations, is subject to the jurisdiction of the applicable foreign regulatory authority (or authorities), and can meet any conditions in the Capital Comparability Determination.

Each non-U.S. nonbank SD and/or non-U.S. nonbank MSP that receives, in accordance with the applicable Commission Capital Comparability Determination Order, confirmation from the Commission that it may comply with a foreign jurisdiction’s capital adequacy and/or financial reporting requirements will be deemed by the Commission to be in compliance with the corresponding CFTC Capital Rules and/or CFTC Financial Reporting Rules.<sup>28</sup> Accordingly, if a nonbank SD or a nonbank MSP fails to comply with the foreign jurisdiction’s capital adequacy and/or financial reporting requirements, the Commission may initiate an action for a violation of the corresponding CFTC Capital Rules and/or CFTC Financial Reporting Rules.<sup>29</sup> In addition, a non-U.S. nonbank SD or non-U.S. nonbank MSP that receives confirmation of its ability to use substituted compliance remains subject to the Commission’s examination and enforcement authority.<sup>30</sup> A finding of a violation by a foreign jurisdiction’s regulatory authority is not a prerequisite for the exercise of such examination and enforcement authority by the Commission.

The Commission will consider an application for a Capital Comparability

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

### C. Application for a Capital Comparability Determination for PRA-Designated UK Nonbank Swap Dealers

The Applicants submitted the UK Application requesting that the Commission issue a Capital Comparability Determination finding that a PRA-designated UK nonbank SD’s compliance with the capital requirements of the UK and the financial reporting requirements of the UK, as specified in the UK Application and applicable to PRA-designated UK nonbank SDs, satisfies corresponding CFTC Capital Rules and the CFTC Financial Reporting Rules applicable to a nonbank SD under sections 4s(e)–(f) of the CEA and Commission Regulations 23.101 and 23.105.<sup>32</sup>

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

<sup>32</sup> UK Application, p. 1. There are currently no MSPs registered with the Commission, and the Applicants have not requested that the Commission issue a Capital Comparability Determination concerning UK nonbank MSPs. Accordingly, the Commission’s Capital Comparability Determination and proposed Capital Comparability Determination Order do not address UK nonbank MSPs.

To be designated for prudential supervision by the PRA, a UK-domiciled investment firm must be authorized, or have requested authorization, to deal in investments as principal.<sup>33</sup> For an investment firm that is authorized, or has requested authorization, to deal in investments as principal, the PRA may designate the firm for prudential supervision if the PRA determines that the dealing activities of the firm should be a PRA-regulated activity. The PRA considers the following in determining whether an investment firm should be subject to PRA supervision: (i) the assets of the investment firm; and (ii) where the investment firm is a member of a group, (a) the assets of other firms within the group that are authorized, or have sought authorization, to deal in investments as principal, (b) whether any other member of the group is subject to prudential supervision by the PRA, and (c) whether the investment firm’s activities have, or might have, a material impact on the ability of the PRA to advance any of its objectives in relation to PRA-authorized person in its group.<sup>34</sup> The PRA also must consult with the FCA before designating a person for prudential supervision.<sup>35</sup>

The PRA also has issued a Statement of Policy providing further detail regarding the factors that are considered in assessing an investment firm for prudential supervision.<sup>36</sup> The factors include: (i) whether the firm’s balance sheet exceeds an average of GBP 15 billion total gross assets over four quarters; (ii) where the investment firm is part of a group, whether the sum of the balance sheets of all firms within the group that are authorized, or have requested authorization, to deal in investments as principals exceeds an average of GBP 15 billion over four quarters; and/or (iii) where the firm is part of a group subject to PRA supervision, whether the investment firm’s revenues, balance sheet and risk taking is significant relative to the group’s revenues, balance sheet, and risk-taking.<sup>37</sup> There are currently six PRA-designated UK nonbank SDs registered with the Commission:

<sup>33</sup> Article 3(1) and (2) of *The Financial Services and Markets Act 2000 (PRA-regulated Activities) Order 2013*.

<sup>34</sup> *Id.*, Article 3(4).

<sup>35</sup> *Id.*, Article 3(6).

<sup>36</sup> See PRA, *Statement of Policy, Designation of Investment Firms for Prudential Supervision by the Prudential Regulation Authority, December 2021*, available here: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/statement-of-policy/2021/designation-of-investment-firms-for-prudential-supervision-by-the-pra-december-2021.pdf?la=en&hash=007EB17EDF2FA84714D372095F9E03627355776F>.

<sup>37</sup> *Id.*, at p. 5.

<sup>26</sup> Notices must be filed in electronic form to the following email address: [MPDFinancialRequirements@cftc.gov](mailto:MPDFinancialRequirements@cftc.gov).

<sup>27</sup> See 17 CFR 140.91(a)(11).

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

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

<sup>30</sup> *Id.*

Citigroup Global Markets Limited, Goldman Sachs International, Merrill Lynch International, Morgan Stanley & Co. International Plc, MUFG Securities EMEA Plc, and Nomura International Plc.

The Applicants represent that the capital and financial reporting framework applicable to PRA-designated UK nonbank SDs is primarily based on the framework established by the European Union's ("EU") Capital Requirements Regulation<sup>38</sup> and Capital Requirements Directive,<sup>39</sup> which set forth capital and financial reporting requirements applicable to "credit institutions"<sup>40</sup> and "investment firms."<sup>41</sup> CRR, as a regulation, is directly applicable in all member states of the EU ("EU Member States") and was, therefore, binding law in the UK during the UK's membership in the EU.<sup>42</sup> CRD, as a directive, was required to be transposed into EU Member States' national law, including UK law.<sup>43</sup> With regard to PRA-

designated UK nonbank SDs, the UK implemented CRD primarily through a series of regulations, including the Capital Requirements Regulations 2013<sup>44</sup> and the Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014,<sup>45</sup> and the rules of the PRA.<sup>46</sup>

Following the UK's withdrawal from EU membership ("Brexit"), EU laws that were in effect and applicable as of December 31, 2020, were retained in UK law subject to certain non-substantive amendments seeking to reflect the UK's new position outside of the EU.<sup>47</sup> As such, directly applicable EU law, such as CRR, was converted into domestic UK law and UK legislation implementing EU directives, such as CRD, was preserved. The UK subsequently adopted additional changes, generally consistent with amendments introduced by the EU to CRR, CRD and other relevant EU provisions,<sup>48</sup> and incorporated certain CRR provisions in the PRA Rulebook.<sup>49</sup> The CRR provisions as applicable in the UK are referred hereafter as "UK CRR."<sup>50</sup> The UK capital and financial reporting framework also comprises UK-specific requirements in respect of certain matters. Requirements applicable to PRA-designated UK nonbank SDs are included in the PRA Rulebook. In addition, Commission Delegated Regulation (EU) 2015/61,<sup>51</sup>

which supplements UK CRR with regard to liquidity coverage requirement for credit institutions, applies to PRA-designated UK nonbank SDs and imposes separate liquidity requirements to these firms.<sup>52</sup>

The Applicants also represent that in addition to UK CRR and the PRA Rulebook, the Banking Act 2009 and its related secondary legislation, through which the UK transposed the Bank Recovery and Resolution Directive ("BRRD"), include relevant UK capital requirements.<sup>53</sup> Specifically, pursuant to the Banking Act 2009 and its secondary legislation, the Bank of England, in its role as resolution authority, requires certain investment firms, including PRA-designated UK nonbank SDs, to satisfy a firm-specific minimum requirement for own funds and eligible liabilities ("MREL").<sup>54</sup>

UK CRR, Capital Requirements Regulations 2013, Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014, Liquidity Coverage Delegated Regulation, the Banking Act 2009 and its secondary legislation, and relevant parts of the PRA Rulebook are referred to hereafter as the "UK PRA Capital Rules."

The Applicants further represent that with respect to supervisory financial reporting, the framework applicable to PRA-designated UK nonbank SDs is also based on the EU requirements. In addition, the framework comprises PRA-specific rules for matters not addressed by the EU-based requirements. Specifically, Commission Implementing Regulation (EU) 680/2014,<sup>55</sup> which was initially retained in UK law following Brexit, supplemented CRR with implementing technical standards ("CRR Reporting ITS")

(EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions ("Liquidity Coverage Delegated Regulation").

<sup>52</sup> See PRA Rulebook, CRR Firms, Liquidity Coverage Requirement—UK Designated Investment Firms Part.

<sup>53</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council. See UK Application, p. 7.

<sup>54</sup> Banking Act 2009, Section 3A(4) and (4B); Bank Recovery and Resolution (No 2) Order 2014, Statutory Instrument No. 3348 ("Bank Recovery and Resolution (No 2) Order 2014"), Part 9.

<sup>55</sup> Commission Implementing Regulation (EU) 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council.

<sup>38</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012 ("Capital Requirements Regulation" or "CRR").

<sup>39</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC ("Capital Requirements Directive" or "CRD").

<sup>40</sup> The term "credit institution" is defined as an entity whose business consists of taking deposits and other repayable funds from the public and granting credits. CRR, Article 4(1), as applicable in the UK. For a reference to CRR provisions applicable in the UK, see *infra* notes 49 and 50.

<sup>41</sup> The term "investment firm" is defined as an entity authorized under Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU ("Markets in Financial Instruments Directive" or "MiFID"), and whose regular business is the provision of one or more investment services to third parties and/or the performance of one or more investment-related activities on a professional basis, which includes dealing in derivatives for its own account. CRR, Article 4(1)(2) cross-referencing Article 4(1)(1) of MiFID.

<sup>42</sup> Consolidated Version of the Treaty on the Functioning of the European Union, OJ (C 326) 171, Oct. 26, 2012 ("TFEU"), Article 288.

<sup>43</sup> *Id.*, Article 288 (stating that a directive is binding as to the result to be achieved upon each EU Member State to which the directive is addressed, and further provides, however, that each EU Member State elects the form and method of implementing the directive). In this connection, EU Member States were required to implement and start applying amendments to CRD, introduced by Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures ("CRD V") by December 29, 2020. Some CRD V provisions were subject to delayed implementation deadlines of June 28, 2021 and January 1, 2022. CRD V, Article 2.

<sup>44</sup> Capital Requirements Regulations 2013, Statutory Instrument 2013 No. 3115 ("Capital Requirements Regulations 2013").

<sup>45</sup> Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014, Statutory Instrument 2014 No. 894 ("Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014").

<sup>46</sup> The PRA's rules ("PRA Rulebook") are available here: <https://www.prarulebook.co.uk/>.

<sup>47</sup> See, An Act to Repeal the European Communities Act 1972 and make other provisions in connection with the withdrawal of the United Kingdom from the EU (2018 c.16) ("European Union (Withdrawal) Act 2018").

<sup>48</sup> See PRA, Policy Statement 21/21—The UK Leverage Framework, October 2021, available here: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/june/changes-to-the-uk-leverage-ratio-framework>, and Policy Statement 22/21—Implementation of Basel standards: Final rules, October 2021, available here: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/october/implementation-of-basel-standards>.

<sup>49</sup> Pursuant to the Financial Services and Markets Act 2023 ("FSMA 2023"), the UK revoked CRR and replaced it with: (i) PRA rules adopted under Section 144 of the Financial Services and Markets Act 2000 ("FSMA") and (ii) UK regulations, adopted under Section 4 of FSMA 2023, restating CRR provisions.

<sup>50</sup> The UK CRR is available here: <https://www.legislation.gov.uk/eur/2013/575/contents>. The provisions that were incorporated in the PRA Rulebook are no longer part of UK CRR and appear instead in the PRA Rulebook.

<sup>51</sup> Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation

specifying, among other things, uniform formats and frequencies for the financial and capital requirements reporting required under CRR.<sup>56</sup> CRR Reporting ITS included templates for the common reporting (“COREP”) and the financial reporting (“FINREP”) that specify the contents of the EU-based supervisory reporting requirements. As part of the regulatory reforms that followed Brexit and sought to implement Basel III standards, the PRA incorporated the entire body of the UK version of COREP and FINREP requirements into the PRA Rulebook to create a single source for reporting requirements for firms.<sup>57</sup> For PRA-designated UK nonbank SDs that are not subject to the EU-based FINREP requirements, the PRA Rulebook includes PRA-specific requirements.<sup>58</sup>

The Applicants also represent that the Companies Act 2006 contains provisions related to financial reporting, including a mandate that entities of a certain size be required to prepare annual audited financial statements and a strategic report.<sup>59</sup> UK CRR, relevant provisions of the PRA Rulebook, and relevant provisions of the Companies Act 2006, are collectively referred to hereafter as the “UK PRA Financial Reporting Rules.”

The Applicants also note that the U.S. Securities and Exchange Commission (“SEC”) has issued orders permitting an SEC-registered nonbank security-based swap dealer domiciled in the UK (“UK nonbank SBSD”) to satisfy SEC capital<sup>61</sup> and financial reporting requirements via substituted compliance with applicable UK capital and financial reporting.<sup>62</sup> The UK Order

conditioned substituted compliance for capital requirements on a UK nonbank SBSD complying with specified laws and regulations, including relevant parts of UK CRR and the PRA Rulebook, and also maintaining total liquid assets in an amount that exceeds the UK nonbank SBSD’s total liabilities by at least \$100 million and by at least \$20 million after applying certain deductions to the value of the liquid assets to reflect market, credit, and other potential risks to the value of the assets.<sup>63</sup>

## II. General Overview of Commission and UK PRA Nonbank Swap Dealer Capital Rules

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

The CFTC Capital Rules provide nonbank SDs with three alternative capital approaches: (i) the Tangible Net Worth Capital Approach (“TNW Approach”); (ii) the Net Liquid Assets Capital Approach (“NLA Approach”); and (iii) the Bank-Based Capital Approach (“Bank-Based Approach”).<sup>64</sup>

Nonbank SDs that are “predominantly engaged in non-financial activities” may elect the TNW Approach.<sup>65</sup> The TNW Approach requires a nonbank SD to maintain a level of “tangible net

worth”<sup>66</sup> equal to or greater than the higher of: (i) \$20 million plus the amount of the nonbank SD’s “market risk exposure requirement”<sup>67</sup> and “credit risk exposure requirement”<sup>68</sup> associated with the nonbank SD’s swap and related hedge positions that are part of the nonbank SD’s swap dealing activities; (ii) 8 percent of the nonbank SD’s “uncleared swap margin” amount;<sup>69</sup> or (iii) the amount of capital required by a registered futures association of which the nonbank SD is a member.<sup>70</sup> The TNW Approach is intended to ensure the safety and soundness of a qualifying nonbank SD by requiring the firm to maintain a minimum level of tangible net worth that is based on the nonbank SD’s swap dealing activities to provide a sufficient level of capital to absorb losses resulting from its swap dealing and other business activities.

The TNW approach requires a nonbank SD to compute its market risk exposure requirement and credit risk

<sup>66</sup> The term “tangible net worth” is defined in Commission Regulation 23.100 and generally means the net worth (*i.e.*, assets less liabilities) of a nonbank SD, computed in accordance with applicable accounting principles, with assets further reduced by a nonbank SD’s recorded goodwill and other intangible assets. 17 CFR 23.100.

<sup>67</sup> The terms “market risk exposure” and “market risk exposure requirement” are defined in Commission Regulation 23.100 and generally mean the risk of loss in a financial position or portfolio of financial positions resulting from movements in market prices and other factors. 17 CFR 23.100. Market risk exposure is the sum of: (i) general market risks including changes in the market value of a particular asset that results from broad market movements, which may include an additive for changes in market value under stressed conditions; (ii) specific risk, which includes risks that affect the market value of a specific instrument but do not materially alter broad market conditions; (iii) incremental risk, which means the risk of loss on a position that could result from the failure of an obligor to make timely payments of principal and interest; and (iv) comprehensive risk, which is the measure of all material price risks of one or more portfolios of correlation trading positions.

<sup>68</sup> The term “credit risk exposure requirement” is defined in Commission Regulation 23.100 and generally reflects the amount at risk if a counterparty defaults before the final settlement of a swap transaction’s cash flows. 17 CFR 23.100.

<sup>69</sup> The term “uncleared swap margin” is defined in Commission Regulation 23.100 to generally mean the amount of initial margin that a nonbank SD would be required to collect from each counterparty for each outstanding swap position of the nonbank SD. 17 CFR 23.100. A nonbank SD must include all swap positions in the calculation of the uncleared swap margin amount, including swaps that are exempt or excluded from the scope of the Commission’s uncleared swap margin regulations. A nonbank SD must compute the uncleared swap margin amount in accordance with the Commission’s margin rules for uncleared swaps. See 17 CFR 23.154.

<sup>70</sup> The National Futures Association (“NFA”) is currently the only entity that is a registered futures association. The Commission will refer to NFA in this document when referring to the requirements or obligations of a registered futures association.

<sup>56</sup> UK Application, p. 24 and Responses to Staff Questions dated October 5, 2023.

<sup>57</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part.

<sup>58</sup> PRA Rulebook, CRR Firms, Regulatory Reporting Part.

<sup>59</sup> UK Application, p.7. Companies Act 2006, Part 15 and 16. The Companies Act 2006 is available here: <https://www.legislation.gov.uk/ukpga/2006/46/contents>.

<sup>60</sup> All six of the PRA-designated UK nonbank SDs currently registered with the Commission are also UK nonbank SBSDs.

<sup>61</sup> Section 15F(e)(1)(B) of the Exchange Act (15 U.S.C. 78o–10) directs the SEC to adopt capital rules for security-based swap dealers (“SBSDs”) that do not have a prudential regulator.

<sup>62</sup> See *Order Granting Conditional Substituted Compliance in Connection with Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the United Kingdom*, 86 FR 43318 (July 30, 2021) (“Final UK Order”); *Amended and Restated Order Granting Conditional Substituted Compliance in Connection with Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the Federal Republic of Germany; Amended Orders Addressing Non-U.S. Security-Based Swap Entities Subject to Regulation in the*

*French Republic or the United Kingdom; and Order Extending the Time to Meet Certain Conditions Relating to Capital and Margin*, 86 FR 59797 (Oct. 28, 2021) (“Amended UK Order,” together with the Final UK Order, “UK Order”); and *Order Specifying the Manner and Format of Filing Unaudited Financial and Operational Information by Security-Based Swap Dealers and Major Security-Based Swap Participants that are not U.S. Persons and are Relying on Substituted Compliance with Respect to Rule 18a–7*, 86 FR 59208 (Oct. 26, 2021) (“SEC Order on Manner and Format of Filing Unaudited Financial and Operational Information”).

<sup>63</sup> The conditioning of the UK substituted compliance order on UK nonbank SBSDs maintaining liquid assets in an amount that exceeds the UK nonbank SBSD’s total liabilities by at least \$100 million and by at least \$20 million after applying certain deductions to the value of the liquid assets reflects that the SEC’s capital rule for nonbank SBSDs is a liquidity-based requirement and that the SEC capital requirements are not based on the Basel bank capital standards. See 17 CFR 240.18a–1(a)(1) (requiring a SBSD to maintain, in relevant part, net capital of \$20 million or, if approved to use capital models, \$100 million of tentative net capital and \$20 million of net capital).

<sup>64</sup> 17 CFR 23.101.

<sup>65</sup> 17 CFR 23.101(a)(2). The term “predominantly engaged in non-financial activities” is defined in Commission Regulation 23.100 and generally provides that: (i) the nonbank SD’s, or its parent entity’s, annual gross financial revenues for either of the previous two completed fiscal years represents less than 15 percent of the nonbank SD’s or the nonbank SD’s parent’s, annual gross revenues for all operations (*i.e.*, commercial and financial) for such years; and (ii) the nonbank SD’s, or its parent entity’s, total financial assets at the end of its two most recently completed fiscal years represents less than 15 percent of the nonbank SD’s, or its parent’s, total consolidated financial and nonfinancial assets as of the end of such years. 17 CFR 23.100.



exposure requirement using standardized capital charges set forth in SEC Rule 18a-1<sup>71</sup> that are applicable to entities registered with the SEC as SBSBs or standardized capital charges set forth in Commission Regulation 1.17 applicable to entities registered as FCMs or entities dually-registered as an FCM and nonbank SD.<sup>72</sup> Nonbank SDs that have received Commission or NFA approval pursuant to Commission Regulation 23.102 may use internal models to compute market risk and/or credit risk capital charges in lieu of the SEC or CFTC standardized capital charges.<sup>73</sup>

A nonbank SD that elects the NLA Approach is required to maintain “net capital” in an amount that equals or exceeds the greater of: (i) \$20 million; (ii) 2 percent of the nonbank SD’s uncleared swap margin amount; or (iii) the amount of capital required by NFA.<sup>74</sup> The NLA Approach is intended to ensure the safety and soundness of a nonbank SD by requiring the firm to maintain at all times at least one dollar of highly liquid assets to cover each dollar of the nonbank SD’s liabilities.

A nonbank SD is required to reduce the value of its highly liquid assets by the market risk exposure requirement and/or the credit risk exposure requirement in computing its net capital.<sup>75</sup> A nonbank SD that does not have Commission or NFA approval to use internal models must compute its market risk exposure requirement and/or credit risk exposure requirement using the standardized capital charges contained in SEC Rule 18a-1 as modified by the Commission’s rule.<sup>76</sup>

A nonbank SD that has obtained Commission or NFA approval, may use internal market risk and/or credit risk models to compute market risk and/or credit risk capital charges in lieu of the standardized capital charges.<sup>77</sup> A nonbank SD that is approved to use internal market risk and/or credit risk models is further required to maintain a minimum of \$100 million of “tentative net capital.”<sup>78</sup>

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

The Commission’s Bank-Based Approach for computing regulatory capital for nonbank SDs is based on certain capital requirements imposed by the Federal Reserve Board for bank holding companies.<sup>79</sup> The Bank-Based Approach also is consistent with the Basel Committee on Banking Supervision’s (“BCBS”) international framework for bank capital requirements.<sup>80</sup> The Bank-Based Approach requires a nonbank SD to maintain regulatory capital equal to or in excess of each of the following requirements: (i) \$20 million of common equity tier 1 capital; (ii) an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital (including qualifying subordinated debt) equal to or greater than 8 percent of the nonbank SD’s risk-weighted assets (provided that common equity tier 1 capital comprises at least 6.5 percent of the 8 percent minimum requirement); (iii) an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital equal to or greater than 8 percent of the nonbank SD’s uncleared swap margin amount; and (iv) an amount of capital required by NFA.<sup>81</sup> The Bank-Based Approach is intended to ensure that the safety and soundness of a nonbank SD by requiring the firm to maintain at all times qualifying capital in an amount sufficient to absorb unexpected losses, expenses, decrease in firm assets, or increases in firm liabilities without the firm becoming insolvent.

The terms used in the Commission’s Bank-Based Approach are defined by reference to regulations of the Federal Reserve Board.<sup>82</sup> Specifically, the term

“common equity tier 1 capital” is defined for purposes of the CFTC Capital Rules to generally mean the sum of a nonbank SD’s common stock instruments and any related surpluses, retained earnings, and accumulated other comprehensive income.<sup>83</sup> The term “additional tier 1 capital” is defined to include equity instruments that are subordinated to claims of general creditors and subordinated debt holders, but contain certain provisions that are not available to common stock, such as the right of nonbank SD to call the instruments for redemption or to convert the instruments to other forms of equity.<sup>84</sup> The term “tier 2 capital” is defined to include certain types of instruments that include both debt and equity characteristics (*e.g.*, certain perpetual preferred stock instruments and subordinated term debt instruments).<sup>85</sup> Subordinated debt also must meet certain requirements to qualify as tier 2 capital, including that the term of the subordinated debt instrument is for a minimum of one year (with the exception of approved revolving subordinated debt agreements which may have a maturity term that is less than one year), and the debt instrument is an effective subordination of the rights of the lender to receive any payment, including accrued interest, to other creditors.<sup>86</sup>

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

A nonbank SD also must compute its risk-weighted assets using standardized capital charges or, if approved, internal models. Risk-weighting assets involves adjusting the notional or carrying value of each asset based on the inherent risk of the asset. Less risky assets are

the minimum capital requirements under the Bank-Based Approach. 17 CFR 23.101(a)(1)(i) and 12 CFR 217.20.

<sup>83</sup> See 12 CFR 217.20(b).

<sup>84</sup> See 12 CFR 217.20(c).

<sup>85</sup> See 12 CFR 217.20(d).

<sup>86</sup> The subordinated debt must meet the requirements set forth in SEC Rule 18a-1d (17 CFR 240.18a-1d). See 17 CFR 23.101(a)(1)(i)(B) providing that the subordinated debt used by a nonbank SD to meet its minimum capital requirement under the Bank-Based Approach must satisfy the conditions for subordinated debt under SEC Rule 18a-1d.

<sup>71</sup> 17 CFR 240.18a-1.

<sup>72</sup> 17 CFR 23.101(a)(2)(ii)(A).

<sup>73</sup> *Id.*

<sup>74</sup> 17 CFR 23.101(a)(1)(ii)(A). “Net capital” consists of a nonbank SD’s highly liquid assets (subject to haircuts) less all of the firm’s liabilities, excluding certain qualified subordinated debt. See 17 CFR 240.18a-1 for the calculation of “net capital.”

<sup>75</sup> See 17 CFR 240.18a-1(c) and (d).

<sup>76</sup> See 17 CFR 23.101(a)(1)(ii).

<sup>77</sup> See 17 CFR 23.102.

<sup>78</sup> 17 CFR 23.101(a)(1)(ii)(A)(1). The term “tentative net capital” is defined in Commission Regulation 23.101(a)(1)(ii)(A)(1) by reference to SEC Rule 18a-1 and generally means a nonbank SD’s net capital prior to deducting market risk and credit risk capital charges.

<sup>79</sup> See 17 CFR 23.101(a)(1)(i).

<sup>80</sup> The BCBS is the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Institutions represented on the BCBS include the Federal Reserve Board, the European Central Bank, Deutsche Bundesbank, Bank of England, Bank of France, Bank of Japan, Banco de Mexico, and Bank of Canada. The BCBS framework is available at [https://www.bis.org/basel\\_framework/index.htm](https://www.bis.org/basel_framework/index.htm).

<sup>81</sup> 17 CFR 23.101(a)(1)(i).

<sup>82</sup> *Id.* Commission Regulation 23.101(a)(1)(i) references Federal Reserve Board Rule 217.20 for purposes of defining the terms used in establishing

adjusted to lower values (*i.e.*, have less risk-weight) than more risky assets. As a result, nonbank SDs are required to hold lower levels of regulatory capital for less risky assets and higher levels of regulatory capital for riskier assets.

Nonbank SDs not approved to use internal models to risk-weight their assets must compute market risk capital charges using the standardized charges contained in Commission Regulation 1.17 and SEC Rule 18a-1, and must compute their credit risk charges using the standardized capital charges set forth in regulations of the Federal Reserve Board for bank holding companies in subpart D of 12 CFR part 217.<sup>87</sup>

Standardized market risk charges are computed under Commission Regulation 1.17 and SEC Rule 18a-1 by multiplying, as appropriate to the specific asset schedule, the notional value or market value of the nonbank SD's proprietary financial positions (such as swaps, security-based swaps, futures, equities, and U.S. Treasuries) by fixed percentages set forth in the Regulation or Rule.<sup>88</sup> Standardized credit risk charges require the nonbank SD to multiply on-balance sheet and off-balance sheet exposures (such as receivables from counterparties, debt instruments, and exposures from derivatives) by predefined percentages set forth in the applicable Federal Reserve Board regulations contained in subpart D of 12 CFR part 217.

A nonbank SD also may apply to the Commission or NFA for approval to use internal models to compute market risk exposure and/or credit risk exposure for purposes of determining its total risk-weighted assets.<sup>89</sup> Nonbank SDs approved to use internal models for the calculation of credit risk or market risk, or both, must follow the model requirements set forth in Federal Reserve Board regulations for bank holding companies codified in subpart E and F, respectively, of 12 CFR part 217. Credit risk and market risk capital charges computed with internal models require the estimation of potential losses, with a certain degree of likelihood, within a specified time period, of a portfolio of assets. Internal models allow for consideration of potential co-movement of prices across assets in the portfolio, leading to offsets of gains and losses. Internal credit risk models can also further include

estimation of the likelihood of default of counterparties.

#### *B. General Overview of UK PRA Capital Rules for PRA-Designated UK Nonbank SDs*

The Applicants state that the UK PRA Capital Rules impose bank-like capital requirements on a PRA-designated UK nonbank SD that are consistent with the BCBS framework for international bank-based capital standards.<sup>90</sup> The Applicants further state that the UK PRA Capital Rules are intended to require each PRA-designated UK nonbank SD to hold a sufficient amount of qualifying equity capital and subordinated debt based on the PRA-designated UK nonbank SD's activities, to absorb decreases in the value of firm assets, increases in the value of firm liabilities, and to cover losses from business activities, including possible counterparty defaults and margin collateral shortfalls associated with swap dealing activities, without the firm becoming insolvent.<sup>91</sup>

The UK PRA Capital Rules require each PRA-designated UK nonbank SD to hold and maintain regulatory capital in the form of qualifying common equity tier 1 capital, additional tier 1 capital, and tier 2 capital in an aggregate amount that equals or exceeds 8 percent of the PRA-designated UK nonbank SD's total risk exposure amount, which is calculated as a sum of the firm's risk-weighted assets and exposures.<sup>92</sup> Common equity tier 1 capital must comprise a minimum of 4.5 percent of the 8 percent capital ratio,<sup>93</sup> and tier 1 capital (which is the aggregate of common equity tier 1 capital and additional tier 1 capital) must comprise a minimum of 6 percent of the total 8 percent capital ratio.<sup>94</sup> Tier 2 capital may comprise a maximum of 2 percent of the total 8 percent capital ratio.<sup>95</sup>

Under the UK PRA Capital Rules, common equity tier 1 capital is composed of common equity capital instruments, retained earnings, accumulated other comprehensive income, and other reserves of the PRA-

designated UK nonbank SD.<sup>96</sup> Additional tier 1 capital is composed of capital instruments other than common equity and retained earnings (*i.e.*, common equity tier 1 capital), and includes certain long-term convertible debt securities.<sup>97</sup> Tier 2 capital instruments, which provide an additional layer of supplementary capital, include other reserves, hybrid capital instruments, and certain subordinated debt.<sup>98</sup>

To qualify as tier 2 regulatory capital, capital instruments and subordinated debt must meet certain conditions including that: (i) the capital instruments are issued by the PRA-designated UK nonbank SD and are fully paid-up; (ii) the capital instruments are not purchased by the PRA-designated UK nonbank SD or its subsidiaries; (iii) the claims on the principal amount of the capital instruments rank below any claim from instruments that are "eligible liabilities,"<sup>99</sup> meaning that they are effectively subordinated to claims of all non-subordinated creditors of the PRA-designated UK nonbank SD; (iv) the capital instruments have an original maturity of at least five years; and (v) the provisions governing the capital instruments do not include any incentive for the principal amount to be redeemed or repaid by the PRA-designated UK nonbank SD prior to the capital instruments' respective maturities.<sup>100</sup>

In addition to the requirement to maintain total regulatory capital in an amount equal to or in excess of 8 percent of its risk-weighted assets, the UK PRA Capital Rules also require a PRA-designated UK nonbank SD to maintain a capital conservation buffer composed exclusively of common equity tier 1 capital in an amount equal to 2.5 percent of the firm's total risk-

<sup>96</sup> UK CRR, Articles 26 and 28. Retained earnings, accumulated other comprehensive income and other reserves qualify as common equity tier 1 capital only where the funds are available to the PRA-designated UK nonbank SD for unrestricted and immediate use to cover risks or losses as such risks or losses occur. See UK CRR, Article 26(1).

<sup>97</sup> *Id.*, Articles 51-52.

<sup>98</sup> *Id.*, Articles 62-63.

<sup>99</sup> "Eligible liabilities" are non-capital instruments, including instruments that are directly issued by the PRA-designated UK nonbank SD and fully paid up with remaining maturities of at least a year. Bank Recovery and Resolution (No. 2) Order 2014, Article 123. In addition, the liabilities cannot be owned, secured, or guaranteed, by the PRA-designated UK nonbank SD itself, and the PRA-designated UK nonbank SD cannot have either directly or indirectly funded their purchase. *Id.*

<sup>100</sup> UK CRR, Article 63 (listing the conditions that capital instruments must meet to qualify as tier 2 instruments) and Bank Recovery and Resolution (No. 2) Order 2014, Article 123. See also *infra* note 121.

<sup>90</sup> See UK Application, p. 12.

<sup>91</sup> See UK Application, pp. 7 and 12.

<sup>92</sup> UK CRR, Articles 26, 28, 50-52, 61-63 and 92.

<sup>93</sup> *Id.*, Article 92(1)(a).

<sup>94</sup> *Id.*, Article 92(1)(b).

<sup>95</sup> *Id.*, Article 92(1)(c) (providing that the total capital ratio must be equal to or greater than 8 percent, with a minimum common equity and additional tier 1 capital comprising at least 6 percent of the 8 percent minimum requirement). In addition to the requirement to maintain minimum capital ratios, a PRA-designated UK nonbank SD must maintain at all times capital resources equal to or in excess of GBP 750,000. PRA Rulebook, CRR Firms, Definition of Capital Part, Chapter 12 Base Capital Resource Requirement, Rule 12.1.

<sup>87</sup> See 17 CFR 23.101(a)(1)(i)(B) and the definition of the term *BHC risk-weighted assets* in 17 CFR 23.100.

<sup>88</sup> See 17 CFR 1.17(c)(5) and 17 CFR 240.15c3-1(c)(2).

<sup>89</sup> See 17 CFR 23.102.



weighted assets.<sup>101</sup> The common equity tier 1 capital used to meet the 2.5 percent capital conservation buffer must be separate and independent of the 4.5 percent of common equity tier 1 capital used to meet the 8 percent core capital requirement.<sup>102</sup>

The UK PRA Capital Rules also impose a 3.25 percent leverage ratio floor on PRA-designated UK nonbank SDs that hold significant amounts of non-UK assets, as an additional element to the capital requirements.<sup>103</sup> Specifically, a PRA-designated UK nonbank SD that has non-UK assets equal to or greater than GBP 10 billion is required to maintain an aggregate amount of common equity tier 1 capital and additional tier 1 capital equal to or in excess of 3.25 percent of the firm's on-balance sheet and off-balance sheet exposures, including exposures on

<sup>101</sup> PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 2 Capital Conservation Buffer, Rule 2.1.

<sup>102</sup> *Id.* In effect, the UK PRA Capital Rules require a PRA-designated UK nonbank SD to hold common equity tier 1 capital equal to or in excess of 7 percent of the firm's risk-weighted assets, and total capital equal to or in excess of 10.5 percent of the firm's risk-weighted assets.

In addition, a PRA-designated nonbank SD may also be subject to a firm-specific countercyclical capital buffer, whose rate consists of the weighted average of the countercyclical buffer rates that apply to exposures in the jurisdictions where the firm's relevant credit exposures are located. The rate for each jurisdiction is determined by the UK Financial Policy Committee or a third country countercyclical buffer authority, as applicable. See PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 3 Countercyclical Capital Buffer, Rule 3.1., and Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014, Articles 7–20. The sum of the capital conservation buffer and the countercyclical buffer is referred to as the "combined buffer." PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 1 Application and Definitions, Rule 1.2. To meet these additional capital buffer requirements, the PRA-designated UK nonbank SD must maintain a level of common equity tier 1 capital that is in addition to the common equity tier 1 capital required to meet its core capital requirement of 4.5 percent of its risk-weighted assets and the common equity tier 1 capital required to meet its capital conservation buffer. See PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 1 Application and Definitions, Rule 1.2, and Capital Buffers Part, Chapter 4 Capital Conservation Measures, Rule 4.1. In practice, the countercyclical buffer rate in the UK, as of July 2023, is 2 percent of risk-weighted assets. Several EU Member States of relevance to the UK have also implemented countercyclical capital buffers with rates ranging from 0.5 percent to 2.5 percent of risk-weighted assets. The countercyclical capital buffer rate is published by the Bank of England, and is available at: <https://bankofengland.co.uk/financial-stability/the-countercyclical-capital-buffer>.

<sup>103</sup> PRA Rulebook, CRR Firms, Leverage Ratio—Capital Requirements and Buffers Part, Chapter 1 Application and Definitions and Chapter 3 Minimum Leverage Ratio. The Applicants represented that the six PRA-designated UK nonbank SDs currently registered with the Commission are subject to a leverage ratio floor requirement. See Responses to Staff Questions dated October 5, 2023.

uncleared swaps but excluding certain exposures to central banks, without regard to any risk-weighting.<sup>104</sup> The leverage ratio is a non-risk based minimum capital requirement that is intended to prevent a PRA-designated UK nonbank SD from engaging in excessive leverage, and complements the risk-based minimum capital requirement that is based on the PRA-designated UK nonbank SD's risk-weighted assets.

As noted above, the amount of regulatory capital that a PRA-designated UK nonbank SD is required to hold is determined by calculating the firm's total risk exposure, which requires the PRA-designated UK nonbank SD to risk-weight its on-balance sheet and off-balance sheet assets and exposures using specified standardized weights or, if approved for use by the PRA, internal model-based methodologies.<sup>105</sup> Risk-weighting assets and exposures involves adjusting the notional or carrying value of each asset and risk exposure based on the inherent risk of the asset or exposure. Less risky assets and exposures are adjusted to lower values (*i.e.*, have less weight) than more risky assets or exposures. As a result, PRA-designated UK nonbank SDs are required to hold lower levels of regulatory capital for less risky assets and exposures and higher levels of regulatory capital for riskier assets and exposures. The categories of risk charges that a PRA-designated UK nonbank SD must include in determining its total risk exposure include charges reflecting: (i) market risk; (ii) credit risk; (iii) settlement risk; (iv) CVA risk of OTC derivative instruments; and (v) operational risk.<sup>106</sup> The methods for calculating such risk charges are based on the BCBS framework.<sup>107</sup>

<sup>104</sup> Total exposures are required to be computed in accordance with PRA Rulebook, CRR Firms, Leverage Ratio (CRR) Part, Chapter 3 Leverage Ratio (Part Seven CRR), Article 429 *et seq.* A PRA-designated UK nonbank SD may also be subject to a countercyclical leverage ratio buffer of common equity tier 1 capital equal to the firm's institution-specific countercyclical capital buffer rate multiplied by 35 percent, multiplied by the firm's total exposures. PRA Rulebook, CRR Firms, Leverage Ratio—Capital Requirements and Buffers Part, Chapter 4 Countercyclical Leverage Ratio Buffer.

<sup>105</sup> With regulator permission, PRA-designated UK nonbank SDs may use internal models to calculate credit risk (UK CRR, Article 143), including certain counterparty credit risk exposures (UK CRR, Article 283), operational risk (UK CRR, Article 312(2)), market risk (UK CRR, Article 363), and credit valuation adjustment risk ("CVA risk") of over-the-counter ("OTC") derivatives instruments (UK CRR, Article 383). The permission to use, and continue using, internal models is subject to strict criteria and supervisory oversight by the PRA.

<sup>106</sup> UK CRR, Article 92(3).

<sup>107</sup> UK Application, pp. 12–15.

Standardized market risk charges are generally calculated by multiplying the notional or carrying amount of net positions or of adjusted net positions by risk-weighting factors, which are based on the underlying market risk of each asset or exposure. The sum of the calculated amounts comprises the portion of the risk exposure amount attributable to market risk.<sup>108</sup> Standardized credit risk charges are generally calculated by multiplying the notional or carrying value of the PRA-designated UK nonbank SD's on-balance sheet and off-balance sheet assets and exposures by clearly defined risk-weighting factors, which are based on the underlying credit risk of each asset or exposure. The sum of the calculated amounts comprises the portion of the risk exposure amount attributable to credit risk.<sup>109</sup>

Settlement risk charges are intended to account for the price difference to which a PRA-designated UK nonbank SD is exposed if its transactions remain unsettled after the respective transaction's due delivery date.<sup>110</sup> CVA risk charges reflect the current market value of the credit risk of the counterparty to the PRA-designated UK nonbank SD in an OTC derivatives transaction.<sup>111</sup> Operational risk charges reflect the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk.<sup>112</sup>

As noted above, PRA-designated UK nonbank SDs may use internal model-based methodologies to calculate certain categories of risk charges in lieu of standardized charges if they have obtained the requisite regulatory approval.<sup>113</sup> The UK PRA Capital Rules set out quantitative and qualitative requirements that internal models must meet in order to obtain and maintain approval.<sup>114</sup> Quantitative and qualitative requirements address, among other issues, governance, validation, monitoring, and review. Modeled risk charges generally require the estimation of potential losses, with a certain degree of likelihood, within a specified time

<sup>108</sup> UK CRR, Articles 326–361.

<sup>109</sup> *Id.*, Articles 111–134 and PRA Rulebook, CRR Firms, Standardised Approach and Internal Ratings Based Approach to Credit Risk (CRR) Part, Chapter 3 Credit Risk (Part Three Title Two Chapters Two and Three CRR), Article 132.

<sup>110</sup> UK CRR, Article 378.

<sup>111</sup> *Id.*, Article 381.

<sup>112</sup> *Id.*, Article 4(1)(52).

<sup>113</sup> *Id.*, Articles 143 (credit risk), 283 (counterparty credit risk), 312(2) (operational risk), 363 (market risk), and 383 (CVA risk).

<sup>114</sup> See *e.g.*, UK CRR, Articles 144, 283; 321–322 and 365–369.

period, of a portfolio of assets.<sup>115</sup> Internal models allow for consideration of potential co-movement of prices across assets in the portfolio, leading to offsets of gains and losses. Credit risk models can also further include estimation of the likelihood of default of counterparties.

Furthermore, the UK PRA Capital Rules also impose separate requirements on an PRA-designated UK nonbank SD to address liquidity risk. More specifically, PRA-designated UK nonbank SDs are subject to the liquidity coverage requirement applicable under UK CRR to credit institutions.<sup>116</sup> The liquidity coverage requirement provides that PRA-designated UK nonbank SDs must hold liquid assets in an amount sufficient to cover liquidity outflows (less liquidity inflows) under stressed conditions over a period of 30 days.<sup>117</sup> For purposes of the liquidity coverage requirement, the term “stressed” means a sudden or severe deterioration in the solvency or liquidity position of a firm due to changes in market conditions or idiosyncratic factors as a result of which there is a significant risk that the firm

<sup>115</sup> The UK PRA Capital Rules require PRA-designated UK nonbank SDs with internal model approval for market risk to use a VaR model with a 99 percent, one-tailed confidence interval with: (i) price change equivalent to 10 business-day movement in rates and prices; (ii) effective historical observation periods of at least one year; and (iii) at least monthly data set updates. See UK CRR, Article 365(1). PRA-designated UK nonbank SDs approved to use internal ratings-based credit risk models must support the assessment of credit risk, the assignment of exposures to rating grades or pools, and the quantification of default and loss estimates that have been developed for a certain type of exposures, among other conditions. See UK CRR, Articles 142–144. In addition, when PRA-designated UK nonbank SDs are approved to use a model to calculate counterparty credit risk exposures for OTC derivatives transactions, the model must specify the forecasting distribution for changes in the market value of a netting set attributable to joint changes in relevant market variables and calculate the exposure value for the netting set at each of the future dates on the basis of the joint changes in the market variables. See UK CRR, Article 284. PRA-designated nonbank SDs allowed to follow the “advanced method” of calculating CVA risk charges for OTC derivatives transactions must also use an internal market risk model to simulate changes in the credit spreads of counterparties, applying a 99 percent confidence interval and a 10-day equivalent holding period. See UK CRR, Article 383. Finally, PRA-designated UK nonbank SDs using “advanced measurement approaches” based on their own measurement systems to compute operational risk exposures must calculate capital requirements as comprising both expected loss and unexpected loss and capture potentially severe tail events, achieving a sound standard comparable to a 99.9 confidence interval over a one-year period. See UK CRR, Article 322.

<sup>116</sup> PRA Rulebook, CRR Firms, Liquidity (CRR) Part and PRA Rulebook, CRR Firms, Liquidity Coverage Requirement—UK Designated Investment Firms Part.

<sup>117</sup> PRA Rulebook, CRR Firms, Liquidity (CRR) Part, Chapter 4 Liquidity (Part Six CRR), Article 412(1).

becomes unable to meet its commitments as they become due within the next 30 days.<sup>118</sup>

In addition, Article 413 of UK CRR, which has been incorporated into the PRA Rulebook, establishes a general requirement that firms ensure that long-term obligations and off-balance sheet items are adequately met with a diverse set of funding instruments that are stable under both normal and stressed conditions.<sup>119</sup>

In addition, the Bank of England, in its capacity of resolution authority,<sup>120</sup> requires that PRA-designated UK nonbank SDs satisfy a firm-specific MREL pursuant to provisions of the Banking Act 2009 and the Bank Recovery and Resolution (No. 2) Order 2014, which transposed BRRD.<sup>121</sup> The MREL requirement is separate from the minimum capital requirements imposed on PRA-designated UK nonbank SDs under UK CRR and PRA Rulebook and is designed to ensure that PRA-designated UK nonbank SDs maintain at all times sufficient eligible instruments to facilitate resolution consistently with the resolution objectives under the preferred resolution strategy.<sup>122</sup> Specifically, the MREL is intended to permit loss absorption, where appropriate, such that the PRA-designated UK nonbank SD’s capital ratio could be restored to the level necessary for compliance with its

<sup>118</sup> PRA Rulebook, CRR Firms, Liquidity (CRR) Part, Chapter 4 Liquidity (Part Six CRR), Article 411(10).

<sup>119</sup> PRA Rulebook, CRR Firms, Liquidity (CRR) Part, Chapter 4 Liquidity (Part Six CRR), Article 413(1).

<sup>120</sup> In application of BRRD, Article 3, EU Member States designate resolution authorities that are empowered to apply the resolution tools and exercise the resolution powers described in BRRD. In the UK, the resolution authority is the Bank of England.

<sup>121</sup> Banking Act 2009, Section 3A(4) and (4B) and the Bank Recovery and Resolution (No. 2) Order 2014, Part 9. Eligible liabilities include, among others items, instruments that are directly issued by the PRA-designated UK nonbank SD and fully paid up with remaining maturities of at least a year. See Bank Recovery and Resolution (No. 2) Order 2014, Part 9, Article 123(4). In addition, the liabilities cannot arise from a derivative, be owned, secured or guaranteed by the PRA-designated UK nonbank SD itself, and the PRA-designated UK nonbank SD cannot have either directly or indirectly funded its purchase. *Id.*

<sup>122</sup> The Bank of England’s Approach to Setting a Minimum Requirement for Own Funds and Eligible Liabilities (MREL), Statement of Policy, 3 December 2021, at 3, available at: <https://www.bankofengland.co.uk/-/media/boe/files/paper/2021/mrel-statement-of-policy-december-2021-updating-2018.pdf>. See also The Minimum Requirement for Own Funds and Eligible Liabilities (MREL)—Buffers and Threshold Conditions, Supervisory Statement 16/16, 28 December 2020, available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2020/ss1616-update-dec-2020.pdf>.

capital requirements.<sup>123</sup> The Bank of England calculates a firm’s baseline MREL as the sum of two component: a loss absorption amount and a recapitalization amount.<sup>124</sup> The loss absorption amount is equal to a firm’s capital requirements plus its capital buffers.<sup>125</sup> The Bank of England has some discretion to adjust the amount. The MREL amount varies depending on the entity’s size, funding model, and risk profile, among other considerations.<sup>126</sup>

### III. Commission Analysis of the Comparability of the UK PRA Capital Rules and UK PRA Financial Reporting Rules With CFTC Capital Rules and CFTC Financial Reporting Rules

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

The Commission performed this proposed Capital Comparability Determination by assessing the comparability of the UK PRA Capital Rules for PRA-designated UK nonbank SDs as set forth in the UK Application with the Commission’s Bank-Based Approach. For clarity, the Commission did not assess the comparability of the UK PRA Capital Rules to the Commission’s TNW Approach or NLA Approach as the Commission understands that PRA-designated UK nonbank SDs, as of the date of the UK Application, are subject to bank-based capital requirements pursuant to the UK

<sup>123</sup> Bank Recovery and Resolution (No. 2) Order 2014, Part 9, Article 123(6).

<sup>124</sup> See The Bank of England’s Approach to Setting a Minimum Requirement for Own Funds and Eligible Liabilities (MREL), Statement of Policy, Dec. 3, 2021, at 5.

<sup>125</sup> *Id.* The reference to “capital requirements” in this context means the amount of capital the PRA thinks the firm should maintain at all times under PRA Rulebook, CRR Firms, Internal Capital Adequacy Assessment.

<sup>126</sup> Bank Recovery and Resolution (No. 2) Order 2014, Part 9, Article 123(6).

PRA Capital Rules. In addition, as noted above, due to the differences between the capital and financial reporting regimes applicable to PRA-designated UK nonbank SD and FCA-regulated UK nonbank SDs, the Commission anticipates assessing the comparability of the rules applicable to FCA-regulated UK nonbank SDs through a separate capital comparability determination.<sup>127</sup> Accordingly, when the Commission makes a preliminary determination herein regarding the comparability of the UK PRA Capital Rules with the CFTC Capital Rules, the determination solely pertains to the comparability of the UK PRA Capital Rules as applicable to PRA-designated UK nonbank SD with the Bank-Based Approach under the CFTC Capital Rules.

As described below, it is proposed that any material changes to the UK PRA Capital Rules would require notification to the Commission. Therefore, if there are subsequent material changes to the UK PRA Capital Rules to include, for example, another capital approach, the Commission will review and assess the impact of such changes on the Capital Comparability Determination Order as it is then in effect, and may amend or supplement the Order.<sup>128</sup>

In addition, although the BCBS bank capital standards establish minimum capital standards that are consistent with the requirements of the Commission's Bank-Based Approach, the Commission notes that consistency with the international standards is not determinative of a finding of comparability with the CFTC Capital Rules. In the Commission's view, a foreign jurisdiction's consistency with the BCBS international bank capital standards is an element in the

Commission's comparability assessment, but, in and of itself, it may not be sufficient to demonstrate comparability with the CFTC Capital Rules without an assessment of the individual elements of the foreign jurisdiction's capital framework.

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

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

and enforced. The Commission invites public comment on all aspects of the UK Application and on the Commission's proposed Capital Comparability Determination discussed below.

#### *A. Regulatory Objectives of CFTC Capital Rules and CFTC Financial Reporting Rules and UK PRA Capital Rules and UK PRA Financial Reporting Rules*

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

The regulatory objectives of the CFTC Capital Rules and the CFTC Financial Reporting Rules are to further the Congressional mandate to ensure the safety and soundness of nonbank SDs to mitigate the greater risk to nonbank SDs and the financial system arising from the use of swaps that are not cleared.<sup>129</sup> A primary function of the nonbank SD's capital is to protect the solvency of the firm from decreases in the value of firm assets, increases in the value of firm liabilities, and from losses, including losses resulting from counterparty defaults and margin collateral failures, by requiring the firm to maintain an appropriate level of quality capital, including qualifying subordinated debt, to absorb such losses without becoming insolvent. With respect to swap positions, capital and margin perform complementary risk mitigation functions by protecting nonbank SDs, containing the amount of risk in the financial system as a whole, and reducing the potential for contagion arising from uncleared swaps.

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

<sup>127</sup> See *supra* note 5.

<sup>128</sup> The Commission also may amend or supplement the Capital Comparability Determination Order to address any material changes to the CFTC Capital Rules and CFTC Financial Reporting Rules that are adopted after a final Order is issued.

The Commission is aware that the UK PRA is considering changes to the PRA Capital Rules to implement Basel 3.1 standards. See PRA, *PS17/23—Implementation of the Basel 3.1 Standards Near-Final Part 1, December 12, 2023*, available here: <https://www.bankofengland.co.uk/news/2023/december/pr-publishes-first-of-two-policy-statements-for-basel-3-1-standards-implementation>. If the UK PRA proceeds with the implementation of the Basel 3.1 standards as proposed, the regulatory changes would be applicable after July 1, 2025 with a 4.5-year transitional period ending on January 1, 2030. The Commission will monitor progress on the UK PRA's proposed regulatory changes and may amend or supplement the Capital Comparability Determination Order, as appropriate, after a final Order is issued. As noted, the Commission proposes to require notification of any material changes to the UK PRA Capital Rules, including any Basel 3.1 implementing provisions.

<sup>129</sup> See 7 U.S.C. 6s(e)(3)(A).

swaps market, or impact the firm's solvency.<sup>130</sup>

## 2. Regulatory Objective of UK PRA Capital Rules and UK PRA Financial Reporting Rules

The regulatory objective of the UK PRA Capital Rules is to ensure the safety and soundness of PRA-designated UK nonbank SDs.<sup>131</sup> The UK PRA Capital Rules are designed to preserve the financial stability and solvency of a PRA-designated UK nonbank SD by requiring the firm to maintain a sufficient amount of qualifying equity capital and subordinated debt based on the PRA-designated UK nonbank SD's activities to absorb decreases in the value of firm assets, increases in the value of firm liabilities, and to cover losses from business activities, including possible counterparty defaults and margin collateral shortfalls associated with the firm's swap dealing activities.<sup>132</sup> The UK PRA Capital Rules are also designed to ensure that the PRA-designated UK nonbank SDs have sufficient liquidity to meet their financial obligations to counterparties and other creditors in a distress scenario by requiring each firm to hold an amount of liquid assets to ensure that the firm could face any possible imbalance between liquidity inflows and outflows under gravely stressed conditions over a period of 30 days<sup>133</sup> and to hold a diversity of stable funding instruments sufficient to meet long-term obligations under both normal and stressed conditions.<sup>134</sup>

With respect to financial reporting, the objective of the UK PRA Financial Reporting Rules is to enable the PRA to assess the financial condition and safety and soundness of PRA-designated UK

nonbank SDs.<sup>135</sup> The UK PRA Financial Reporting Rules aim to achieve this objective by requiring a PRA-designated nonbank SD to provide financial reports and other financial position and capital information to the PRA on a regular basis.<sup>136</sup> The financial reporting by a PRA-designated UK nonbank SD provides the PRA with information necessary to effectively monitor the PRA-designated UK nonbank SD's overall financial condition and its ability to meet its regulatory obligations as a nonbank SD.

## 3. Commission Analysis

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

The Commission further preliminarily believes that the UK PRA Financial Reporting Rules have comparable objectives with the CFTC Financial Reporting Rules as both sets of rules require nonbank SDs to file and/or publish, as applicable, periodic financial reports, including unaudited financial reports and an annual audited financial report, detailing their financial operations and demonstrating their compliance with minimum capital requirements, with the goal of providing the PRA and the CFTC staff with information necessary to comprehensively assess the financial condition of a nonbank SD on an ongoing basis. In addition, to achieve this objective, the financial reports

further provide the CFTC and the PRA with information regarding potential changes in a nonbank SD's risk profile by disclosing changes in account balances reported over a period of time. Such changes in account balances may indicate that the nonbank SD has entered into new lines of business, has increased its activity in an existing line of business relative to other activities, or has terminated a previous line of business.

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

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

### B. Nonbank Swap Dealer Qualifying Capital

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

The CFTC Capital Rules require a nonbank SD electing the Bank-Based Approach to maintain regulatory capital in the form of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital in amounts that meet certain stated minimum requirements set forth in Commission Regulation 23.101.<sup>137</sup> Common equity tier 1 capital, additional tier 1 capital, and tier 2 capital are composed of certain defined forms of equity of the nonbank SD, including common stock, retained earnings, and qualifying subordinated debt.<sup>138</sup> The Commission's requirement for a nonbank SD to maintain a minimum amount of defined qualifying capital and subordinated debt is intended to

<sup>130</sup> See 17 CFR 23.105.

<sup>131</sup> See PRA, *The Prudential Regulation Authority's Approach to Banking Supervision*, July 2023, available here: <https://www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors>.

<sup>132</sup> *Id.*

<sup>133</sup> PRA Rulebook, CRR Firms, Liquidity (CRR) Part, Chapter 4 Liquidity (Part Six CRR), Article 412 (Liquidity Coverage Requirement). Liquid assets primarily include cash, exposures to central banks, government-backed assets and other highly liquid assets with high credit quality. PRA Rulebook, CRR Firms, Liquidity (CRR) Part, Chapter 4 Liquidity (Part Six CRR), Article 416 (Reporting on Liquid Assets).

<sup>134</sup> PRA Rulebook, CRR Firms, Liquidity (CRR) Part, Chapter 4 Liquidity (Part Six CRR), Article 413 (Stable Funding Requirement). Stable funding instruments include common equity tier 1 capital instruments, additional tier 1 capital instruments, tier 2 capital instruments, and other preferred shares and capital instruments in excess of the tier 2 allowable amount with an effective maturity of one year or greater. PRA Rulebook, CRR Firms Liquidity (CRR) Part, Chapter 4 Liquidity (Part Six CRR), Article 427 (Reporting on Stable Funding).

<sup>135</sup> See generally PRA, *The Prudential Regulation Authority's Approach to Banking Supervision*, July 2023, available here: <https://www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors>.

<sup>136</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part.

<sup>137</sup> See 17 CFR 23.101(a)(1)(i).

<sup>138</sup> The terms "common equity tier 1 capital," "additional tier 1 capital," and "tier 2 capital" are defined in the bank holding company regulations of the Federal Reserve Board. See 12 CFR 217.20.

ensure that the firm maintains a sufficient amount of regulatory capital to absorb decreases in the value of the firm's assets and increases in the value of the firm's liabilities, and to cover losses resulting from the firm's swap dealing and other activities, including possible counterparty defaults and margin collateral shortfalls, without the firm becoming insolvent.

Common equity tier 1 capital is generally composed of an entity's common stock instruments and any related surpluses, retained earnings, and accumulated other comprehensive income, and is a more conservative or permanent form of capital than additional tier 1 and tier 2 capital.<sup>139</sup> Additional tier 1 capital is generally composed of equity instruments such as preferred stock and certain hybrid securities that may be converted to common stock if triggering events occur.<sup>140</sup> Total tier 1 capital is composed of common equity tier 1 capital and further includes additional tier 1 capital.<sup>141</sup> Tier 2 capital includes certain types of instruments that include both debt and equity characteristics such as qualifying subordinated debt.<sup>142</sup>

Subordinated debt must meet certain conditions to qualify as tier 2 capital under the CFTC Capital Rules. Specifically, subordinated debt instruments must have a term of at least one year (with the exception of approved revolving subordinated debt agreements which may have a maturity term that is less than one year), and contain terms that effectively subordinate the rights of lenders to receive any payments, including accrued interest, to other creditors of the firm.<sup>143</sup>

Common equity tier 1 capital, additional tier 1 capital, and tier 2 capital are permitted to be included in a nonbank SD's regulatory capital and used to meet the firm's minimum capital requirement due to their characteristics of being permanent forms of capital that are subordinate to the claims of other creditors, which ensures that a nonbank SD will have this regulatory capital to absorb decreases in the value of the firm's assets and increases in the value of the firm's liabilities, and to cover losses from

business activities, including swap dealing activities, without the firm becoming insolvent.

## 2. UK PRA Capital Rules: Qualifying Capital

The UK PRA Capital Rules require a PRA-designated nonbank SD to maintain an amount of regulatory capital (*i.e.*, equity capital and qualifying subordinated debt) equal to or greater than 8 percent of the PRA-designated UK nonbank SD's total risk exposure, which is calculated as the sum of the firm's: (i) capital charges for market risk; (ii) risk-weighted exposure amounts for credit risk; (iii) capital charges for settlement risk; (iv) CVA risk of OTC derivatives instruments; and (v) capital charges for operational risk.<sup>144</sup> The UK Capital Rules limit the composition of regulatory capital to common equity tier 1 capital, additional tier 1 capital, and tier 2 capital in a manner consistent with the BCBS bank capital framework.<sup>145</sup> In this regard, the UK PRA Capital Rules provide that a PRA-designated UK nonbank SD's regulatory capital may be composed of: (i) common equity tier 1 capital instruments, which generally include the PRA-designated UK nonbank SD's common equity, retained earnings, and accumulated other comprehensive income;<sup>146</sup> (ii) additional tier 1 capital instruments, which include other forms of capital instruments and certain long-term convertible debt instruments;<sup>147</sup> and (iii) tier 2 capital instruments, which includes other reserves, hybrid

capital instruments, and certain qualifying subordinated term debt.<sup>148</sup>

Furthermore, subordinated debt instruments must meet certain conditions to qualify as tier 2 regulatory capital under the UK PRA Capital Rules, including that the: (i) loans are not granted by the PRA-designated UK nonbank SD or its subsidiaries; (ii) claims on the principal amount of the subordinated loans under the provisions governing the subordinated loan agreement rank below any claim from eligible liabilities instruments (*i.e.*, certain non-capital instruments), meaning that they are effectively subordinated to claims of all non-subordinated creditors of the PRA-designated UK nonbank SD; (iii) subordinated loans are not secured, or subject to a guarantee that enhances the seniority of the claim, by the PRA-designated UK nonbank SD, its subsidiaries, or affiliates; (iv) loans have an original maturity of at least five years; and (v) provisions governing the loans do not include any incentive for the principal amount to be repaid by the PRA-designated UK nonbank SD prior to the loans' maturity.<sup>149</sup>

A PRA-designated UK nonbank SD must also maintain a capital conservation buffer equal to 2.5 percent of the firm's total risk exposure in addition to the requirement to maintain qualifying regulatory capital in excess of 8 percent of its total risk exposure.<sup>150</sup> The 2.5 percent capital conservation buffer must be met with common equity tier 1 capital.<sup>151</sup> Common equity tier 1 capital, as noted above, is limited to the

<sup>144</sup> UK CRR, Article 92.

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

<sup>146</sup> UK CRR, Articles 26 and 28. Capital instruments that qualify as common equity tier 1 capital under the UK PRA Capital Rules include instruments that: (i) are issued directly by the PRA-designated UK nonbank SD; (ii) are paid in full and not funded directly or indirectly by the PRA-designated UK nonbank SD; and (iii) are perpetual. In addition, the principal amount of the instruments may not be reduced or repaid, except in the liquidation of the PRA-designated UK nonbank SD.

<sup>147</sup> *Id.*, Articles 51–52. To qualify as additional tier 1 capital, the instruments must meet certain conditions including: (i) the instruments are issued directly by the PRA-designated UK nonbank SD and paid in full; (ii) the instruments are not owned by the PRA-designated UK nonbank SD or its subsidiaries; (iii) the purchase of the instruments is not funded directly or indirectly by the PRA-designated UK nonbank SD; (iv) the instruments rank below tier 2 instruments in the event of the insolvency of the PRA-designated UK nonbank SD; (v) the instruments are not secured or guaranteed by the PRA-designated UK nonbank SD or an affiliate; (vi) the instruments are perpetual and do not include an incentive for the PRA-designated UK nonbank SD to redeem them; and (vii) distributions under the instruments are pursuant to defined terms and may be cancelled under the full discretion of the PRA-designated UK nonbank SD.

<sup>148</sup> *Id.*, Articles 62–63.

<sup>149</sup> UK CRR, Article 63.

<sup>150</sup> PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 2 Capital Conservation Buffer, Rule 2.1. In addition, a PRA-designated nonbank SD may also be subject to a firm-specific countercyclical capital buffer, which requires the PRA-designated UK nonbank SD to hold an additional amount of common equity tier 1 capital equal to its total risk-weighted assets multiplied by the weighted average of the countercyclical buffer rates that apply to exposures in the jurisdictions where the firm's relevant credit exposures are located. The rate for each jurisdiction is determined by the UK Financial Policy Committee or a third country countercyclical buffer authority, as applicable. See PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 3 Countercyclical Capital Buffer, Rule 3.1., and Capital Requirements (Capital Buffers and Macroprudential Measures) Regulations 2014, Articles 7–20. In practice, the countercyclical buffer rate in the UK, as of July 2023, is 2 percent of risk-weighted assets. The countercyclical capital buffer rate is published by the Bank of England, and is available at: <https://bankofengland.co.uk/financial-stability/the-countercyclical-capital-buffer>. Several EU Member States of relevance to the UK have also implemented countercyclical capital buffers with rates ranging from 0.5 percent to 2.5 percent of risk-weighted assets.

<sup>151</sup> PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 2 Capital Conservation Buffer, Rule 2.1.

<sup>139</sup> 12 CFR 217.20.

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

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> The subordinated debt must meet the requirements set forth in SEC Rule 18a–1d (17 CFR 240.18a–1d). See 17 CFR 23.101(a)(1)(i)(B) (providing that the subordinated debt used by a nonbank SD to meet its minimum capital requirement under the Bank-Based Approach must satisfy the conditions for subordinated debt under SEC Rule 18a–1d).

PRA-designated UK nonbank SD's common equity, retained earnings, and accumulated other comprehensive income, and represents a more permanent form of capital than equity instruments that qualify as additional tier 1 capital and tier 2 capital.

The UK PRA Capital Rules also impose different ratios for the various components of regulatory capital that are consistent with the BCBS bank capital framework.<sup>152</sup> In this regard, the UK PRA Capital Rules provide that a PRA-designated UK nonbank SD's minimum regulatory capital must satisfy the following requirements: (i) common equity tier 1 capital ratio of 4.5 percent of the firm's total risk exposure amount; (ii) total tier 1 capital (*i.e.*, common equity tier 1 capital plus additional tier 1 capital) ratio of 6 percent of the firm's total risk exposure amount; and (iii) total capital (*i.e.*, an aggregate amount of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital) ratio of 8 percent of the firm's total risk exposure amount. As noted above, a PRA-designated UK nonbank SD must also maintain a capital conservation buffer of 2.5 percent of its total risk exposure amount that must be met with common equity tier 1 capital.<sup>153</sup> With the addition of the capital conservation buffer, each PRA-designated UK nonbank SD is required to maintain minimum regulatory capital that equals or exceeds 10.5 percent of the firm's total risk exposure amount, with common equity tier 1 capital comprising at least 7 percent of the 10.5 percent minimum regulatory capital requirement.<sup>154</sup>

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

### 3. Commission Analysis

The Commission has reviewed the UK Application and the relevant UK laws and regulations, and has preliminarily determined that the UK PRA Capital Rules are comparable in purpose and effect to the CFTC Capital Rules with regard to the types and characteristics of a nonbank SD's equity that qualifies as regulatory capital in meeting its minimum requirements. The UK PRA Capital Rules and the CFTC Capital Rules for nonbank SDs both require a nonbank SD to maintain a quantity of high-quality capital and permanent capital, all defined in a manner that is consistent with the BCBS international bank capital framework, that based on the firm's activities and on-balance sheet and off-balance sheet exposures, is sufficient to absorb losses and decreases in the value of the firm's assets and increases in the value of the firm's liabilities without resulting in the firm becoming insolvent. Specifically, equity instruments that qualify as common equity tier 1 capital and additional tier 1 capital under the UK PRA Capital Rules and the CFTC Capital Rules have similar characteristics (*e.g.*, the equity must be in the form of high-quality, committed and permanent capital) and the equity instruments generally have no priority in distribution of firm assets or income with respect to other shareholders or creditors of the firm, which makes the equity available to a nonbank SD to absorb unexpected losses, including counterparty defaults.<sup>155</sup>

In addition, the Commission has preliminarily determined that the conditions imposed on subordinated debt instruments under the UK PRA Capital Rules and the CFTC Capital Rules are comparable and are designed to ensure that the subordinated debt has qualities that support its recognition by a nonbank SD as equity for regulatory capital purposes. Specifically, in both sets of rules, the conditions include a requirement that the debt holders have effectively subordinated their claims for repayment of the debt to the claims of other creditors of the nonbank SD.<sup>156</sup>

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

#### C. Nonbank Swap Dealer Minimum Capital Requirement

##### 1. CFTC Capital Rules: Nonbank SD Minimum Capital Requirement

The CFTC Capital Rules require a nonbank SD electing the Bank-Based Approach to maintain regulatory capital that satisfies each of the following criteria: (i) an amount of common equity tier 1 capital of at least \$20 million; (ii) an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital in an amount equal to or in excess of 8 percent of the nonbank SD's uncleared swap margin amount; (iii) an aggregate amount of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital equal to or greater than 8 percent of the nonbank SD's total risk-weighted assets, provided that common equity tier 1 capital comprises at least 6.5 percent of the 8 percent; and (iv) the amount of capital required by the NFA.<sup>157</sup>

Prong (i) above requires each nonbank SD electing the Bank-Based Approach to maintain a minimum of \$20 million of common equity tier 1 capital to operate as a nonbank SD. The requirement that each nonbank SD electing the CFTC Bank-Based Approach maintain a minimum of \$20 million of common equity tier 1 capital is also consistent with the minimum capital requirement for nonbank SDs electing the NLA Approach and the TNW Approach.<sup>158</sup> The Commission adopted this minimum requirement as it believed that the role a nonbank SD performs in the financial

<sup>155</sup> Compare 12 CFR 217.20(b) (defining capital instruments that qualify as common equity tier 1 capital under the rules of the Federal Reserve Board) and 12 CFR 217.20(c) (defining capital instruments that qualify as additional tier 1 capital under the rules of the Federal Reserve Board) with UK CRR, Articles 26 and 28 (defining items and capital instruments that qualify as common equity tier 1 capital under the UK PRA Capital Rules) and UK CRR, Article 52 (defining capital instruments that qualify as additional tier 1 capital under the UK PRA Capital Rules).

<sup>156</sup> Compare 17 CFR 240.18a-1d with UK CRR, Article 63(d).

<sup>157</sup> See 17 CFR 23.101(a)(1)(i). NFA has adopted the CFTC minimum capital requirements for nonbank SDs, but has not adopted additional capital requirements at this time.

<sup>158</sup> Nonbank SDs electing the NLA Approach are subject to a minimum capital requirement that includes a fixed minimum dollar amount of net capital of \$20 million. See 17 CFR 23.101(a)(1)(ii)(A)(1). Nonbank SDs electing the TNW Approach are required to maintain levels of tangible net worth that equals or exceeds \$20 million plus the amount of the nonbank SDs' market risk and credit risk associated with the firms' dealing activities. See 17 CFR 23.101(a)(2)(ii)(A).

<sup>152</sup> UK CRR, Article 92(1).

<sup>153</sup> PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 2 Capital Conservation Buffer, Rule 2.1.

<sup>154</sup> The countercyclical capital buffer is not included in the analysis given that it is firm-specific and its rate depends on the location of the firm's exposures.



markets by engaging in swap dealing activities warranted a minimum level of capital, stated as a fixed dollar amount that does not fluctuate with the level of the firm's dealing activities to help ensure the safety and soundness of the nonbank SD.<sup>159</sup>

Prong (ii) above is a minimum capital requirement that is based on the amount of uncleared margin for swap transactions entered into by the nonbank SD and is computed on a counterparty by counterparty basis. The requirement for a nonbank SD to maintain minimum capital equal to or greater than 8 percent of the firm's uncleared swap margin provides a capital floor based on a measure of the risk and volume of the swap positions, and the number of counterparties and the complexity of operations, of the nonbank SD. The intent of the minimum capital requirement based on a percentage of the nonbank SD's uncleared swap margin was to establish a minimum capital requirement that would help ensure that the nonbank SD meets all of its obligations as a SD to market participants, and to cover potential operational risk, legal risk, and liquidity risk in addition to the risks associated with its trading portfolio.<sup>160</sup>

Prong (iii) above is a minimum capital requirement that is based on the Federal Reserve Board's capital requirements for bank holding companies and is consistent with the BCBS international capital framework for banking institutions. As noted above, a nonbank SD under prong (iii) must maintain an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital in an amount equal to or greater than 8 percent of the nonbank SD's total risk-weighted assets, with common equity tier 1 capital comprising at least 6.5 percent of the 8 percent.

Risk-weighted assets are a nonbank SD's on-balance sheet and off-balance sheet exposures, including proprietary swap, security-based swap, equity, and futures positions, weighted according to risk. The Bank-Based Approach requires each nonbank SD to maintain regulatory capital in an amount that equals or exceeds 8 percent of the firm's total risk-weighted assets to help ensure that the nonbank SD's level of capital is sufficient to absorb decreases in the value of the firm's assets and increases in the value of the firm's liabilities, and to cover unexpected losses resulting from business activities, including uncollateralized defaults from swap counterparties, without the nonbank SD becoming insolvent.

A nonbank SD must compute its risk-weighted assets using standardized market risk and/or credit risk charges, unless the nonbank SD has been approved by the Commission or NFA to use internal models.<sup>161</sup> For standardized market risk charges, the Commission incorporates by reference the standardized market risk charges set forth in Commission Regulation 1.17 for FCMs and SEC Rule 18a-1 for nonbank SBSDs.<sup>162</sup> The standardized market risk charges under Commission Regulation 1.17 and SEC Rule 18a-1 are calculated as a percentage of the market value or notional value of the nonbank SD's marketable securities and derivatives positions, with the percentages applied to the market value or notional value increasing as the expected or anticipated risk of the positions increases.<sup>163</sup> The resulting total market risk exposure amount is multiplied by a factor of 12.5 to cancel the effect of the 8 percent multiplication factor applied to all of the nonbank SD's risk-weighted assets, which effectively requires a nonbank SD to hold qualifying regulatory capital equal to or greater than 100 percent of the amount of its market risk exposure.<sup>164</sup>

With respect to standardized credit risk charges for exposures from non-derivatives positions, a nonbank SD computes its on-balance sheet and off-balance sheet exposures in accordance with the standardized credit risk charges adopted by the Federal Reserve Board and set forth in subpart D of 12 CFR 217 as if the SD itself were a bank holding company subject to subpart D.<sup>165</sup> Standardized credit risk charges are computed by multiplying the amount of the exposure by defined counterparty credit risk factors that range from 0 percent to 150 percent.<sup>166</sup>

<sup>161</sup> See 17 CFR 23.101(a)(1)(i)(B) and the definition of the term *BHC equivalent risk-weighted assets* in 17 CFR 23.100.

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

<sup>163</sup> See 17 CFR 240.18a-1(c)(1).

<sup>164</sup> See 17 CFR 23.100 (Definition of *BHC equivalent risk-weighted assets*). As noted, a nonbank SD is required to maintain qualifying capital (*i.e.*, an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital) in an amount that exceeds 8 percent of its market risk-weighted assets and credit-risk-weighted assets. The regulations, however, require the nonbank SD to effectively maintain qualifying capital in excess of 100 percent of its market risk-weighted assets by requiring the nonbank SD to multiply its market-risk-weighted assets by 12.5.

<sup>165</sup> See 17 CFR 23.101(a)(1)(i)(B) and paragraph (1) of the definition of the term *BHC equivalent risk-weighted assets* in 17 CFR 23.100.

<sup>166</sup> See 17 CFR 217.32. Lower credit risk factors are assigned to entities with lower credit risk and higher credit risk factors are assigned to entities with higher credit risk. For example, a credit risk

A nonbank SD with off-balance sheet exposures is required to calculate a credit risk charge by multiplying each exposure by a credit conversion factor that ranges from 0 percent to 100 percent, depending on the type of exposure.<sup>167</sup> In addition to the risk-weighted assets for general credit risk, a nonbank SD calculating risk charges under subpart D of 12 CFR 217 must also calculate risk-weighted assets for unsettled transactions involving securities, foreign exchange instruments, and commodities that have a risk of delayed settlement or delivery.

A nonbank SD may compute standardized credit risk charges for derivatives positions, including uncleared swaps and non-cleared security-based swaps, using either the current exposure method ("CEM") or the standardized approach for measuring counterparty credit risk ("SA-CCR").<sup>168</sup> Both CEM and SA-CCR are non-model, rules-based, approaches to calculating counterparty credit risk exposures for derivatives positions. Credit risk exposure under CEM is the sum of: (i) the current exposure (*i.e.*, the positive mark-to-market) of the derivatives contract; and (ii) the potential future exposure, which is calculated as the product of the notional principal amount of the derivatives contract multiplied by a standard credit risk conversion factor set forth in the rules of the Federal Reserve Board.<sup>169</sup> Credit risk exposure under SA-CCR is defined as the exposure at default amount of a derivatives contract, which is computed by multiplying a factor of 1.4 by the sum of: (i) the replacement costs of the contract (*i.e.*, the positive mark-to-market); and (ii) the potential future exposure of the contract.<sup>170</sup>

A nonbank SD may also obtain approval from the Commission or NFA to use internal models to compute market risk and/or credit risk charges in lieu of the standardized charges. A nonbank SD seeking approval to use an internal model is required to submit an

factor of 0% is applied to exposures to the U.S. government, the Federal Reserve Bank, and U.S. government agencies (*see* 12 CFR 217.32 (a)(1)), and a credit risk factor of 100% is assigned to an exposure to foreign sovereigns that are not members of the Organization of Economic Co-operation and Development (*see* 12 CFR 217.32(a)(2)).

<sup>167</sup> See 17 CFR 217.33.

<sup>168</sup> See 17 CFR 217.34. *See also*, Commission Regulation 23.100 (17 CFR 23.100) defining the term *BHC risk-weighted assets*, which provides that a nonbank SD that does not have model approval may use either CEM or SA-CCR to compute its exposures for over-the-counter derivative contracts without regard to the status of its affiliate entities with respect to the use of a calculation approach under the Federal Reserve Board's capital rules.

<sup>169</sup> See 12 CFR 217.34.

<sup>170</sup> See 12 CFR 217.132(c).

<sup>159</sup> See, *e.g.*, 85 FR 57492.

<sup>160</sup> See 85 FR 57462.

application to the Commission or NFA.<sup>171</sup> The application is required to include, among other things, a list of categories of positions that the nonbank SD holds in its proprietary accounts and a brief description of the methods that the nonbank SD will use to calculate market risk and/or credit risk charges for such positions, as well as a description of the mathematical models used to compute market risk and credit risk charges.

A nonbank SD approved by the Commission or NFA to use internal models to compute market risk is required to comply with subpart F of the Federal Reserve Board's Part 217 regulations ("Subpart F").<sup>172</sup> Subpart F is based on models that are consistent with the BCBS Basel 2.5 capital framework.<sup>173</sup> The Commission's qualitative and quantitative requirements for internal capital models are also comparable to the SEC's existing internal capital model requirements for broker-dealers in securities and SBSs,<sup>174</sup> which are broadly based on the BCBS Basel 2.5 capital framework.

A nonbank SD approved to use internal models to compute credit risk charges is required to perform such computation in accordance with subpart E of the Federal Reserve Board's Part 217 regulations<sup>175</sup> as if the SD itself were a bank holding company subject to subpart E.<sup>176</sup> The internal credit risk modeling requirements are also based on the Basel 2.5 capital framework and the Basel 3 capital framework. A nonbank SD that computes its credit risk charges using internal models must multiply the resulting capital requirement by a factor of 12.5.<sup>177</sup>

In adopting the final Bank-Based Approach rules, the Commission also noted that in choosing an alternative calculation, the nonbank SD must adopt the entirety of the alternative. As such,

<sup>171</sup> See 17 CFR 23.102(c).

<sup>172</sup> See paragraph (4) of the definition of *BHC equivalent risk-weighted assets* in 17 CFR 23.100.

<sup>173</sup> Compare 17 CFR 23.100 (providing for a nonbank SD that is approved to use internal models to calculate market and credit risk to calculate its risk-weighted assets using subparts E and F of 12 CFR part 217), subpart F of 12 CFR, 17 CFR 23.101(a)(1)(ii) (providing for an SD that elects the Net Liquid Assets Approach to calculate its net capital in accordance with Rule 18a-1), and 17 CFR 23.102(a), with Basel Committee on Banking Supervision, Revisions to the Basel II Market Risk Framework (2011), <https://www.bis.org/publ/bcb193.pdf> (describing the revised internal model approach under Basel 2.5).

<sup>174</sup> The SEC internal model requirements for SBSs are listed in 17 CFR 240.18a-1(d).

<sup>175</sup> 12 CFR 217 subpart E.

<sup>176</sup> See 85 FR 57462 at 57496.

<sup>177</sup> 12 CFR 217.131(e)(1)(iii), 217.131(e)(2)(iv), and 217.132(d)(9)(iii).

if the nonbank SD is calculating its risk-weighted assets using the regulations in subpart E of 12 CFR 217, the nonbank SD must include charges reflecting all categories of risk-weighted assets applicable under these regulations, which include among other things, charges for operational risk, CVA of OTC derivatives contracts, and unsettled transactions involving securities, foreign exchange instruments, and commodities that have a risk of delayed settlement or delivery.<sup>178</sup> The capital charge for operational risk and CVA of OTC derivatives contracts calculated in accordance with subpart E of 12 CFR 217 must also be multiplied by a factor of 12.5.<sup>179</sup>

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

The Commission and the Basel standards for internal models also have requirements on the selection of appropriate risk factors as well as on data quality and update frequency.<sup>180</sup> One specific concern is that internal models must capture the non-linear price characteristics of options positions, including but not limited to, relevant volatilities at different maturities.<sup>181</sup>

In addition, BCBS standards for market risk models include a series of

<sup>178</sup> Settlement risk for OTC derivatives contracts is addressed as part of the counterparty-credit risk calculation methodology described in 12 CFR 217.132.

<sup>179</sup> 12 CFR 217.162(c) (operational risk) and 217.132(e)(4) (CVA of OTC derivative contracts).

<sup>180</sup> See 17 CFR appendix A to subpart E of part 23(i)(2)(iii), and Basel Committee on Banking Supervision, Revisions to the Basel II Market Risk Framework (2011), paragraph 718(Lxxvi)(e), available at: <https://www.bis.org/publ/bcb193.pdf>.

<sup>181</sup> The Commission's requirement is set forth in paragraph (i)(2)(iv)(A) of appendix A to subpart E of 17 CFR part 23. See also, Basel Committee on Banking Supervision, Revisions to the Basel II Market Risk Framework (2011), paragraph 718(Lxxvi)(h), available at: <https://www.bis.org/publ/bcb193.pdf>.

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

## 2. UK PRA Capital Rules: PRA-Designated UK Nonbank Swap Dealer Minimum Capital Requirements

The UK PRA Capital Rules impose bank-like capital requirements on a PRA-designated UK nonbank SD that, consistent with the BCBS international bank capital framework, require the PRA-designated UK nonbank SD to hold a sufficient amount of qualifying equity capital and subordinated debt based on the PRA-designated UK nonbank SD's activities to absorb decreases in the value of firm assets and increases in the value of the firm's liabilities, and to cover losses from its business activities, including possible counterparty defaults and margin collateral shortfalls associated with the firm's swap dealing activities, without the firm becoming insolvent. Specifically, the UK PRA Capital Rules require each PRA-designated UK nonbank SD to maintain sufficient levels of capital to satisfy the following capital ratios, expressed as a percentage of the PRA-designated UK nonbank SD's total risk exposure amount (*i.e.*, the sum of the PRA-designated UK nonbank SD's risk-weighted assets and exposures): (i) a common equity tier 1 capital ratio of 4.5 percent;<sup>182</sup> (ii) a tier 1 capital ratio of 6 percent;<sup>183</sup> and (iii) a total capital ratio of 8 percent.<sup>184</sup> The UK PRA Capital Rules further require a PRA-designated UK nonbank SD to maintain a capital conservation buffer composed of common equity capital tier 1 capital in amount equal to 2.5 percent of the firm's total risk exposure.<sup>185</sup> The common equity tier 1 capital used to

<sup>182</sup> UK CRR, Article 92(1)(a).

<sup>183</sup> *Id.*, Article 92(1)(b). Tier 1 capital is the sum of the PRA-designated UK nonbank SD's common equity tier 1 capital and additional tier 1 capital.

<sup>184</sup> *Id.*, Article 92(1)(c). The total capital is the sum of the PRA-designated UK nonbank SD's tier 1 capital and tier 2 capital.

<sup>185</sup> PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 2 Capital Conservation Buffer, Rule 2.1.

meet the capital conservation buffer must be separate and in addition to the 4.5 percent of common equity tier 1 capital that the PRA-designated UK nonbank is required to maintain in meeting its core 8 percent capital requirement.<sup>186</sup> Thus, a PRA-designated UK nonbank SD is required to maintain regulatory capital equal to at least 10.5 percent of its total risk exposure amount, with common equity tier 1 capital comprising at least 7 percent of the regulatory capital (4.5 percent of the core capital plus the 2.5 percent capital conservation buffer).

A PRA-designated UK nonbank SD's total risk exposure amount is calculated as the sum of the firm's: (i) capital requirements for market risk; (ii) risk-weighted exposure amounts for credit risk; (iii) capital requirements for settlement risk; (iv) capital requirements for CVA risk of OTC derivatives instruments; and (v) capital requirements for operational risk.<sup>187</sup> Capital charges for market risk and risk-weighted exposures for credit risk are computed based on the PRA-designated UK nonbank SD's on-balance sheet and off-balance sheet exposures, including proprietary swap, security-based swap, equity, and futures positions, weighted according to risk.<sup>188</sup> Settlement risk

capital charges reflect the price difference to which a PRA-designated UK nonbank SD is exposed if its transactions in debt instruments, equity, foreign currency, and commodities remain unsettled after the respective product's due delivery date.<sup>189</sup> CVA is an adjustment to the mid-market value of the portfolio of OTC derivative transactions with a counterparty and reflects the current market value of the credit risk of the counterparty to the PRA-designated UK nonbank SD.<sup>190</sup> Operational risk capital charges reflect the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk.<sup>191</sup>

To compute its total risk exposure amount, a PRA-designated UK nonbank SDs is also required to multiply the capital requirements for market risk, settlement risk, CVA risk, and operational risk, calculated in accordance with the UK PRA Capital Rules, by a factor of 12.5, which effectively requires a PRA-designated UK nonbank SD to hold qualifying regulatory capital equal to or greater than the full amount of the relevant risk exposures.<sup>192</sup> The formulae for calculating risk-weighted exposure amounts for credit risk also include a 12.5 multiplication factor.<sup>193</sup>

Consistent with the Commission's Bank-Based Approach and the BCBS capital framework, the UK PRA Capital Rules require PRA-designated UK nonbank SDs to compute market risk exposures and credit risk exposures using a standardized approach or, if approved by the PRA, internal risk models.<sup>194</sup> In addition, UK PRA Capital Rules, consistent with the BCBS capital framework, require PRA-designated UK nonbank SDs to compute capital charges for CVA risk and operational risk using standardized approaches, unless

amounts for counterparty risk arising from the trading book business for certain derivatives transactions, repurchase agreements, securities or commodities lending or borrowing transactions, margin lending or long settlement transactions. See UK CRR, Article 92(3)(a) and (f).

<sup>189</sup> UK CRR, Article 378. Settlement risk is calculated as 8 percent, 50 percent, 75 percent, or 100 percent of the price difference for transactions that are not settled within 5 to 15 business days, 16 to 30 business days, 31 to 45 business days, or 46 or more business days, respectively, from the due settlement date.

<sup>190</sup> *Id.*, Article 381.

<sup>191</sup> *Id.*, Article 4(1)(52).

<sup>192</sup> *Id.*, Article 92(4).

<sup>193</sup> *Id.*, Article 153 *et seq.*

<sup>194</sup> With the permission of the PRA, a PRA-designated UK nonbank SD may use internal models to calculate market risk (*see* UK CRR, Article 363) and credit risk (*see* UK CRR, Articles 143 and 283).

approved to use internal models by the PRA.<sup>195</sup>

PRA-designated UK nonbank SDs calculate standardized market risk charges generally by multiplying the notional or carrying amount of net positions by risk-weighting factors, which are based on the underlying market risk of each asset or exposure and increase as the expected risk of the positions increase. Market risk requirements for debt instruments and equity instruments are calculated separately under the standardized approach, and are each calculated as the sum of specific risk and general risk of the positions.<sup>196</sup> Securitizations are treated as debt instruments for market risk requirements,<sup>197</sup> whereas derivative positions are generally treated as exposures on their underlying assets,<sup>198</sup> with options being delta-adjusted.<sup>199</sup>

The UK PRA Capital Rules also require PRA-designated UK nonbank SDs to include in their risk-weighted assets market risk exposures to certain foreign currency and gold positions. Specifically, a PRA-designated UK nonbank SD with net positions in foreign exchange and gold that exceed 2 percent of the firm's total capital must calculate capital requirements for foreign exchange risk.<sup>200</sup> The capital requirement for foreign exchange risk under the standardized approach is 8 percent of the PRA-designated UK nonbank SD's net positions in foreign exchange and gold.<sup>201</sup>

The UK PRA Capital Rules further require PRA-designated UK nonbank SDs to include exposures to commodity positions in calculating the firm's risk-weighted assets. The standardized calculation of commodity risk exposures may follow one of three approaches depending on type of position or exposure. The first is the sum of a flat percentage rate for net positions, with netting allowed among tightly defined sets, plus another flat percentage rate for the gross position.<sup>202</sup> The other two standardized approaches are based on maturity-ladders, where unmatched portions of each maturity band (*i.e.*, portions that do not net out to zero) are charged at a step-up rate in comparison

<sup>195</sup> *See* UK CRR, Articles 382–384 for CVA risk calculations; and Article 312(2) for operational risk.

<sup>196</sup> *Id.*, Article 326.

<sup>197</sup> *Id.* *See also* UK CRR, Articles 334–340 (provisions related to debt instruments) and 341–343 (provisions related to equities).

<sup>198</sup> *Id.*, Articles 328–330, 358.

<sup>199</sup> *Id.*, Article 329.

<sup>200</sup> *Id.*, Article 351.

<sup>201</sup> *Id.*

<sup>202</sup> *Id.*, Article 360.

<sup>186</sup> *Id.* A PRA-designated UK nonbank SD may also be required to maintain a countercyclical capital buffer composed of common equity tier 1 capital equal to the firm's total risk exposure multiplied by an institution-specific countercyclical buffer rate. The institution-specific countercyclical capital buffer rate is determined by calculating the weighted average of the countercyclical buffer rates that apply in the jurisdictions in which the PRA-designated UK nonbank SD has relevant credit exposures. *See* PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 3 Countercyclical Capital Buffer. The rate for each jurisdiction is determined by the UK Financial Policy Committee or a third country countercyclical buffer authority, as applicable. *See* PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 3 Countercyclical Capital Buffer, Rule 3.1., and Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014, Articles 7–20. In practice, the countercyclical buffer rate in the UK, as of July 2023, is 2 percent of risk-weighted assets. The countercyclical capital buffer rate is published by the Bank of England, and is available at: <https://bankofengland.co.uk/financial-stability/the-countercyclical-capital-buffer>. Several EU Member States of relevance to the UK have also implemented countercyclical capital buffers with rates ranging from 0.5 percent to 2.5 percent of risk-weighted assets.

<sup>187</sup> UK CRR, Article 92(3).

<sup>188</sup> To compute capital requirements for market risk, PRA-designated UK nonbank SDs are required to calculate capital charges for all trading book positions and non-trading book positions that are subject to foreign exchange or commodity risk. *See* UK CRR, Article 325. The risk-weighted exposure amounts for credit risk include: (i) risk-weighted exposure amounts for credit risk and dilution risk in respect of all the business activities of the PRA-designated UK nonbank SD, excluding risk-weighted exposure amounts from the trading book business of the firm; and (ii) risk-weighted exposure

to the base charges for matched portions.<sup>203</sup>

With respect to credit risk, the UK PRA Capital Rules require a PRA-designated UK nonbank SD to calculate its standardized credit risk exposure in a manner aligned with the Commission's Bank-Based Approach and the BCBS framework by taking the carrying value or notional value of each of the PRA-designated UK nonbank SD's on-balance sheet and off-balance sheet exposures, making certain additional credit risk adjustments, and then applying specific risk-weights based on the type of counterparty and the asset's credit quality.<sup>204</sup> For instance, credit exposures to the ECB, the UK government, and the Bank of England carry a zero percent risk-weight; exposures to other central governments and central banks may carry risk-weights between 0 and 150, depending on the credit rating available for the central government or central bank; and exposures to banks, PRA-designated investment firms, or other businesses may carry risk-weights between 20 percent and 150 percent depending on the credit ratings available for the entity or, for exposures to banks and investment firms, for the central government of the jurisdiction in which the entity is incorporated.<sup>205</sup> If no credit rating is available, the PRA-designated UK nonbank SD must generally apply a 100 percent risk-weight, meaning the total accounting value of the exposure is used.<sup>206</sup>

With respect to counterparty credit risk for derivatives transactions and certain other agreements that give rise to bilateral credit risk, the UK PRA Capital Rules require a PRA-designated UK nonbank SD that is not approved to use credit risk models to calculate its exposure using the standardized approach for counterparty credit risk (*i.e.*, SA-CCR),<sup>207</sup> which is one of the

methods that a nonbank SD may use to calculate its credit risk exposure under a derivatives transaction pursuant to the Commission's Bank-Based Approach.<sup>208</sup> The exposure amount under the SA-CCR is computed, under both the UK PRA Capital Rules and the Commission's Bank-Based Approach, as the sum of the replacement cost of the contract and the potential future exposure of the contract, multiplied by a factor of 1.4.<sup>209</sup>

UK PRA Capital Rules also require a PRA-designated UK nonbank SD to calculate capital requirements for settlement risk.<sup>210</sup> Consistent with the BCBS framework, the capital charge for settlement risk for transactions settled on a delivery-versus-payment basis is computed by multiplying the price difference to which a PRA-designated UK nonbank SD is exposed as a result of an unsettled transaction by a percentage factor that varies from 8 percent to 100 percent based on the number of working days after the due settlement date during which the transaction remains unsettled.<sup>211</sup> The CFTC's Bank-Based Approach provides for a similar calculation methodology for risk-weighted asset amounts for unsettled transactions involving securities, foreign exchange instruments, and commodities.<sup>212</sup>

Consistent with the BCBS framework, a PRA-designated UK nonbank SD is also required to calculate capital charges for CVA risk for OTC derivative instruments<sup>213</sup> to reflect the current market value of the credit risk of the counterparty to the PRA-designated UK

nonbank SD.<sup>214</sup> CVA can be calculated following similar methodologies as those described in subpart E of the Federal Reserve Board's part 217 regulations.<sup>215</sup>

A PRA-designated UK nonbank SD's total risk exposure amount also includes operational risk charges. Consistent with the BCBS framework, PRA-designated UK nonbank SDs may calculate standardized operational risk charges using either one of two approaches—the Basic Indicator Approach or the Standardized Approach.<sup>216</sup> Both the Basic Indicator Approach and the Standardized Approach use as a calculation basis the three-year average of the “relevant indicator,” which is the sum of certain items on the statement of income/loss (*i.e.*, the firm's net interest income and net non-interest income). Under the Basic Indicator Approach, PRA-designated UK nonbank SDs are required to multiply the relevant indicator by a factor of 15 percent. When using the Standardized Approach, firms need to allocate the relevant indicator into eight business lines specified by regulation (*e.g.*, trading and sales; retail brokerage; corporate finance) and multiply the corresponding portion by a percentage factor ranging from 12 to 18 percent depending on the business line. The capital requirements for operational risk are calculated as the sum of the individual business lines' charges.

As noted above, if approved by the PRA, a PRA-designated UK nonbank SD may use internal models to calculate its market risk charges, credit risk charges, including counterparty credit risk charges, CVA risk charges, and operational risk charges in lieu of using a standardized approach.<sup>217</sup> To obtain permission, a PRA-designated UK nonbank SD must demonstrate to the satisfaction of the PRA that it meets

(CRR) Part, Chapter 3 Counterparty Credit Risk (Part Three, Title Two, Chapter Six CRR), Article 273a.

<sup>208</sup> 12 CFR 217.34.

<sup>209</sup> PRA Rulebook, CRR Firms, Counterparty Credit Risk (CRR) Part, Chapter 3 Counterparty Credit Risk (Part Three, Title Two, Chapter Six CRR), Article 274 and 12 CFR 217.132(c).

<sup>210</sup> UK CRR, Article 378 (indicating that if transactions in which debt instruments, equities, foreign currencies and commodities excluding repurchase transactions and securities or commodities lending and securities or commodities borrowing are unsettled after their due delivery dates, a PRA-designated UK nonbank SD must calculate the price difference to which it is exposed).

<sup>211</sup> *Id.* The price difference to which a PRA-designated UK nonbank SD is exposed is the difference between the agreed settlement price for an instrument (*i.e.*, a debt instrument, equity, foreign currency or commodity) and the instrument's current market value, where the difference could involve a loss for the firm. UK CRR, Article 378.

<sup>212</sup> 17 CFR 23.100 (definition of *BHC equivalent risk-weighted assets*), 12 CFR 217.38 and 12 CFR 217.136.

<sup>213</sup> UK CRR, Article 382 (1). CVA risk charges need not be calculated for credit derivatives recognized to reduce risk-weighted exposure amounts for credit risk. *Id.*

<sup>214</sup> *Id.*, Article 381. CVA is defined to exclude debit valuation adjustment.

<sup>215</sup> See UK CRR, Articles 383–384 and 12 CFR 217.132(e)(5) and (6). Under the CFTC's Bank-Based Approach, nonbank SDs calculating their credit risk-weighted assets using the regulations in subpart D of the Federal Reserve Board's part 217 regulations, do not calculate CVA of OTC derivatives instruments.

<sup>216</sup> UK CRR, Article 312 and PRA Rulebook, CRR Firms, Operational Risk (CRR) Part.

<sup>217</sup> UK CRR, Articles 143 (credit risk), 283 (counterparty credit risk), 312 (operational risk), 363 (market risk) and 383 (CVA risk). PRA-designated UK nonbank SDs are not permitted, however, to calculate counterparty credit risk charges using internal models when calculating large exposures. PRA Rulebook, CRR Firms, Large Exposures (CRR) Part, Chapter 4 Large Exposures (Part Four CRR), Article 390.

<sup>203</sup> *Id.*, Articles 359 and 361.

<sup>204</sup> *Id.*, Articles 111 and 113(1).

<sup>205</sup> *Id.*, Articles 114–122.

<sup>206</sup> *Id.*, Articles 121(2) and 122(2).

<sup>207</sup> UK CRR, Articles 92(3)(f) and PRA Rulebook, CRR Firms, Counterparty Credit Risk (CRR) Part, Chapter 3 Counterparty Credit Risk (Part Three, Title Two, Chapter Six CRR). PRA-designated UK nonbank SDs with smaller-sized derivatives business may also use a “simplified standardized approach to counterparty credit risk” or an “original exposure method” as simpler methods for calculating exposure values. PRA Rulebook, CRR Firms, Counterparty Credit Risk (CRR) Part, Chapter 3 Counterparty Credit Risk (Part Three, Title Two, Chapter Six CRR), Articles 281–282. To use either of these alternative methods, an entity's on-and off-balance sheet derivatives business must be equal or less than 10 percent of the entity's total assets and GBP 260 million or 5 percent of the entity's total assets and GBP 88 million, respectively. PRA Rulebook, CRR Firms, Counterparty Credit Risk

certain conditions for the use of models.<sup>218</sup>

With respect to market risk, the PRA may grant a PRA-designated UK nonbank SD permission to use internal models to calculate one or more of the following risk categories: (i) general risk of equity instruments, (ii) specific risk of equity instruments, (iii) general risk of debt instruments, (iv) specific risk of debt instruments, (v) foreign exchange risk, or (vi) commodities risk,<sup>219</sup> along with interest rate risk on derivatives.<sup>220</sup> To obtain approval to use a market risk model, a PRA-designated UK nonbank SD must meet conditions related to specified model elements and controls including risk and stressed risk calculations,<sup>221</sup> back-testing and multiplication factors,<sup>222</sup> risk measurement requirements,<sup>223</sup> governance and qualitative requirements,<sup>224</sup> internal validation,<sup>225</sup> and specific requirements by risk categories.<sup>226</sup> A PRA-designated UK nonbank SD approved to use models must also obtain approval from the PRA to implement a material change to the model or make a material extension to the use of the model.<sup>227</sup> The UK PRA Capital Rules' market risk model-based methodology is based on the Basel 2.5 standard<sup>228</sup> and incorporates relevant aspects of the BCBS framework in terms of requiring PRA-designated UK nonbank SDs with model approval to use a VaR model with a 99 percent, one-tailed confidence level with: (i) price changes equivalent to a 10-business day movement in rates and prices, (ii) effective historical observation periods of at least one year, and (iii) at least monthly data set updates.<sup>229</sup> The UK PRA Capital Rules also include a framework for governance that includes requirements related to the implementation of independent risk management,<sup>230</sup> senior management's involvement in the risk-control process,<sup>231</sup> establishment of procedures for monitoring and ensuring compliance with a documented set of internal policies and controls,<sup>232</sup> and the

conducting of independent review of the models as part of the internal audit process.<sup>233</sup>

With regulatory permission, PRA-designated UK nonbank SDs may also use models to calculate credit risk exposures.<sup>234</sup> Credit risk models may include internal ratings based on the estimation of default probabilities and loss given default, consistent with the BCBS framework and subject to similar model risk management guidelines.<sup>235</sup> To obtain approval for the use of internal ratings-based models, a PRA-designated UK nonbank SD must meet requirements related to, among other things, the structure of its rating systems and its criteria for assigning exposures to grades and pools within a rating system, the parameters of risk quantification, the validation of internal estimates, and the internal governance and oversight of the rating systems and estimation processes.<sup>236</sup>

In addition, subject to regulatory approval, PRA-designated UK nonbank SDs may use internal models to calculate counterparty credit risk exposures for derivatives, securities financing, and long settlement transactions.<sup>237</sup> The prerequisites for approval for such models include requirements related to the establishment and maintenance of a counterparty credit risk management framework, stress testing, the integrity of the modelling process, the risk management system, and validation.<sup>238</sup> The UK PRA Capital Rules' internal counterparty credit risk model-based methodology is also based on the Basel 2.5 standard.<sup>239</sup> The UK PRA Capital Rules allow for the estimation of expected exposure as a measure of the average of the distribution of exposures at a particular future date,<sup>240</sup> with adjustments to the period of risk, as appropriate to the asset and counterparty.

PRA-designated UK nonbank SDs may also obtain regulatory permission to use "advanced measurement approaches"

based on their own operational risk measurement systems, to calculate capital charges for operational risk. To obtain such permission, PRA-designated UK nonbank SDs must meet qualitative and quantitative standards, as well as general risk management standards set forth in the UK PRA Capital Rules.<sup>241</sup> Specifically, among other qualitative standards, PRA-designated UK nonbank SDs must meet requirements related to the governance and documentation of their operational risk management processes and measurement systems.<sup>242</sup> In addition, PRA-designated UK nonbank SDs must meet quantitative standards related to process, data, scenario analysis, business environment and internal control factors laid down in the UK PRA Capital Rules.<sup>243</sup>

As an additional element to the capital requirements, the UK PRA Capital Rules further impose a 3.25 percent leverage ratio floor on PRA-designated UK nonbank SDs that hold significant amounts of non-UK assets.<sup>244</sup> Specifically, a PRA-designated UK nonbank SD that has non-UK assets equal to or greater than GBP 10 billion is required to maintain an aggregate amount of common equity tier 1 capital and additional tier 1 capital equal to or in excess of 3.25 percent of the firm's on-balance sheet and off-balance sheet exposures, including exposures on uncleared swaps but excluding certain exposures to central banks, without regard to any risk-weighting.<sup>245</sup> For the purposes of complying with the leverage ratio requirement, at least 75 percent of the firm's tier 1 capital must consist of common equity tier 1 capital.<sup>246</sup> The leverage ratio is a non-risk based minimum capital requirement that is intended to prevent a PRA-designated

<sup>241</sup> UK CRR, Article 312(1), cross-referencing UK CRR, Articles 321 and 322; PRA Rulebook, CRR Firms, General Organizational Requirements Part, Rules 2.1 and 2.2; and PRA Rulebook, CRR Firms, Internal Liquidity Adequacy Assessment Part.

<sup>242</sup> UK CRR, Article 321.

<sup>243</sup> *Id.*, Article 322.

<sup>244</sup> PRA Rulebook, CRR Firms, Leverage Ratio—Capital Requirements and Buffers Part, Chapter 1 Application and Definitions and Chapter 3 Minimum Leverage Ratio.

<sup>245</sup> Total exposures are required to be computed in accordance with PRA Rulebook, CRR Firms, Leverage Ratio (CRR) Part, Chapter 3 Leverage Ratio (Part Seven CRR), Article 429 *et seq.* A PRA-designated UK nonbank SD may also be subject to a countercyclical leverage ratio buffer of common equity tier 1 capital equal to the firm's institution-specific countercyclical capital buffer rate multiplied by 35 percent, multiplied by the firm's total exposures. PRA Rulebook, CRR Firms, Leverage Ratio—Capital Requirements and Buffers Part, Chapter 4 Countercyclical Leverage Ratio Buffer.

<sup>246</sup> PRA Rulebook, CRR Firms, Leverage Ratio—Capital Requirements and Buffers Part, Chapter 3 Minimum Leverage Ratio, Rule 3.2.

<sup>233</sup> *Id.*, Articles 368 (1)(h).

<sup>234</sup> *Id.*, Article 143.

<sup>235</sup> *Id.*

<sup>236</sup> *Id.*, Articles 170–177 (rating systems), 178–184 (risk quantification), 185 (validation of internal estimates), and 189–191 (internal governance and oversight).

<sup>237</sup> *Id.*, Article 283. As noted above, however, PRA-designated UK nonbank SDs are not permitted to calculate counterparty credit risk charges using internal models when calculating large exposures. PRA Rulebook, CRR Firms, Large Exposures (CRR) Part, Chapter 4 Large Exposures (Part Four CRR), Article 390.

<sup>238</sup> *Id.*, Articles 283–294.

<sup>239</sup> Compare UK CRR, Article 362–377 with Revisions to the Basel II Market Risk Framework.

<sup>240</sup> UK CRR, Article 272(19), 283–285.

<sup>218</sup> UK CRR, Articles 143, 283, 312(2) and 363(1).

<sup>219</sup> *Id.*, Article 363(1).

<sup>220</sup> *Id.*, Article 331(1), using sensitivity models.

<sup>221</sup> *Id.*, Articles 364–365.

<sup>222</sup> *Id.*, Article 366.

<sup>223</sup> *Id.*, Article 367.

<sup>224</sup> *Id.*, Article 368.

<sup>225</sup> *Id.*, Article 369.

<sup>226</sup> *Id.*, Articles 364–377.

<sup>227</sup> *Id.*, Article 363(3).

<sup>228</sup> Compare UK CRR, Articles 362–377 with Revisions to the Basel II Market Risk Framework.

<sup>229</sup> UK CRR, Article 365(1).

<sup>230</sup> *Id.*, Articles 368 (1)(b).

<sup>231</sup> *Id.*, Articles 368 (1)(c).

<sup>232</sup> *Id.*, Articles 368 (1)(e).

UK nonbank SD from engaging in excessive leverage, and complements the risk-based minimum capital requirement that is based on the PRA-designated UK nonbank SD's risk-weighted assets.

Furthermore, the UK PRA Capital Rules also impose a separate liquidity coverage requirement on a PRA-designated UK nonbank SD to address liquidity risk. The liquidity coverage requirement provides that PRA-designated UK nonbank SDs must hold liquid assets in an amount sufficient to cover liquidity outflows (less liquidity inflows) under stressed conditions over a period of 30 days.<sup>247</sup> For purposes of the liquidity coverage requirement, the term "stressed" means a sudden or severe deterioration in the solvency or liquidity position of a firm due to changes in market conditions or idiosyncratic factors as a result of which there is a significant risk that the firm becomes unable to meet its commitments as they become due within the next 30 days.<sup>248</sup> In addition, Article 413 of UK CRR, which has been incorporated into the PRA Rulebook, establishes a general requirement that firms ensure that long-term obligations and off-balance sheet items are adequately met with a diverse set of funding instruments that are stable under both normal and stressed conditions.<sup>249</sup>

The UK PRA Capital Rules also require PRA-designated UK nonbank SDs to maintain at all times a minimum base capital requirement of GBP 750,000.<sup>250</sup>

### 3. Commission Analysis

The Commission has reviewed the UK Application and the relevant UK laws and regulations, and has preliminarily determined that the UK PRA Capital Rules are comparable in purpose and effect to the CFTC Capital Rules with regard to the establishment of the nonbank SD's minimum capital requirement and the calculation of the nonbank SD's amount of regulatory capital to meet that requirement.<sup>251</sup>

<sup>247</sup> PRA Rulebook, CRR Firms, Liquidity (CRR) Part, Chapter 4 Liquidity (Part Six CRR), Article 412(1).

<sup>248</sup> PRA Rulebook, CRR Firms, Liquidity (CRR) Part, Chapter 4 Liquidity (Part Six CRR), Article 411(10).

<sup>249</sup> PRA Rulebook, CRR Firms, Liquidity (CRR) Part, Chapter 4 Liquidity (Part Six CRR), Article 413(1).

<sup>250</sup> PRA Rulebook, CRR Firms, Definition of Capital Part, Chapter 12 Base Capital Resource Requirement, Rule 12.1.

<sup>251</sup> The Commission notes that pursuant to Article 7 of UK CRR, the PRA may exempt an entity subject to UK CRR from the applicable capital requirements, provided certain conditions are met.

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

#### a. Fixed Amount Minimum Capital Requirement

CFTC Capital Rules and the UK PRA Capital Rules both require nonbank SDs to hold a minimum amount of regulatory capital that is not based on the risk-weighted assets of the firms. Prong (i) of the CFTC Capital Rules requires each nonbank SD electing the Bank-Based Approach to maintain a minimum of \$20 million of common equity tier 1 capital. The CFTC's \$20 million fixed-dollar minimum capital requirement is intended to ensure that each nonbank SD maintains a level of regulatory capital, without regard to the level of the firm's dealing and other activities, sufficient to meet its obligations to swap market participants given the firm's status as a CFTC-registered nonbank SD and to help ensure the safety and soundness of the nonbank SD.<sup>252</sup> The UK PRA Capital Rules also contain a requirement that a PRA-designated UK nonbank SD maintain a fixed amount of minimum initial capital of GBP 750,000.<sup>253</sup>

The Commission recognizes that the \$20 million fixed-dollar minimum

In such case, the relevant requirements would apply to the entity's parent entity, on a consolidated basis. The Commission's assessment does not cover the application of Article 7 of UK CRR and therefore an entity that benefits from an exemption under Article 7 of UK CRR would not qualify for substituted compliance under the Capital Comparability Determination Order.

<sup>252</sup> 85 FR 57492.

<sup>253</sup> PRA Rulebook, CRR Firms, Definition of Capital Part, Chapter 12 Base Capital Resource Requirement, Rule 12.1.

capital required under the CFTC Capital Rules is substantially higher than the GBP 750,000 minimum base capital required under the UK PRA Capital Rules and the Commission preliminarily believes that the \$20 million represents a more appropriate level of minimum capital to help ensure the safety and soundness of the nonbank SD that is engaging in uncleared swap transactions. Accordingly, the Commission is proposing to condition the Capital Comparability Determination Order to require each PRA-designated UK nonbank SD to maintain, at all times, a minimum level of \$20 million regulatory capital in the form of common equity tier 1 items as defined in Article 26 of UK CRR.<sup>254</sup> The proposed condition would require each PRA-designated UK nonbank SD to maintain an amount of common equity tier 1 capital denominated in British pound that is equivalent to the \$20 million in U.S. dollars.<sup>255</sup> The Commission is also proposing that a PRA-designated UK nonbank SD may convert the pound-denominated common equity tier 1 capital amount to the U.S. dollar equivalent based on a commercially reasonable and observable exchange rate.

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

Prong (iii) of the CFTC Capital Rules requires each nonbank SD to maintain an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital in an amount equal to or

<sup>254</sup> The Commission notes that the proposed requirement that PRA-designated UK nonbank SDs maintain a minimum level of \$20 million of common equity tier 1 capital is consistent with conditions set forth in the proposed Capital Comparability Determination Orders for Japan, Mexico, and the EU, respectively. *See, Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination from the Financial Services Agency of Japan*, 87 FR 48092 (Aug. 8, 2022) ("Proposed Japan Order"); *Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on behalf of Nonbank Swap Dealers subject to Regulation by the Mexican Comision Nacional Bancaria y de Valores*, 87 FR 76374 (Dec. 13, 2022) ("Proposed Mexico Order"); and *Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Domiciled in the French Republic and Federal Republic of Germany and Subject to Capital and Financial Reporting Requirements of the European Union* (June 27, 2023) ("Proposed EU Order").

<sup>255</sup> Each of the six current PRA-designated UK nonbank SDs currently maintains common equity tier 1 capital in excess of \$20 million based on financial filings made with the Commission. Therefore, the Commission does not anticipate that the proposed condition would have any material impact on the PRA-designated UK nonbank SDs currently registered with the Commission. Nonetheless, the Commission requests comment on the proposed condition.



greater than 8 percent of the nonbank SD's total risk-weighted assets, with common equity tier 1 capital comprising at least 6.5 percent of the 8 percent.<sup>256</sup> Risk-weighted assets are a nonbank SD's on-balance sheet and off-balance sheet market risk and credit risk exposures, including exposures associated with proprietary swap, security-based swap, equity, and futures positions, weighted according to risk. The requirements and capital ratios set forth in prong (iii) are based on the Federal Reserve Board's capital requirements for bank holding companies and are consistent with the BCBS international bank capital adequacy framework. The requirement for each nonbank SD to maintain regulatory capital in an amount that equals or exceeds 8 percent of the firm's total risk-weighted assets is intended to help ensure that the nonbank SD's level of capital is sufficient to absorb decreases in the value of the firm's assets and increases in the value of the firm's liabilities, and to cover unexpected losses resulting from the firm's business activities, including losses resulting from uncollateralized defaults from swap counterparties, without the nonbank SD becoming insolvent.

The UK PRA Capital Rules contain capital requirements for PRA-designated UK nonbank SDs that the Commission preliminarily believes are comparable to the requirements contained in prong (iii) of the CFTC Capital Rules. Specifically, the UK PRA Capital Rules require a PRA-designated UK nonbank SD to maintain: (i) common equity tier 1 capital equal to at least 4.5 percent of the PRA-designated UK nonbank SD's total risk exposure amount; (ii) total tier 1 capital (*i.e.*, common equity tier 1 capital plus additional tier 1 capital) equal to at least 6 percent of the PRA-designated UK nonbank SD's total risk exposure amount; and (iii) total capital (*i.e.*, an aggregate amount of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital) equal to at least 8 percent of the PRA-designated UK nonbank SD's total risk exposure amount.<sup>257</sup> In addition, the UK PRA Capital Rules further require each PRA-designated UK nonbank SD to maintain an additional capital conservation buffer equal to 2.5 percent of the PRA-designated UK nonbank SD's total risk exposure amount, which must be met with common equity tier 1 capital.<sup>258</sup> Thus, a PRA-designated UK nonbank SD is effectively required to maintain total

qualifying regulatory capital in an amount equal to or in excess of 10.5 percent of the market risk, credit risk, CVA risk, settlement risk and operational risk of the firm (*i.e.*, total capital requirement of 8 percent of risk-weighted assets and an additional 2.5 percent of risk-weighted assets as a capital conservation buffer), which is higher than the 8 percent required of nonbank SDs under prong (iii) of the CFTC Capital Rules.<sup>259</sup>

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

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

The Commission also preliminarily believes that the UK PRA Capital Rules and CFTC Capital Rules are comparable in that nonbank SDs are required to

account for operational risk in computing their minimum capital requirements. In this connection, the UK PRA Capital Rules require a PRA-designated UK nonbank SD to calculate an operational risk exposure as a component of the firm's total risk exposure amount.<sup>260</sup> PRA-designated UK nonbank SDs may use either a standardized approach or, if the PRA-designated UK nonbank SD has obtained regulatory permission, an internal approach based on the firm's own measurement systems, to calculate their capital charges for operational risk. The CFTC Capital Rules address operational risk both as a stand-alone, separate minimum capital requirement that a nonbank SD is required to meet under prong (ii) of the Bank-Based Approach<sup>261</sup> and as a component of the calculation of risk-weighted assets for nonbank SDs that use subpart E of the Federal Reserve Board's Part 217 regulations to calculate their credit risk-weighted assets via internal models.<sup>262</sup>

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

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

The UK PRA Capital Rules differ from the CFTC Capital Rules in that they do not impose a capital requirement on PRA-designated UK nonbank SDs based

<sup>260</sup> UK CRR, Article 92(3).

<sup>261</sup> Specifically, as further discussed below, prong (ii) of the CFTC Capital Rules' Bank-Based Approach requires a nonbank SD to maintain regulatory capital in an amount equal to or greater than 8 percent of the firm's total uncleared swaps margin amount associated with its uncleared swap transactions to address potential operational, legal, and liquidity risks. 17 CFR 101(a)(i)(C). The term "uncleared swap margin" is defined by Commission Regulation 23.100 as the amount of initial margin, computed in accordance with the Commission's margin rules for uncleared swaps, that a nonbank SD would be required to collect from each counterparty for each outstanding swap position of the nonbank SD. 17 CFR 23.100 and 23.154. A nonbank SD must include all swap positions in the calculation of the uncleared swap margin amount, including swaps that are exempt or excluded from the scope of the Commission's margin regulations for uncleared swaps pursuant to Commission Regulation 23.150, exempt foreign exchange swaps or foreign exchange forwards, or netting set of swaps or foreign exchange swaps, for each counterparty, as if that counterparty was an unaffiliated swap dealer. 17 CFR 23.100 and 23.150. Furthermore, in computing the uncleared swap margin amount, a nonbank SD may not exclude any de minimis thresholds contained in Commission Regulation 23.151. 17 CFR 23.100 and 23.151.

<sup>262</sup> 17 CFR 23.101(a)(1)(i) and 17 CFR 23.100 (definition of *BHC equivalent risk-weighted assets*).

<sup>256</sup> 17 CFR 23.101(a)(1)(B).

<sup>257</sup> UK CRR, Article 92(1).

<sup>258</sup> PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 2 Capital Conservation Buffer.

<sup>259</sup> UK CRR, Article 92(1) and PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 2 Capital Conservation Buffer.

on a percentage of the margin for uncleared swap transactions. The Commission notes, however, that the UK PRA Capital Rules impose capital and liquidity requirements that may compensate for the lack of direct analogue to the 8 percent uncleared swap margin requirement. Specifically, as discussed above, under the UK PRA Capital Rules, the total risk exposure amount is computed as the sum of the PRA-designated UK nonbank SD's capital charges for market risk, credit risk, settlement risk, CVA risk of OTC derivatives instruments, and operational risk.<sup>263</sup> Notably, the UK PRA Capital Rules require that PRA-designated UK nonbank SDs, including firms that do not use internal models, calculate capital charges for operational risk as a separate component of the total risk exposure amount. The UK PRA Capital Rules also impose separate liquidity requirements designed to ensure that the PRA-designated UK nonbank SDs can meet both short- and long-term obligations, in addition to the general requirement to maintain processes and systems for the identification of liquidity risk.<sup>264</sup> In comparison, the Commission requires nonbank SDs to maintain a risk management program covering liquidity risk, among other risk categories, but does not have a distinct liquidity requirement.<sup>265</sup>

As such, the Commission preliminarily believes the inclusion of an operational risk charge in the PRA-designated UK nonbank SD's total risk exposure amount in all circumstances, and the existence of separate liquidity requirements, will achieve a comparable

<sup>263</sup> UK CRR, Article 92(3).

<sup>264</sup> More specifically, the UK PRA Capital Rules impose separate liquidity buffers and "stable funding" requirements designed to ensure that PRA-designated UK nonbank SDs can cover both long-term obligations and short-term payment obligations under stressed conditions for 30 days. PRA Rulebook, CRR Firms, Liquidity (CRR) Part, Chapter 4 Liquidity (Part Six CRR), Article 412–413. In addition, PRA-designated UK nonbank SDs are required to maintain robust strategies, policies, processes, and systems for the identification of liquidity risk over an appropriate set of time horizons, including intra-day. PRA Rulebook, CRR Firms, Internal Liquidity Adequacy Assessment Part.

<sup>265</sup> Specifically, CFTC Regulation 23.600(b) requires each SD to establish, document, maintain, and enforce a system of risk management policies and procedures designed to monitor and manage the risks related to swaps, and any products used to hedge swaps, including futures, options, swaps, security-based swaps, debt or equity securities, foreign currency, physical commodities, and other derivatives. The elements of the SD's risk management program are required to include the identification of risks and risk tolerance limits with respect to applicable risks, including operational, liquidity, and legal risk, together with a description of the risk tolerance limits set by the SD and the underlying methodology in written policies and procedures. 17 CFR 23.600.

outcome to the Commission's requirement for nonbank SDs to hold regulatory capital in excess of 8 percent of its uncleared swap margin amount. In that regard, the Commission, in establishing the requirement that a nonbank SD must maintain a level of regulatory capital in excess of 8 percent of the uncleared swap margin amount associated with the firm's swap transactions, stated that the intent of the requirement was to establish a method of developing a minimum amount of required capital for a nonbank SD to meet its obligations as an SD to market participants, and to cover potential operational, legal, and liquidity risks.<sup>266</sup>

#### d. Preliminary Finding of Comparability

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

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

<sup>266</sup> See 85 FR 57462 at 57485.

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

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

The CFTC Financial Reporting Rules impose financial recordkeeping and reporting requirements on nonbank SDs. The CFTC Financial Reporting Rules require each nonbank SD to prepare and keep current ledgers or similar records summarizing each transaction affecting the nonbank SD's asset, liability, income, expense, and capital accounts.<sup>267</sup> The nonbank SD's ledgers and similar records must be prepared in accordance with generally accepted accounting principles as adopted in the United States ("U.S. GAAP"), except that if the nonbank SD is not otherwise required to prepare financial statements in accordance with U.S. GAAP, the nonbank SD may prepare and maintain its accounting records in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board.<sup>268</sup>

The CFTC Financial Reporting Rules also require each nonbank SD to prepare and file with the Commission and with NFA periodic unaudited and annual audited financial statements.<sup>269</sup> A nonbank SD that elects the TNW Approach is required to file unaudited financial statements within 17 business days of the close of each quarter, and its annual audited financial statements within 90 days of its fiscal year-end.<sup>270</sup> A nonbank SD that elects the NLA Approach or the Bank-Based Approach is required to file unaudited financial statements within 17 business days of the end of each month, and to file its annual audited financial statements within 60 days of its fiscal year-end.<sup>271</sup>

The CFTC Financial Reporting Rules provide that a nonbank SD's unaudited financial statements must include: (i) a statement of financial condition; (ii) a statement of income/loss; (iii) a statement of changes in liabilities subordinated to claims of general creditors; (iv) a statement of changes in ownership equity; (v) a statement demonstrating compliance with and calculation of the applicable regulatory requirement; and (vi) such further material information necessary to make the required statements not misleading.<sup>272</sup> The annual audited

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

<sup>268</sup> *Id.*

<sup>269</sup> 17 CFR 23.105(d) and (e).

<sup>270</sup> 17 CFR 23.105(d)(1) and (e)(1).

<sup>271</sup> *Id.*

<sup>272</sup> 17 CFR 23.105(d)(2).

financial statements must include: (i) a statement of financial condition; (ii) a statement of income/loss; (iii) a statement of cash flows; (iv) a statement of changes in liabilities subordinated to claims of general creditors; (v) a statement of changes in ownership equity; (vi) a statement demonstrating compliance with and calculation of the applicable regulatory capital requirement; (vii) appropriate footnote disclosures; and (viii) a reconciliation of any material differences from the unaudited financial report prepared as of the nonbank SD's year-end date.<sup>273</sup>

A nonbank SD that has obtained approval from the Commission or NFA to use internal capital models also must submit certain model metrics, such as aggregate VaR and counterparty credit risk information, each month to the Commission and NFA.<sup>274</sup> A nonbank SD also is required to provide the Commission and NFA with a detailed list of financial positions reported at fair market value as part of its monthly unaudited financial statements.<sup>275</sup> Each nonbank SD is also required to provide information to the Commission and NFA regarding its counterparty credit concentration for the 15 largest exposures in derivatives, a summary of its derivatives exposures by internal credit ratings, and the geographical distribution of derivatives exposures for the 10 largest countries.<sup>276</sup>

CFTC Financial Reporting Rules also require a nonbank SD to attach to each unaudited and audited financial report an oath or affirmation that to the best knowledge and belief of the individual making the affirmation the information contained in the financial report is true and correct.<sup>277</sup> The individual making the oath or affirmation must be a duly authorized officer if the nonbank SD is a corporation, or one of the persons specified in the regulation for business organizations that are not corporations.<sup>278</sup>

The CFTC Financial Reporting Rules further require a nonbank SD to make certain financial information publicly available by posting the information on its public website.<sup>279</sup> Specifically, a nonbank SD must post on its website a statement of financial condition and a statement detailing the amount of the nonbank SD's regulatory capital and the

minimum regulatory capital requirement based on its audited financial statements and based on its unaudited financial statements that are as of a date that is six months after the nonbank SD's audited financial statements.<sup>280</sup> Such public disclosure is required to be made within 10 business days of the filing of the audited financial statements with the Commission, and within 30 calendar days of the filing of the unaudited financial statements required with the Commission.<sup>281</sup> A nonbank SD also must obtain written approval from NFA to change the date of its fiscal year-end for financial reporting.<sup>282</sup>

The CFTC Financial Reporting Rules also require a nonbank SD to provide the Commission and NFA with information regarding the custodianship of margin for uncleared swap transactions ("Margin Report").<sup>283</sup> The Margin Report must contain: (i) the name and address of each custodian holding initial margin or variation margin that is required for uncleared swaps subject to the CFTC margin rules ("uncleared margin rules"), on behalf of the nonbank SD or its swap counterparties; (ii) the amount of initial and variation margin required by the uncleared margin rules held by each custodian on behalf of the nonbank SD and on behalf its swap counterparties; and (iii) the aggregate amount of initial margin that the nonbank SD is required to collect from, or post with, swap counterparties for uncleared swap transactions subject to the uncleared margin rules.<sup>284</sup> The Commission requires this information in order to monitor the use of custodians by nonbank SDs and their swap counterparties. Such information assists the Commission in monitoring the safety and soundness of a nonbank SD by verifying whether the firm is current with its swap counterparties with respect to the posting and collecting of margin required by the uncleared margin rules. By requiring the nonbank SD to report the required amount of margin to be posted and collected, and the amount of margin that is actually posted and collected, the Commission could identify potential issues with the margin practices and compliance by nonbank SDs that may hinder the ability of the firm to meet its obligations to market participants. The Margin Report also allows the Commission to identify custodians used by nonbank SDs and

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

## 2. PRA-Designated UK Nonbank Swap Dealer Financial Reporting Requirements

The UK PRA Financial Reporting Rules impose financial reporting requirements on a PRA-designated UK nonbank SD that are designed to provide the PRA with a comprehensive view of the financial information and capital position of the firm.

Specifically, Article 430 of the Reporting (CRR) Part of the PRA Rulebook requires a PRA-designated UK nonbank SD to report information concerning its capital and financial condition, including information on the firm's capital requirements, leverage ratio, large exposures, and liquidity requirements.<sup>285</sup> PRA-designated UK nonbank SDs must follow the templates and instructions provided in the PRA Rulebook for purposes of the prudential requirements reporting referred to COREP.<sup>286</sup> Under the COREP requirements, PRA-designated UK nonbank SDs are required to provide, on a quarterly basis,<sup>287</sup> calculations in relation to the PRA-designated UK nonbank SD's capital and capital requirements,<sup>288</sup> capital ratios and capital levels,<sup>289</sup> and market risk,<sup>290</sup> among other items.

In addition to the prudential requirements reporting, Article 430(3) of the Reporting (CRR) Part of the PRA Rulebook imposes financial information reporting on PRA-designated UK nonbank SDs that are subject to Section 403(1) of the Companies Act 2006 (*i.e.*, entities that are parent companies<sup>291</sup> and report on a consolidated basis using UK-adopted IFRS and that issue securities admitted to trading on a UK-

<sup>273</sup> 17 CFR 23.105(e)(4).

<sup>274</sup> 17 CFR 23.105(k) and (l) and appendix B to subpart E of part 23.

<sup>275</sup> 17 CFR 23.105(l) and appendix B to subpart E of part 23.

<sup>276</sup> 17 CFR 23.105(l) in Schedules 2, 3, and 4, respectively.

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

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

<sup>279</sup> 17 CFR 23.105(i).

<sup>280</sup> *Id.*

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

<sup>282</sup> 17 CFR 23.105(g).

<sup>283</sup> 17 CFR 23.105(m).

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

<sup>285</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 4 Reporting (Part Seven A CRR), Rule 1.

<sup>286</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 6 Templates and Instructions.

<sup>287</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, 5 Reporting Requirements, Chapter 3 Format and Frequency of Reporting on Own Funds, Own Funds Requirements.

<sup>288</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 6 Templates and Instructions, Annex I, Templates C 01.00 and C 02.00.

<sup>289</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 6 Templates and Instructions, Annex I, Template C 03.00.

<sup>290</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 6 Templates and Instructions, Annex I, Template C 02.00.

<sup>291</sup> A parent company (*i.e.*, "parent undertaking") is defined in Companies Act 2006, Section 1162.

regulated market).<sup>292</sup> The relevant reporting templates and instructions, referred to as FINREP, are included in Chapter 6 of the Reporting (CRR) Part of the PRA Rulebook. Under the FINREP requirements, PRA-designated UK nonbank SDs subject to the requirements of Article 430(3) of the Reporting (CRR) Part of the PRA Rulebook are required to provide the following documents to the PRA, among other items: (i) on a quarterly basis, a balance sheet statement (or statement of financial position) that reflects the PRA-designated UK nonbank SD's financial condition;<sup>293</sup> (ii) on a quarterly basis, a statement of profit or loss;<sup>294</sup> (iii) on a quarterly basis, a breakdown of financial liabilities by product and by counterparty sector;<sup>295</sup> (iv) on a quarterly basis, a listing of subordinated financial liabilities;<sup>296</sup> and (v) on an annual basis, a statement of changes in equity.<sup>297</sup>

Under the FINREP requirements, a PRA-designated UK nonbank SD subject to the requirements of Article 430(3) of the Reporting (CRR) Part of the PRA Rulebook is also required to provide the PRA with additional financial information, including a breakdown of its loans and advances by product and type of counterparty,<sup>298</sup> as well as detailed information regarding its

derivatives trading activities,<sup>299</sup> collateral and guarantees.<sup>300</sup>

For PRA-designated UK nonbank SD that are not subject to financial information reporting under Article 430(3) of the Reporting (CRR) Part of the PRA Rulebook, the Regulatory Reporting Part of the PRA Rulebook dictates the applicable reporting requirements.<sup>301</sup> Specifically, as firms that fall into Regulated Activity Group 3 ("RAG 3"), PRA-designated UK nonbank SDs are required to provide the following documents to the PRA, among other items: (i) on a quarterly basis, a balance sheet statement (or statement of financial position) that reflects the PRA-designated UK nonbank SD's financial condition;<sup>302</sup> (ii) on a quarterly basis, a statement of profit or loss;<sup>303</sup> and (iii) on an annual basis, an annual report and accounts.<sup>304</sup> The Applicants represented that the six UK PRA-designated nonbank SDs currently registered with the Commission are designated as RAG 3 firms and are required to provide the aforementioned documents.<sup>305</sup>

Furthermore, all PRA-designated UK nonbank SDs are required to prepare annual audited accounts and a strategic report (together, "annual audited financial report") pursuant to Parts 15

and 16 of the Companies Act 2006.<sup>306</sup> The audit of the accounts and report is required to be performed by one or more independent statutory auditors, which have the required skill, resources, and experience to perform their duties based on the complexity of the firm's business and the regulatory requirements to which the firm is subject.<sup>307</sup> PRA-designated UK nonbank SDs must submit the annual audited financial report to the PRA within 80 business days from the firm's accounting reference date.<sup>308</sup> In addition, under generally applicable company law requirements, PRA-designated UK nonbank SDs are required to submit the annual audited financial report to the UK Registrar of Companies.<sup>309</sup> The registrar makes the report available to the public on its website, free of charge.<sup>310</sup>

The annual audited accounts must comprise, at a minimum, a balance sheet, a profit and loss statement, and notes about the accounts.<sup>311</sup> The auditor's audit report must include: (i) a description of the annual accounts subject to the audit and the financial reporting framework that was applied in their preparation; (ii) a description of the scope of the audit, which must specify the auditing standards used to conduct the audit; (iii) an audit opinion stating whether the annual accounts give a true and fair view of the state of affairs and/or the profit and loss of the firm, as applicable, and whether the annual accounts have been prepared in accordance with the relevant financial reporting framework; and (iv) a

<sup>292</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 4 Reporting (Part Seven A CRR), Article 430, Rule 3.

<sup>293</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 6 Templates and Instructions, Templates 1.1., 1.2., and 1.3 at Annex III (for reporting according to IFRS) and Templates 1.1., 1.2., and 1.3 at Annex IV (for reporting according to national accounting frameworks).

<sup>294</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 6 Templates and Instructions, Template 2 at Annex III (for reporting according to IFRS) and Template 2 at Annex IV (for reporting according to national accounting frameworks).

<sup>295</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 6 Templates and Instructions, Template 8.1 at Annex III (for reporting according to IFRS) and Template 8.1 at Annex IV (for reporting according to national accounting frameworks).

<sup>296</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 6 Templates and Instructions, Template 8.2 at Annex III (for reporting according to IFRS) and Template 8.2 at Annex IV (for reporting according to national accounting frameworks).

<sup>297</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 6 Templates and Instructions, Template 46 at Annex III (for reporting according to IFRS) and Template 46 at Annex IV (for reporting according to national accounting frameworks).

<sup>298</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 6 Templates and Instructions, Templates 5.1 and 6.1 at Annex III (for reporting according to IFRS) and Templates 5.1 and 6.1 at Annex IV (for reporting according to national accounting frameworks).

<sup>299</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 6 Templates and Instructions, Template 10 at Annex III (for reporting according to IFRS) and Template 10 at Annex IV (for reporting according to national accounting frameworks).

<sup>300</sup> PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 6 Templates and Instructions, Template 13 at Annex III (for reporting according to IFRS) and Template 13 at Annex IV (for reporting according to national accounting frameworks).

<sup>301</sup> As indicated by the Applicants, the Regulatory Reporting Part of the PRA Rulebook applies to all PRA-designated UK nonbank SDs. See Responses to Staff Questions dated October 5, 2023.

<sup>302</sup> PRA Rulebook, CRR Firms, Regulatory Reporting Part, Chapter 9 Regulated Activity Group 3, Rule 9.2 (referencing Templates 1.1., 1.2., and 1.3 at Annex III and Templates 1.1., 1.2., and 1.3 at Annex IV of Chapter 6 of the Reporting (CRR) Part) and Rule 9.3.

<sup>303</sup> PRA Rulebook, CRR Firms, Regulatory Reporting Part, Chapter 9 Regulated Activity Group 3, Rule 9.2 (referencing Template 2 at Annex III and Template 2 at Annex IV of Chapter 6 of the Reporting (CRR) Part) and Rule 9.3.

<sup>304</sup> PRA Rulebook, CRR Firms, Regulatory Reporting Part, Chapter 9 Regulated Activity Group 3, Rule 9.2 and Rule 9.3.

<sup>305</sup> See Response to Staff Questions of October 5, 2023. For the avoidance of doubt, as represented by the Applicants, the six PRA-designated UK nonbank SDs currently registered with the Commission are subject to the RAG 3 requirements in the Regulatory Reporting Part of the PRA Rulebook but are not subject to the FINREP requirements set forth in Article 430(3) of the Reporting (CRR) Part of the PRA Rulebook. As such, the six PRA-designated UK nonbank SDs currently registered with the Commission are required to submit to the PRA only Templates 1 through 3 of FINREP.

<sup>306</sup> Companies Act 2006, Sections 393 to 414D and 475. Section 475 provides for an exemption from the audit requirement for certain entities (*i.e.*, "small companies", qualifying "subsidiary companies" and "dormant companies.") None of the six PRA-designated UK nonbank SD, however, falls into the exempt categories. See Responses to Staff Questions dated October 5, 2023.

<sup>307</sup> Companies Act 2006, Section 485 *et seq.*; see also PRA Rulebook, CRR Firms, Auditors Part, Rule 3 Auditors' Qualifications, and Rule 4 Auditors' Independence.

<sup>308</sup> PRA Rulebook, CRR Firms, Regulatory Reporting Part, Chapter 9 Regulatory Activity Group 3, Rules 9.1. and 9.4. The "accounting reference date" is determined in accordance with Section 391 of the Companies Act 2006 and depending on the firm's date of incorporation.

<sup>309</sup> See Companies Act 2006, Section 441. The deadline for filing the annual audited financial report with the UK Registrar of Companies is nine months from the firm's accounting reference date for private companies and six months from the firm's accounting reference date for public companies. *Id.*, Articles 442 (setting forth the filing deadlines by category of firm) and 391 (defining the terms "accounting reference period" and "accounting reference date").

<sup>310</sup> See Companies Act 2006, Sections 1080 and 1085. Information filed with the UK Registrar of Companies is available at: <https://www.gov.uk/government/organisations/companies-house>.

<sup>311</sup> Companies Act 2006, Section 396.

reference to any matters emphasized by the auditor that did not qualify the audit opinion.<sup>312</sup>

The strategic report is required to include a review of the development and performance of the PRA-designated UK nonbank SD's during the financial year and a description of the principal risks and uncertainties that the firm faces.<sup>313</sup> The auditors are required to express an opinion on whether the strategic report is consistent with the accounts for the same financial year, and whether the strategic report has been prepared in accordance with applicable legal requirements.<sup>314</sup> The opinion also must state whether the auditor has identified material misstatements in the strategic report and, if so, describe the misstatement.<sup>315</sup>

In addition, the SEC's UK Order granting substituted compliance for financial reporting to UK nonbank SBSs, as supplemented by the SEC Order on Manner and Format of Filing Unaudited Financial and Operational Information, require a UK nonbank SBS to file an unaudited SEC Form X-17A-5 Part II ("FOCUS Report") with the SEC on a monthly basis.<sup>316</sup> The FOCUS Report is required to include, among other statements and schedules: (i) a statement of financial condition; (ii) a statement of the UK nonbank SBS's capital computation in accordance with home country Basel-Based requirements; (iii) a statement of income/loss; and (iv) a statement of capital withdrawals.<sup>317</sup> A UK nonbank SBS is required to file its FOCUS Report with the SEC within 35 calendar days of the month end.<sup>318</sup>

### 3. Commission Analysis

The Commission has reviewed the UK Application and the relevant UK laws and regulations, and has preliminarily determined that, subject to the proposed conditions described below, the financial reporting requirements of the UK PRA Financial Reporting Rules are comparable to CFTC Financial Reporting Rules in purpose and effect as they are intended to provide the PRA and the Commission, respectively, with financial information to monitor and assess the financial condition of nonbank SDs and their ability to absorb

decreases in firm assets and increases in firm liabilities, and to cover losses from business activities, including swap dealing activities, without the firm becoming insolvent.

The UK PRA Financial Reporting Rules require PRA-designated UK nonbank SDs to prepare and submit to the PRA on a quarterly basis unaudited financial information that includes a statement of financial condition and a statement of profit or loss. Under the FINREP reporting requirements, a PRA-designated UK nonbank SD subject to the requirements set forth in Article 430(3) of the Reporting (CRR) Part of the PRA Rulebook is also required to provide the PRA with additional financial information, including: (i) a schedule of the breakdown of financial liabilities by product and by counterparty sector; (ii) a breakdown of its loans and advances by product and type of counterparty; and (iii) detailed information regarding its derivatives trading activities, collateral, and guarantees. PRA-designated UK nonbank SDs subject to the Regulatory Reporting Part of the PRA Rulebook are not required to submit such additional financial information. To the extent the Commission believes some of this additional information is necessary to the exercise of its and NFA's oversight function, the Commission is proposing, as noted below, to require the submission of such information as a condition to the Capital Comparability Determination Order.

In addition, under the COREP reporting requirement, all PRA-designated UK nonbank SDs are required to provide the PRA on a quarterly basis with calculations in relation to the PRA-designated UK nonbank SD's capital requirements and capital ratios, among other items. The UK PRA Financial Reporting Rules further require all PRA-designated UK nonbank SDs to prepare and publish an annual audited financial report. The annual audited financial report is required to include a statement of financial condition and a statement of profit or loss, and must also include relevant notes to the financial statements.<sup>319</sup>

The Commission preliminarily finds that the UK PRA Financial Reporting Rules impose reporting requirements that are comparable with respect to overall form and content to the CFTC Financial Reporting Rules, which require each nonbank SD to file, among other items, periodic unaudited financial reports with the Commission and NFA that contain at a minimum: (i)

a statement of financial condition; (ii) a statement of profit or loss; and (iii) a statement demonstrating compliance with the capital requirements. Accordingly, the Commission has preliminarily determined that a PRA-designated UK nonbank SD may comply with the financial reporting requirements contained in Commission Regulation 23.105 by complying with the corresponding UK PRA Financial Reporting Rules, subject to the conditions set forth below.<sup>320</sup>

The Commission is proposing to condition the Capital Comparability Determination Order on a PRA-designated UK nonbank SD providing the Commission and NFA with copies of the relevant templates of the FINREP reports and COREP reports that correspond to the PRA-designated UK nonbank SD's statement of financial condition, statement of income/loss, and statement of regulatory capital, total risk exposure, and capital ratios. These templates consist of FINREP templates 1.1 (Balance Sheet Statement: assets), 1.2 (Balance Sheet Statement: liabilities), 1.3 (Balance Sheet Statement: equity), and 2 (Statement of profit or loss), and COREP templates 1 (Own Funds), 2 (Own Funds Requirements) and 3 (Capital Ratios).

The Commission also notes that PRA-designated UK nonbank SDs submit COREP templates in addition to the ones listed above to the PRA. These templates generally provide supporting detail to the core templates that the Commission is proposing to require from each PRA-designated UK nonbank SD. The Commission is not proposing to require a PRA-designated UK nonbank SD to file these additional COREP templates as a condition to the Capital Comparability Order, and alternatively would exercise its authority under Commission Regulation 23.105(h) to direct PRA-designated UK nonbank SDs to provide such additional information to the Commission and NFA on an ad hoc basis as necessary to oversee the financial condition of the firms.<sup>321</sup>

As noted in Section D.2. of this Determination, the UK PRA Financial Reporting Rules require PRA-designated UK nonbank SDs to submit the unaudited FINREP and COREP templates to PRA on a quarterly basis.

<sup>320</sup> A PRA-designated UK nonbank SD that qualifies and elects to seek substituted compliance with the UK PRA Capital Rules must also seek substituted compliance with the UK PRA Financial Reporting Rules.

<sup>321</sup> Commission Regulation 23.105(h) provides that the Commission or NFA may, by written notice, require any nonbank SD to file financial or operational information as may be specified by the Commission or NFA. 17 CFR 23.105(h).

<sup>312</sup> *Id.*, Section 495.

<sup>313</sup> *Id.*, Section 414C.

<sup>314</sup> *Id.*, Section 496.

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

<sup>316</sup> See, UK Order. See also, SEC Order on Manner and Format of Filing Unaudited Financial and Operational Information.

<sup>317</sup> See, SEC Order on Manner and Format of Filing Unaudited Financial and Operational Information.

<sup>318</sup> *Id.*

<sup>319</sup> Companies Act 2006, Section 396.

The CFTC Financial Reporting Rules contain a more frequent reporting requirement by requiring nonbank SDs that elect the Bank-Based Approach to file unaudited financial information with the Commission and NFA, on a monthly basis.<sup>322</sup> The financial statement reporting requirements are an integral part of the Commission's and NFA's oversight programs to effectively and timely monitor nonbank SDs' compliance with capital and other financial requirements, and for Commission and NFA staff to assess the overall financial condition and business operations of nonbank SDs. The Commission has extensive experience with monitoring the financial condition of registrants through the receipt of financial statements, including FCMs and, more recently, nonbank SDs. Both FCMs and nonbank SDs that elect the Bank-Based Approach or NLA Approach file financial statements with the Commission and NFA on a monthly basis. The Commission preliminarily believes that receiving financial information from PRA-designated UK nonbank SDs on a quarterly basis is not comparable with the CFTC Financial Reporting Rules and would impede the Commission's and NFA's ability to effectively and timely monitor the financial condition of PRA-designated UK nonbank SDs for the purposes of assessing their safety and soundness, as well as their ability to meet obligations to creditors and counterparties without becoming insolvent. Therefore, the Commission is preliminarily proposing to include a condition in the Capital Comparability Determination Order to require PRA-designated UK nonbank SDs to file the applicable templates of the FINREP reports and COREP reports with the Commission and NFA on a monthly basis. The Commission also is proposing to condition the Capital Comparability Determination Order on the PRA-designated UK nonbank SD filing the above-listed templates of the FINREP reports and COREP reports with the Commission and NFA within 35 calendar days of the end of each month.<sup>323</sup>

The Commission is further proposing that in lieu of filing such FINREP and COREP reports, PRA-designated UK nonbank SDs that are registered with the

<sup>322</sup> Commission Regulation 23.105(d) (17 CFR 23.105(d)).

<sup>323</sup> The proposed condition for PRA-designated UK nonbank SDs to file monthly unaudited financial information with the Commission and NFA is consistent with proposed conditions contained in the Commission's proposed Capital Comparability Determinations for Japanese nonbank SDs, Mexican nonbank SDs, and EU nonbank SDs. See Proposed Japan Order, Proposed Mexico Order, and Proposed EU Order.

SEC as UK nonbank SBSBs could satisfy this condition by filing with the CFTC and NFA, on a monthly basis, copies of the unaudited FOCUS Reports that the PRA-designated UK nonbank SDs are required to file with the SEC pursuant to the SEC UK Order, as supplemented by the SEC Order on Manner and Format of Filing Unaudited Financial and Operational Information. The FOCUS Report is required to include, among other statements and schedules: (i) a statement of financial condition; (ii) a statement of the UK nonbank SBSB's capital computation in accordance with home country Basel-Based requirements; (iii) a statement of income/loss; and (iv) a statement of capital withdrawals.<sup>324</sup>

The filing of a FOCUS Report would be at the election of the PRA-designated UK nonbank SD as an alternative to the filing of unaudited FINREP and COREP templates that such firms would otherwise be required to file with the Commission and NFA pursuant to the proposed Order. All six of the PRA-designated UK nonbank SDs are currently registered with the SEC as UK nonbank SBSBs and would be eligible to file copies of their monthly FOCUS Report with the Commission and NFA in lieu of the FINREP and COREP templates and Schedule 1. A PRA-designated UK nonbank SD electing to file copies of its monthly FOCUS Report would be required to submit the reports to the Commission and NFA within 35 calendar days of the end of each month.<sup>325</sup>

In addition, the Commission is proposing to condition the Capital Comparability Determination Order on a PRA-designated UK nonbank SD submitting to the Commission and NFA copies of the PRA-designated UK nonbank SD's annual audited financial report that is required to be prepared pursuant to the Companies Act 2006.<sup>326</sup> PRA-designated UK nonbank SDs would

<sup>324</sup> See, SEC Order on Manner and Format of Filing Unaudited Financial and Operational Information.

<sup>325</sup> Commission Regulation 23.105(d)(3) currently provides that a nonbank SD or nonbank MSP that is also registered with the SEC as a broker or dealer, an SBSB, or a major security-based swap participant may elect to file a FOCUS Report in lieu of the financial reports required by the Commission. In a separate rulemaking, the Commission has proposed to amend Regulation 23.105(d)(3) to mandate the filing of a FOCUS Report by such dually-registered entities, including dually-registered non-U.S. nonbank SDs, in lieu of the Commission's financial reports. See CFTC Press Release 8836-23 issued on December 15, 2023, available at *cftc.gov*. If the Commission adopts such a requirement, the Commission would also require PRA-designated UK nonbank SDs that are registered with the SEC as UK nonbank SBSBs to file FOCUS Reports with the Commission.

<sup>326</sup> Companies Act 2006, Parts 15 and 16.

be required to file the annual audited financial report with the Commission and NFA on the earlier of the date the report is filed with the PRA or the date the report is required to be filed with the PRA.<sup>327</sup>

The Commission is also proposing to condition the Capital Comparability Determination Order on the PRA-designated UK nonbank SD providing the reports and statements with balances converted to U.S. dollars.<sup>328</sup> The Commission, however, recognizes that the requirement to convert accounts denominated in British pound to U.S. dollars on the annual audited financial report may impact the opinion provided by the independent auditor. The Commission is therefore proposing to accept the annual audited financial report denominated in British pound.

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

The Commission preliminarily considers that its approach of requiring

<sup>327</sup> PRA-designated UK nonbank SDs are required to submit the annual audited financial report to the PRA within 80 business days of the firm's accounting reference date. See PRA Rulebook, Regulatory Reporting Part, Rule 9.1.

<sup>328</sup> The conversion of account balances from British pound to U.S. dollars is not required to be subject to the audit of the independent auditor. A PRA-designated UK nonbank SD must report the exchange rate that it used to convert balances from British pound to U.S. dollars to the Commission and NFA as part of the financial reporting.



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

The Commission is also proposing to condition the Capital Comparability Determination Order on PRA-designated UK nonbank SDs filing with the Commission and NFA, on a monthly basis, the aggregate securities, commodities, and swap positions information set forth in Schedule 1 of appendix B to subpart E of part 23.<sup>329</sup> The Commission is proposing to require

<sup>329</sup> Schedule 1 of appendix B to subpart E of part 23 includes a nonbank SD's holding of U.S. Treasury securities, U.S. government agency debt securities, foreign debt and equity securities, money market instruments, corporate obligations, spot commodities, cleared and uncleared swaps, cleared and non-cleared security-based swaps, and cleared and uncleared mixed swaps in addition to other position information.

that Schedule 1 be filed with the Commission and NFA as part of the PRA-designated UK nonbank SD's monthly submission of selected FINREP and COREP templates or FOCUS Report, as applicable. Schedule 1 provides the Commission and NFA with detailed information regarding the financial positions that a nonbank SD holds as of the end of each month, including the firm's swap positions, which will allow the Commission and NFA to monitor the types of investments and other activities that the firm engages in and will enhance the Commission's and NFA's ability to monitor the safety and soundness of the firm.

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

The Commission is further proposing to condition the Capital Comparability Determination Order on a PRA-designated UK nonbank SD filing the Margin Report specified in Commission Regulation 23.105(m) with the Commission and NFA. The Margin Report contains: (i) the name and address of each custodian holding initial margin or variation margin on behalf of the nonbank SD or its swap counterparties; (ii) the amount of initial and variation margin held by each custodian on behalf of the nonbank SD and on behalf its swap counterparties; and (iii) the aggregate amount of initial margin that the nonbank SD is required to collect from, or post with, swap counterparties for uncleared swap transactions.<sup>330</sup>

<sup>330</sup> 17 CFR 23.105(m).

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

The Commission notes that the proposed conditions in the UK PRA Capital Comparability Determination Order are consistent with the proposed conditions set forth in the proposed Capital Comparability Determination Orders for Japan, Mexico, and the EU,<sup>331</sup> and reflects the Commission's approach of preliminarily determining that non-U.S. nonbank SDs could meet their financial statement reporting obligations to the Commission by filing financial reports currently prepared for home country regulators, albeit in the case of certain financial reports under a more frequent submission schedule, and, in certain circumstances, with balances expressed in U.S. dollars. The Commission's proposed conditions also include certain financial information and notices that the Commission believes are necessary for effective monitoring of PRA-designated UK nonbank SDs that are not currently part of the PRA's supervision regimes.

The Commission is not proposing to require that a PRA-designated UK nonbank SD that has been approved by the PRA to use capital models files with the Commission or NFA the monthly model metric information contained in

<sup>331</sup> See Proposed Japan Order, Proposed Mexico Order, and Proposed EU Order.

Commission Regulation 23.105(k)<sup>332</sup> or that a PRA-designated UK nonbank SD files with the Commission or NFA the monthly counterparty credit exposure information specified in Commission Regulation 23.105(l) and Schedules 2, 3, and 4 of appendix B to subpart E of part 23.<sup>333</sup>

The Commission, in making the preliminary determination to not require a PRA-designated UK nonbank SD to file the model metrics and counterparty exposures required by Commission Regulations 23.105(k) and (l), respectively, recognizes that NFA's current risk monitoring program requires each bank SD and each nonbank SD, including each PRA-designated UK nonbank SD, to file risk metrics addressing market risk and credit risk with NFA on a monthly basis. NFA's monthly risk metric information includes: (i) VaR for interest rates, credit, foreign exchange, equities, commodities, and total VaR; (ii) total stressed VaR; (iii) interest rate, credit spread, foreign exchange market, and commodity sensitivities; (iv) total swaps current exposure both before and after offsetting against collateral held by the firm; and (v) a list of the 15 largest swaps counterparty current exposures before collateral and net of collateral.<sup>334</sup>

Although there are differences in the information required under Commission Regulations 23.105(k) and (l), the NFA risk metrics provide a level of information that allows NFA to identify SDs that may pose heightened risk and to allocate appropriate NFA regulatory oversight resources. The Commission preliminarily believes that the proposed financial statement reporting set forth in the proposed Capital Comparability Determination Order, and the risk metric and counterparty exposure information currently reported by

<sup>332</sup> Commission Regulation 23.105(k) requires a nonbank SD that has obtained approval from the Commission or NFA to use internal capital models to submit to the Commission and NFA each month information regarding its risk exposures, including VaR and credit risk exposure information when applicable. The model metrics are intended to provide the Commission and NFA with information that would assist with the ongoing oversight and assessment of internal market risk and credit risk models that have been approved for use by a nonbank SD. 17 CFR 23.105(k).

<sup>333</sup> Commission Regulation 23.105(l) requires each nonbank SD to provide information to the Commission and NFA regarding its counterparty credit concentration for the 15 largest exposures in derivatives, a summary of its derivatives exposures by internal credit ratings, and the geographic distribution of derivatives exposures for the 10 largest countries in Schedules 2, 3, and 4, respectively. 17 CFR 23.105(l).

<sup>334</sup> See NFA Financial Requirements, Section 17—Swap Dealer and Major Swap Participant Reporting Requirements, and Notice to Members—Monthly Risk Data Reporting for Swap Dealers (May 30, 2017).

nonbank SDs (including PRA-designated UK nonbank SDs) under NFA rules, provide the appropriate balance of recognizing the comparability of the UK PRA Financial Reporting Rules to the CFTC Financial Reporting Rules while also ensuring that the Commission and NFA receive sufficient data to monitor and assess the overall financial condition of PRA-designated UK nonbank SDs. The Commission has access to the monthly risk metric filings collected by NFA. In addition, the Commission retains authority to request PRA-designated UK nonbank SDs to provide information regarding their model metrics and counterparty exposures on an ad hoc basis.

Furthermore, the Commission notes that although the UK PRA Financial Reporting Rules do not contain an analogue to the CFTC's requirements for nonbank SDs to file monthly model metric information and counterparty exposures information, the PRA has access to comparable information. More specifically, under the UK PRA Financial Reporting Rules, the PRA has broad powers to request any information necessary for the exercise of its functions.<sup>335</sup> As such, the PRA has access to information allowing it to assess the ongoing performance of risk models and to monitor the PRA-designated UK nonbank SD's credit exposures, which may be comprised of credit exposures to primarily other UK and EU counterparties. In addition, the COREP reports, which PRA-designated UK nonbank SDs are required to file with the PRA on a quarterly basis, include information regarding the PRA-designated UK nonbank SD's risk exposure amounts, including risk-weighted exposure amounts for credit risk.<sup>336</sup>

The Commission invites public comment on its analysis above, including comment on the UK Application and relevant UK PRA Financial Reporting Rules. The Commission also invites comment on the proposed conditions listed above and on the Commission's proposal to exclude PRA-designated UK nonbank SDs from certain reporting requirements outlined above. Specifically, the Commission requests comment on its preliminary determination to not require PRA-designated UK nonbank SDs to submit the information set forth in Commission Regulations 23.105(k) and (l). Are there specific elements of

<sup>335</sup> See FSMA, Part XI (indicating that the PRA has broad information gathering powers).

<sup>336</sup> See PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 6 Templates and Instructions, Annex I.

the data required under Commission Regulations 23.105(k) and (l) that the Commission should require of PRA-designated UK nonbank SDs for purposes of monitoring model performance?

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

The Commission also requests specific comment regarding the setting of compliance dates for any new reporting obligations that the proposed Capital Comparability Determination Order would impose on PRA-designated UK nonbank SDs. In this connection, if the Commission were to require PRA-designated UK nonbank SDs to file the Margin Report discussed above and included in the proposed Order below, how much time would PRA-designated UK nonbank SDs need to develop new systems or processes to capture information that is required? Would PRA-designated UK nonbank SDs need a period of time to develop any systems or processes to meet any other reporting obligations in the proposed Capital Comparability Determination Order? If so, what would be an appropriate amount of time for a PRA-designated UK nonbank SD to develop and implement such systems or processes?

#### E. Notice Requirements

##### 1. CFTC Nonbank SD Notice Reporting Requirements

The CFTC Financial Reporting Rules require nonbank SDs to provide the Commission and NFA with written notice of certain defined events.<sup>337</sup> The notice provisions are intended to provide the Commission and NFA with an opportunity to assess whether the information contained in the notices indicates the existence of actual or potential financial and/or operational issues at a nonbank SD, and, when necessary, allows the Commission and NFA to engage the nonbank SD in an effort to minimize potential adverse impacts on swap counterparties and the larger swaps market. The notice provisions are part of the Commission's overall program for helping to ensure the safety and soundness of nonbank SDs and the swaps markets in general.

<sup>337</sup> 17 CFR 23.105(c).

The CFTC Financial Reporting Rules require a nonbank SD to provide written notice within specified timeframes if the firm is: (i) undercapitalized; (ii) fails to maintain capital at a level that is in excess of 120 percent of its minimum capital requirement; or (iii) fails to maintain current books and records.<sup>338</sup> A nonbank SD is also required to provide written notice if the firm experiences a 30 percent or more decrease in excess regulatory capital from its most recent financial report filed with the Commission.<sup>339</sup> A nonbank SD also is required to provide notice if the firm fails to post or collect initial margin for uncleared swap and non-cleared security-based swap transactions or exchange variation margin for uncleared swap and non-cleared security-based swap transactions as required by the Commission's uncleared swaps margin rules or the SEC's non-cleared security-based swaps margin rules, respectively, if the aggregate is equal to or greater than: (i) 25 percent of the nonbank SD's required capital under Commission Regulation 23.101 calculated for a single counterparty or group of counterparties that are under common ownership or control; or (ii) 50 percent of the nonbank SD's required capital under Commission Regulation 23.101 calculated for all of the firm's counterparties.<sup>340</sup>

The CFTC Financial Reporting Rules further require a nonbank SD to provide notice two business days prior to a withdrawal of capital by an equity holder that would exceed 30 percent of the firm's excess regulatory capital.<sup>341</sup> Finally, a nonbank SD that is dually-registered with the SEC as an SBSB or major security based swap participant ("MSBSP") must file a copy of any notice with the Commission and NFA that the SBSB or MSBSP is required to file with the SEC under SEC Rule 18a-8 (17 CFR 240.18a-8).<sup>342</sup> SEC Rule 18a-8 requires SBSBs and MSBSPs to provide written notice to the SEC for comparable reporting events as in the CFTC Capital Rule in Commission Regulation 23.105(c), including if a SBSB or MSBSP is undercapitalized or fails to maintain current books and records.

## 2. PRA-Designated UK Nonbank Swap Dealer Notice Requirements

The UK capital and resolution frameworks require PRA-designated UK nonbank SDs to provide certain notices

to the PRA concerning the firm's compliance with relevant laws and regulations. Specifically, the UK PRA Financial Reporting Rules require a PRA-designated UK nonbank SD to provide notice to the PRA within five business days if the firm fails to meet its combined buffer requirement, which at a minimum consists of a capital conservation buffer of 2.5 percent of the PRA-designated UK nonbank SD's total risk exposure amount.<sup>343</sup> As noted earlier, to meet its capital buffer requirements, a PRA-designated UK nonbank SDs must hold common equity tier 1 capital in addition to the minimum common equity tier 1 ratio requirement of 4.5 percent of the firm's core capital requirement of 8 percent of the firm's total risk exposure amount. The notice to the PRA must be accompanied by a capital conservation plan that sets out how the PRA-designated UK nonbank SD will restore its capital levels.<sup>344</sup> The capital conservation plan is required to include: (i) the "maximum distributable amount" calculated in accordance with the PRA rules; (ii) estimates of income and expenditures and a forecast balance sheet; (iii) measures to increase the capital ratios of the PRA-designated UK nonbank SD; and (iv) a plan and timeframe for the increase in the capital of the PRA-designated UK nonbank SD with the objective of meeting fully the combined buffer requirement.<sup>345</sup>

The PRA assesses the capital conservation plan and will approve the plan only if it considers that the plan would be reasonably likely to conserve or raise sufficient capital to enable the PRA-designated UK nonbank SD to meet its combined capital buffer requirement within a timeframe that the PRA considers to be appropriate.<sup>346</sup> A PRA-designated UK nonbank SD is required to notify the PRA as early as possible where it has identified a material risk to its ability to meet the combined buffer according to the capital conservation

<sup>343</sup> PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 4 Capital Conservation Measures, Rule 4.4. The combined capital buffer requirement is the total common equity tier 1 capital required to meet the sum of the capital conservation buffer and the institution-specific countercyclical capital buffer. PRA Rulebook, Capital Buffers Part, Chapter 1 Application and Definitions, Rule 1.2.

<sup>344</sup> PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 4 Capital Conservation Measures, Rules 4.4 and 4.5.

<sup>345</sup> PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 4 Capital Conservation Measures, Rule 4.5.

<sup>346</sup> Supervisory Statement SS6/14 Implementing Capital Buffers, Prudential Regulation Authority, January 2021 ("SS6/14"), available here: <https://www.bankofengland.co.uk/prudential-regulation/publication/2014/implementing-crdiv-capital-buffers-ss>.

plan and timeframe approved by the PRA.<sup>347</sup>

In addition, a PRA-designated UK nonbank SD must notify the PRA if the firm's management considers that the firm is failing or will in the near future fail to satisfy one or more of the "threshold conditions," which are the minimum requirements that a PRA-designated UK nonbank SD must meet in order to be permitted to carry the regulated activities in which it engages.<sup>348</sup> In broad terms, the PRA's threshold conditions include, among other things, requirements that the firm has appropriate financial resources and capacity to measure, monitor and manage risks.<sup>349</sup>

## 3. Commission Analysis

The Commission has reviewed the UK Application and the relevant UK laws and regulations, and has preliminarily determined that the UK PRA Financial Reporting Rules related to notice provisions, subject to the conditions specified below, are comparable to the notice provisions of the CFTC Financial Reporting Rules. The Commission is therefore proposing to issue a Capital Comparability Determination Order providing that a PRA-designated UK nonbank SD may comply with the notice provisions required under UK laws and regulations in lieu of certain notice provisions required of nonbank SDs under Commission Regulation 23.105(c),<sup>350</sup> subject to the conditions set forth below.

The notice provisions contained in Commission Regulation 23.105(c) are intended to provide the Commission and NFA with information in a prompt manner regarding actual or potential financial or operational issues that may adversely impact the safety and soundness of a nonbank SD by impairing the firm's ability to meet its obligations to counterparties, creditors, and the general swaps market. Upon the receipt of a notice from a nonbank SD under Commission Regulation 23.105(c), the Commission and NFA initiate reviews of the facts and circumstances that resulted in the notice being filed including, as appropriate, communicating with personnel of the nonbank SD. The review of the facts and the interaction with the personnel of the nonbank SD provide the Commission and NFA with information to develop an assessment of whether it is necessary for the nonbank SD to take remedial

<sup>347</sup> See *id.*

<sup>348</sup> PRA Rulebook, CRR Firms, Notifications Part, Chapter 8 Specific Notifications, Rule 8.3.

<sup>349</sup> FSMA, Part 4A and Schedule 6.

<sup>350</sup> 17 CFR 23.105(c).

<sup>338</sup> 17 CFR 23.105(c)(1), (2), and (3).

<sup>339</sup> 17 CFR 23.105(c)(4).

<sup>340</sup> 17 CFR 23.105(c)(7).

<sup>341</sup> 17 CFR 23.105(c)(5).

<sup>342</sup> 17 CFR 23.105(c)(6).

action to address potential financial or operational issues, and whether the remedial actions instituted by the nonbank SD properly address the issues that are the root cause of the operational or financial issues. Such actions may include the infusion of additional capital into the firm, or the development and implementation of additional internal controls to address operational issues. The notice filings further allow the Commission and NFA to monitor the firm's performance after the implementation of remedial actions to assess the effectiveness of such actions.

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

The Commission has preliminarily determined that the requirement for a PRA-designated UK nonbank SD to provide notice of a breach of its capital buffer requirements to the PRA is not sufficiently comparable in purpose and effect to the CFTC notice provisions contained in Commission Regulation 23.105(c)(1) and (2),<sup>351</sup> which require a nonbank SD to provide notice to the Commission and to NFA if the firm fails to meet its minimum capital requirement or if the firm's regulatory capital falls below 120 percent of its minimum capital requirement ("Early Warning Level"). The requirement for a PRA-designated UK nonbank SD to provide notice of a breach of its capital buffer requirements does not achieve a comparable outcome to the CFTC's Early Warning Level requirement due to the difference in the thresholds triggering a notice requirement in the respective rule sets.

The requirement for a nonbank SD to file notice with the Commission and NFA if the firm becomes undercapitalized or if the firm experiences a decrease of excess regulatory capital below defined levels is a central component of the Commission's and NFA's oversight

program for nonbank SDs.<sup>352</sup> Therefore, the Commission preliminarily believes that it is necessary for the Commission and NFA to receive copies of notices filed under the Capital Buffers Part of the PRA Rulebook by PRA-designated UK nonbank SDs alerting the PRA of a breach of the PRA-designated UK nonbank SD's combined capital buffer. The notice must be filed by the PRA-designated UK nonbank SD within 24 hours of the filing of the notice with the PRA, and the Commission expects that, upon the receipt of a notice, Commission staff and NFA staff will engage with staff of the PRA-designated UK nonbank SD to obtain an understanding of the facts that led to the filing of the notice and will discuss with the PRA-designated UK nonbank SD the firm's capital conservation plan. The proposed condition would not require the PRA-designated UK nonbank SD to file copies of its capital conservation plan with the Commission or NFA. To the extent Commission staff needs further information from the PRA-designated UK nonbank SD, the Commission expects to request such information as part of its assessment of the notice and its communications with the PRA-designated UK nonbank SD.

In addition, due to the lack of a sufficiently comparable analogue to the CFTC Financial Reporting Rules' Early Warning Level requirement, the Commission is proposing to condition the Capital Comparability Determination Order to require a PRA-designated UK nonbank SD to file a notice with the Commission and NFA if the firm's capital ratio does not equal or exceed 12.6 percent.<sup>353</sup> The proposed condition would further require the PRA-designated UK nonbank SD to file the notice with the Commission and NFA within 24 hours of when the firm knows or should have known that its regulatory capital was below 120 percent of its minimum capital requirement. The timing requirement for

<sup>352</sup> See Commission Regulation 23.105(c)(4), which requires a nonbank SD to file notice with the Commission and NFA if it experiences decrease in excess capital of 30 percent or more from the excess capital reported in its last financial filing with the Commission. 17 CFR 23.105(c)(4).

<sup>353</sup> The Commission's proposed reporting level of 12.6 percent reflects the aggregate of the PRA-designated UK nonbank SD's core capital requirement of 8 percent and capital conservation buffer requirement of 2.5 percent, multiplied by a factor of 1.20. For purposes of the calculation, the Commission proposes that the 20 percent capital increase must be comprised of common equity tier 1 capital (*i.e.*, common equity tier 1 capital must comprise a minimum of 8.4 percent, which reflects the aggregate of the 4.5 percent core common equity tier 1 capital requirement and the 2.5 percent capital conservation buffer requirement, multiplied by a factor of 1.20).

the filing of the proposed notice with the Commission and NFA is consistent with the Commission's requirements for an FCM or a nonbank SD, which are both required to file an Early Warning Level notice with the Commission and NFA when the firm knows or should have known that its regulatory capital is below specified reporting levels.<sup>354</sup> The requirement for a firm to file a notice with the Commission when it knows or should have known that its capital is below the reporting level is designed to prevent a situation where a firm's deficient recordkeeping leads to an inadequate monitoring of the Early Warning Level threshold. More generally, the "should have known" part of the timing standard for the filing of the proposed notice is intended to cover facts and circumstances that should reasonably lead the firm to believe that its regulatory capital is below 120 percent of the minimum requirement.<sup>355</sup> In practice, even if the PRA-designated UK nonbank SD's books and records do not reflect a decrease of regulatory capital below 120 percent of the minimum requirement or if the computations that may reveal a decrease of regulatory capital below 120 percent have not been made yet, the firm would be expected to provide notice if it became aware of deficiencies in its recordkeeping processes that could result in inaccurate recording of the firm's capital levels or if it had other reasons to believe its regulatory capital is below the Early Warning Level threshold.<sup>356</sup>

As noted above, a purpose of the proposed Early Warning Level notice provision is to allow the Commission and NFA to initiate conversations and fact finding with a registrant that may be experiencing operational or financial issues that may adversely impact the firm's ability to meet its obligations to

<sup>354</sup> 17 CFR 1.12(b) and 17 CFR 23.105(c)(ii)(2).

<sup>355</sup> This interpretation is consistent with the Commission's discussion of the timing standard in the preamble to the 1998 final rule adopting amendments to Commission Regulation 1.12, where the Commission noted that the part of the standard requiring an FCM to report when it "should know" of a problem may be defined as the point at which a party, in the exercise of reasonable diligence, should become aware of an event. See 63 FR 45711 at 45713.

<sup>356</sup> To that point, in discussing the standard applicable to the timing requirement for the filing of a notice by an FCM to report an undersegregated or undersecured condition (*i.e.*, situation where the FCM has insufficient funds in accounts segregated for the benefit of customers trading on U.S. contract markets or has insufficient funds set aside for customers trading on non-U.S. markets to meet the FCM's obligations to its customers), the Commission noted that an obligation to file a notice could arise even before the required computations that would reveal deficiencies must be made. See *id.*

<sup>351</sup> 17 CFR 23.105(c)(1) and (2).

market participants, including customers or swap counterparties. The notice filing is a central component of the Commission's and NFA's oversight program, and the Commission believes that a firm that is experiencing operational challenges that prevent the firm from definitively computing its capital level during a period when it recognizes from the facts and circumstances that the firm's capital level may be below the reporting threshold should file the notice with the Commission and NFA. Therefore, the Commission preliminarily deems it appropriate to include a similar early warning notice condition in the Capital Comparability Determination Order.

The UK PRA Financial Reporting Rules also do not contain an explicit requirement for a PRA-designated UK nonbank SD to notify the PRA if the firm fails to maintain current books and records, experiences a decrease in regulatory capital over levels previously reported, or fails to collect or post initial margin with uncleared swap counterparties that exceed certain threshold levels.<sup>357</sup> The UK PRA Financial Reporting Rules also do not require a PRA-designated UK nonbank SD to provide the PRA with advance notice of equity withdrawals initiated by equity holders that exceed defined amounts or percentages of the firm's excess regulatory capital.<sup>358</sup>

To ensure that the Commission and NFA receive prompt information concerning potential operational or financial issues that may adversely impact the safety and soundness of a PRA-designated UK nonbank SD, the Commission is proposing to condition the Capital Comparability Determination Order to require PRA-designated UK nonbank SDs to file certain notices required under the CFTC Financial Reporting Rules with the Commission and NFA. In this connection, the Commission is proposing to condition the Capital Comparability Determination Order on a PRA-designated UK nonbank SD providing the Commission and NFA with notice if the firm fails to maintain current books and records with respect to its financial condition and financial reporting requirements. For avoidance of doubt, in this context the Commission believes that books and records would include current ledgers

or other similar records which show or summarize, with appropriate references to supporting documents, each transaction affecting the PRA-designated UK nonbank SD's asset, liability, income, expense, and capital accounts in accordance with the accounting principles accepted by the relevant authorities.<sup>359</sup> The Commission preliminarily believes that the maintenance of current books and records is a fundamental and essential component of operating as a registered nonbank SD and that the failure to comply with such a requirement may indicate an inability of the firm to promptly and accurately record transactions and to ensure compliance with regulatory requirements, including regulatory capital requirements. Therefore, the proposed Order would require a PRA-designated UK nonbank SD to provide the Commission and NFA with a written notice within 24 hours if the firm fails to maintain books and records on a current basis.

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

minimum capital requirement. The Commission is proposing to require this notice so that it and the NFA may commence communication with the PRA-designated UK nonbank SD and the PRA in order to obtain an understanding of the facts that have led to the failure to exchange material amounts of initial margin and variation margin in accordance with the applicable margin rules, and to assess whether there is a concern regarding the financial condition of the firm that may impair its ability to meet its financial obligations to customers, counterparties, creditors, and general market participants, or otherwise adversely impact the firm's safety and soundness.

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

The proposed Capital Comparability Determination Order would require a PRA-designated UK nonbank SD to file any notices required under the Order with the Commission and NFA reflecting any balances, where applicable, in U.S. dollars. Each notice required by the proposed Capital Comparability Determination Order must be filed in accordance with instructions issued by the Commission or NFA.<sup>360</sup>

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

The Commission requests comment on the timeframes set forth in the proposed conditions for PRA-designated UK nonbank SDs to file notices with the Commission and NFA. In this regard,

<sup>360</sup> The proposed conditions for PRA-designated UK nonbank SDs to file a notice with the Commission and NFA if the firm fails to maintain current books and records or fails to collect or post margin with uncleared swap counterparties that exceed the above-referenced threshold levels are consistent with the proposed conditions in the proposed Capital Comparability Determination Orders for Japan, Mexico, and the EU. See Proposed Japan Order, Proposed Mexico Order, and Proposed EU Order.

<sup>357</sup> 17 CFR 23.105(c)(3), (4), and (7).

<sup>358</sup> Commission Regulation 23.105(c)(5) requires a nonbank SD to provide written notice to the Commission and NFA two business days prior to the withdrawal of capital by action of the equity holders if the amount of the withdrawal exceeds 30 percent of the nonbank SD's excess regulatory capital. 17 CFR 23.105(c)(5).

<sup>359</sup> For comparison, see Commission Regulation 23.105(b), which similarly defines the term "current books and records" as used in the context of the Commission's requirements. 17 CFR 23.105(b).

the proposed conditions would require PRA-designated UK nonbank SDs to file certain written notices with the Commission within 24 hours of the occurrence of a reportable event or of being alerted to a reportable event by the PRA. The Commission requests comment on the issues PRA-designated UK nonbank SDs may face meeting the filing requirements given time-zone difference or governance issues. The Commission also requests specific comment regarding the setting of compliance dates for the notice reporting conditions that the proposed Capital Comparability Determination Order would impose on PRA-designated UK nonbank SDs.

#### F. Supervision and Enforcement

##### 1. Commission and NFA Supervision and Enforcement of Nonbank SDs

The Commission and NFA conduct ongoing supervision of nonbank SDs to assess their compliance with the CEA, Commission regulations, and NFA rules by reviewing financial reports, notices, risk exposure reports, and other filings that nonbank SDs are required to file with the Commission and NFA. The Commission and/or NFA also conduct periodic examinations as part of the supervision of nonbank SDs, including routine onsite examinations of nonbank SDs' books, records, and operations to ensure compliance with CFTC and NFA requirements.<sup>361</sup>

As noted in Section D.1. above, financial reports filed by a nonbank SD provide the Commission and NFA with information necessary to ensure the firm's compliance with minimum capital requirements and to assess the firm's overall safety and soundness and its ability to meet its financial obligations to customers, counterparties, and creditors. A nonbank SD is also required to provide written notice to the Commission and NFA if certain defined events occur, including that the firm is undercapitalized or maintains a level of capital that is less than 120 percent of the firm's minimum capital requirements.<sup>362</sup> The notice provisions, as stated in Section E.1. above, are intended to provide the Commission and NFA with information of potential issues at a nonbank SD that may impact the firm's ability to maintain

compliance with the CEA and Commission regulations. The Commission and NFA also have the authority to require a nonbank SD to provide any additional financial and/or operational information on a daily basis or at such other times as the Commission or NFA may specify to monitor the safety and soundness of the firm.<sup>363</sup>

The Commission also has authority to take disciplinary actions against a nonbank SD for failing to comply with the CEA and Commission regulations. Section 4b-1(a) of the CEA<sup>364</sup> provides the Commission with exclusive authority to enforce the capital requirements imposed on nonbank SDs adopted under section 4s(e) of the CEA.<sup>365</sup>

##### 2. PRA's Supervision and Enforcement of PRA-Designated UK Nonbank SDs

The PRA has supervision, audit, and investigation powers with respect to PRA-designated UK nonbank SDs, which include the powers to obtain specified information reasonably required in connection with the exercise of the PRA's functions, the power to conduct or order investigations, and the power to impose sanctions on PRA-designated UK nonbank SDs that breach their regulatory obligations, including those deriving from the UK PRA Capital Rules and the UK PRA Financial Reporting Rules.<sup>366</sup>

The PRA also monitors the capital adequacy of PRA-designated UK nonbank SDs through supervisory measures on an ongoing basis. The monitoring includes assessing the notices and the capital conservation plan discussed in Section E.2. above. In addition, the PRA is empowered with a variety of measures to address a PRA-designated UK nonbank SD's financial deterioration.<sup>367</sup> Under its general supervisory powers, the PRA may impose new requirements to a PRA-designated UK nonbank SD if the firm is failing, or likely to fail, to satisfy the threshold conditions for which the PRA is responsible.<sup>368</sup> More specifically, a breach in a PRA-designated UK nonbank SD's capital buffers automatically triggers restrictions on the firm's ability to make certain

distributions (e.g., pay certain dividends or employee bonuses).<sup>369</sup> In addition, 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.<sup>370</sup>

In case of non-compliance with the capital and liquidity thresholds, the PRA may also order PRA-designated UK nonbank SDs to comply with additional requirements, including: (i) maintaining additional capital in excess of the minimum requirements, if certain conditions are met; (ii) requiring that the PRA-designated UK nonbank SD submit a plan to restore compliance with applicable capital or liquidity thresholds; (iii) imposing restrictions on the business or operations of the PRA-designated UK nonbank SD; (iv) imposing restrictions or prohibitions on distributions or interest payments to shareholders or holders of additional tier 1 capital instruments; (v) requiring additional or more frequent reporting requirements; and (vi) imposing additional specific liquidity requirements.<sup>371</sup> The PRA may also sanction the PRA-designated UK nonbank SD if the firm's capital or liquidity fall below the applicable thresholds or the PRA has evidence that the firm will breach such thresholds in the next 12 months.<sup>372</sup> The PRA may also withdraw a PRA-designated UK nonbank SD's authorization if the firm no longer meets its minimum capital requirements.<sup>373</sup>

In addition, if the capital and liquidity requirements are breached, the PRA may take early measures to intervene, such as requiring management to take certain actions, order members of management to be removed or replaced, or require changes to the firm's business strategy or legal or

<sup>369</sup> See PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 4 Capital Conservation Measures, Rule 4.3.

<sup>370</sup> See Capital Requirements Regulations 2013, Regulation 35B and FSMA, Part XIV Disciplinary Measures (setting forth the PRA's disciplinary power with respect to all rules adopted under FSMA). The Applicants represented that "CRR rules" (i.e., general PRA rules applying to CRR firms, including PRA-designated UK nonbank SDs) are adopted pursuant to FSMA, Part 9D, and as such the PRA has power to impose disciplinary measures in connection with these rules. See Response to Staff Questions dated October 5, 2023.

<sup>371</sup> FSMA, Parts 4A, Sections 55M and 55P, and Capital Requirements Regulation 2013, Regulation 35B.

<sup>372</sup> FSMA, Parts 4A and XIV.

<sup>373</sup> FSMA, Part 4A, Sections 55J-55K.

<sup>363</sup> See 17 CFR 23.105(h).

<sup>364</sup> 7 U.S.C. 6b-1(a).

<sup>365</sup> 7 U.S.C. 6s(e).

<sup>366</sup> FSMA, Parts 4A, XI, and XIV.

<sup>367</sup> See PRA, *The Prudential Regulation Authority's approach to banking supervision*, July 2023, available at: <https://www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors>.

<sup>368</sup> FSMA, Part 4A, Section 55M.

<sup>361</sup> Section 17(p)(2) of the CEA requires NFA as a registered futures association to establish minimum capital and financial requirements for non-bank SDs and to implement a program to audit and enforce compliance with such requirements. 7 U.S.C. 21(p)(2). Section 17(p)(2) further provides that NFA's capital and financial requirements may not be less stringent than the capital and financial requirements imposed by the Commission.

<sup>362</sup> See 17 CFR 23.105(c).



operational structure, among other measures.<sup>374</sup>

Although the PRA generally has broad discretion as to what powers it may exercise, the UK PRA Capital Rules and the UK PRA Financial Reporting Rules specifically mandate that the PRA require PRA-designated UK nonbank SDs to hold increased capital when: (i) risks or elements of risks are not covered by the capital requirements imposed by the UK PRA Capital Rules; (ii) the PRA-designated UK nonbank SD lacks robust governance arrangements, appropriate resolution and recovery plans, processes to manage large exposures or effective processes to maintain on an ongoing basis the amounts, types, and distribution of capital needed to cover the nature and level of risks to which they might be exposed; or (iii) the sole application of other administrative measures would be unlikely to timely and sufficiently improve the firm's arrangements and processes.<sup>375</sup>

### 3. Commission Analysis

Based on the above, the Commission preliminarily finds that the PRA has the necessary powers to supervise, investigate, and discipline PRA-designated UK nonbank SDs for compliance with the applicable capital, financial and reporting requirements, and to detect and deter violations of, and ensure compliance with, the applicable capital and financial reporting requirements in the UK.

The Commission would expect to communicate and consult, to the fullest extent permissible under applicable law, with the PRA regarding the supervision of the financial and operational condition of the PRA-designated UK nonbank SDs. An appropriate MOU or similar arrangement with the PRA would facilitate cooperation and information sharing in the context of supervising the PRA-designated UK nonbank SDs. Such an arrangement would enhance communication with respect to entities within the arrangement's scope ("Covered Firms"), as appropriate,

<sup>374</sup> Bank Recovery and Resolution (No. 2) Order 2014, Article 2 (defining "conditions for early intervention" in case of breach of UK CRR requirements or requirements derived from CRD) and Part 8 (laying down the procedure to be followed by the PRA to determine whether early intervention measures should be taken under FSMA). If additional requirements are met, it is also possible that the Bank of England, as the resolution authority, may assess the PRA-designated UK nonbank SD as "failing or likely to fail," triggering a resolution action, which could occur even before the firm actually breached its minimum capital requirements. Banking Act 2009, Sections 4 to 83.

<sup>375</sup> Capital Requirements Regulation 2013, Section 34.

regarding: (i) general supervisory issues, including regulatory, oversight, or other related developments; (ii) issues relevant to the operations, activities, and regulation of Covered Firms; and (iii) any other areas of mutual supervisory interest, and would anticipate periodic meetings to discuss relevant functions and regulatory oversight programs. The arrangement would provide for the Commission and the PRA to inform each other of certain events, including any material events that could adversely impact the financial or operational stability of a Covered Firm, and would provide a procedure for any on-site examinations of Covered Firms.

In the absence of an MOU or similar information sharing arrangement, the Commission is proposing to condition the Capital Comparability Determination Order on a PRA-designated UK nonbank SD providing notice to the Commission and NFA if the PRA has required the PRA-designated UK nonbank SD to: (i) maintain additional capital in excess of the minimum requirements; (ii) require that the PRA-designated UK nonbank SD submit a plan to restore compliance with applicable capital or liquidity thresholds; (iii) impose restrictions on the business or operations of the PRA-designated UK nonbank SD; (iv) impose restrictions or prohibitions on distributions or interest payments to shareholders or holders of additional tier 1 capital instruments; (v) require additional or more frequent reporting requirements; or (vi) impose additional specific liquidity requirements.<sup>376</sup> Upon receipt of such notice, the Commission and NFA would communicate with the PRA-designated UK nonbank SD to obtain further information regarding the underlying issues that prompted the PRA to direct the PRA-designated UK nonbank SD to take such actions and would obtain information regarding how the PRA-designated UK nonbank SD would address the underlying issues.

The Commission invites public comment on the UK Application, the UK laws and regulations, and the Commission's analysis above regarding its preliminary determination that the PRA and the CFTC have supervision programs and enforcement authority that are comparable in that the purpose of the relevant programs and authority is to ensure that nonbank SDs maintain

<sup>376</sup> PRA's authority to impose such conditions or requirements is set forth in FSMA, Part 4A, Sections 55M and 55P, and Capital Requirements Regulation 2013, Regulation 35B.

compliance with applicable capital and financial reporting requirements.

## IV. Proposed Capital Comparability Determination Order

### A. Commission's Proposed Comparability Determination

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

Furthermore, the proposed Capital Comparability Determination Order is limited to the comparison of the UK PRA Capital Rules to the Bank-Based Approach contained within the CFTC Capital Rules. As noted previously, the Applicants have not requested, and the Commission has not performed, a comparison of the UK PRA Capital Rules to the Commission's NAL Approach or TNW Approach. In addition, as discussed in Section I.C. above, due to the differences between the capital and financial reporting regimes applicable to PRA-designated UK nonbank SD and FCA-regulated UK nonbank SDs, the Commission anticipates assessing the comparability of the rules applicable to FCA-regulated UK nonbank SDs through a separate capital comparability determination.

### B. Proposed Capital Comparability Determination Order

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

### C. Proposed Order Providing Conditional Capital Comparability Determination for PRA-Designated UK Nonbank Swap Dealers

It is hereby determined and ordered, pursuant to Commodity Futures Trading Commission ("CFTC" or "Commission") Regulation 23.106 (17 CFR 23.106) under the Commodity Exchange Act ("CEA") (7 U.S.C. 1 *et seq.*) that a swap dealer ("SD") subject to the Commission's capital and financial reporting requirements under sections 4s(e) and (f) of the CEA (7 U.S.C. 6s(e) and (f)), that is organized and domiciled in the United Kingdom ("UK") and designated for prudential supervision by the UK Prudential Regulation Authority ("PRA"), may satisfy the capital requirements under section 4s(e) of the CEA and Commission Regulation 23.101(a)(1)(i) (17 CFR 23.101(a)(1)(i)) ("CFTC Capital Rules"), and the financial reporting rules under section 4s(f) of the CEA and Commission Regulation 23.105 (17 CFR 23.105) ("CFTC Financial Reporting Rules"), by complying with certain specified requirements of the UK laws and regulations cited below and otherwise complying with the following conditions, as amended or superseded from time to time:

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

(2) The SD is organized under the laws of the UK and is domiciled in the UK;

(3) The SD is licensed as an investment firm in the UK and is designated for prudential supervision by the PRA ("PRA-designated UK nonbank SD");

(4) The PRA-designated UK nonbank SD is subject to and complies with: *Regulation (EU) No 575/2013 of the European Parliament and of the Council*

*of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012 as restated and applicable in the UK ("UK CRR"), the provisions implementing the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC ("CRD"), including Capital Requirements Regulations 2013 and Capital Requirements (Capital Buffers and Macro-prudential Measures) Regulations 2014, Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions ("Liquidity Coverage Delegated Regulation"), the Banking Act 2009 and its secondary legislation, and the rules of the PRA as reflected in the PRA Rulebook (collectively the "UK PRA Capital Rules");*

(5) The PRA-designated UK nonbank SD satisfies at all times applicable capital ratio and leverage ratio requirements set forth in Article 92 of UK CRR and the rules in PRA Rulebook, CRR Firms, Leverage Ratio—Capital Requirements and Buffers Part, Chapter 3 Minimum Leverage Ratio, the capital conservation buffer requirements set forth in PRA Rulebook, CRR Firms, Capital Buffers Part, and applicable liquidity requirements set forth in PRA Rulebook, CRR Firms, Liquidity Coverage Requirement—UK Designated Investment Firms Part and PRA Rulebook, CRR Firms, Liquidity (CRR) Part, and otherwise complies with the requirements to maintain a liquidity risk management program as required under PRA Rulebook, CRR Firms, Internal Liquidity Adequacy Assessment Part;

(6) The PRA-designated UK nonbank SD is subject to and complies with: Reporting (CRR) and Regulatory Reporting parts of the PRA Rulebook and the Companies Act 2006, Parts 15 and 16 (collectively and together with UK CRR, the "UK PRA Financial Reporting Rules");

(7) The PRA-designated UK nonbank SD maintains at all times an amount of regulatory capital in the form of common equity tier 1 capital as defined in Article 26 of UK CRR, equal to or in excess of the equivalent of \$20 million in United States dollars ("U.S. dollars"). The PRA-designated UK nonbank SD shall use a commercially reasonable and observable British pound/U.S. dollar exchange rate to convert the value of the

pound-denominated common equity tier 1 capital to U.S. dollars;

(8) The PRA-designated UK nonbank SD has filed with the Commission a notice stating its intention to comply with the UK PRA Capital Rules and the UK PRA Financial Reporting Rules in lieu of the CFTC Capital Rules and the CFTC Financial Reporting Rules. The notice of intent must include the PRA-designated UK nonbank SD's representation that the firm is organized and domiciled in the UK, is a licensed investment firm designated for prudential supervision by the PRA, and is subject to, and complies with, the UK PRA Capital Rules and UK PRA Financial Reporting Rules. A PRA-designated UK nonbank SD may not rely on this Capital Comparability Determination Order until it receives confirmation from Commission staff, acting pursuant to authority delegated by the Commission, that the PRA-designated UK nonbank SD may comply with the applicable UK PRA Capital Rules and UK PRA Financial Reporting Rules in lieu of the CFTC Capital Rules and CFTC Reporting Rules. Each notice filed pursuant to this condition must be submitted to the Commission via email to the following address:

*MPDFinancialRequirements@cftc.gov;*

(9) The PRA-designated UK nonbank SD prepares and keeps current ledgers and other similar records in accordance with the PRA Rulebook, General Organisational Requirements Part, Rule 2.2 and Record Keeping Part, Rule 2.1 and 2.2, and conforming with the applicable accounting principles;

(10) The PRA-designated UK nonbank SD files with the Commission and with the National Futures Association ("NFA") a copy of templates 1.1 (Balance Sheet Statement: assets), 1.2 (Balance Sheet Statement: liabilities), 1.3 (Balance Sheet Statement: equity), and 2 (Statement of profit or loss) of the financial reports ("FINREP") that PRA-designated UK nonbank SDs are required to submit pursuant to PRA Rulebook, CRR Firms, Regulatory Reporting Part, Chapter 9 Regulatory Activity Group 3, Rule 9.2, and templates 1 (Own Funds), 2 (Own Funds Requirements) and 3 (Capital Ratios) of the common reports ("COREP") that PRA-designated UK nonbank SDs are required to submit pursuant to PRA Rulebook, CRR Firms, Reporting (CRR) Part, Chapter 4 Reporting (Part Seven A CRR), Article 430 Reporting on Prudential Requirements and Financial Information, Rule 1. The FINREP and COREP templates must be provided with balances converted to U.S. dollars and must be filed with the Commission

and NFA within 35 calendar days of the end of each month. PRA-designated UK nonbank SDs that are registered as security-based swap dealers (“SBSDs”) with the U.S. Securities and Exchange Commission (“SEC”) may comply with this condition by filing with the Commission and NFA a copy of Form X-17A-5 (“FOCUS Report”) that the PRA-designated UK nonbank SD is required to file with the SEC or its designee pursuant to an order granting conditional substituted compliance with respect to Securities Exchange Act of 1934 Rule 18a-7. The copy of the FOCUS Report must be filed with the Commission and NFA within 35 calendar days after the end of each month in the manner, format and conditions specified by the SEC in Order Specifying the Manner and Format of Filing Unaudited Financial and Operational Information by Security-Based Swap Dealers and Major Security-Based Swap Participants that are not U.S. Persons and are Relying on Substituted Compliance with Respect to Rule 18a-7, 86 FR 59208 (Oct. 26, 2021);

(11) The PRA-designated UK nonbank SD files with the Commission and with NFA a copy of its annual audited accounts and strategic report (together, “annual audited financial report”) that are required to be prepared and published pursuant to Parts 15 and 16 of Companies Act 2006. The annual audited financial report may be reported in British pound. The annual audited financial report must be filed with the Commission and NFA on the earlier of the date the report is filed with the PRA or the date the report is required to be filed with the PRA pursuant to the UK PRA Financial Reporting Rules;

(12) The PRA-designated UK nonbank SD files Schedule 1 of appendix B to subpart E of part 23 of the CFTC’s regulations (17 CFR 23 subpart E—appendix B) with the Commission and NFA on a monthly basis. Schedule 1 must be prepared with balances reported in U.S. dollars and must be filed with the Commission and NFA within 35 calendar days of the end of each month;

(13) The PRA-designated UK nonbank SD submits with each set of FINREP and COREP templates, annual audited financial report, and Schedule 1 of appendix B to subpart E of part 23 of the CFTC’s regulations, a statement by an authorized representative or representatives of the PRA-designated UK nonbank SD that to the best knowledge and belief of the representative or representatives, the information contained in the reports, including the conversion of balances in

the reports to U.S. dollars, is true and correct;

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

(15) The PRA-designated UK nonbank SD files a notice with the Commission and NFA within 24 hours of being informed by the PRA that the firm is not in compliance with any component of the UK PRA Capital Rules or the UK PRA Financial Reporting Rules;

(16) The PRA-designated UK nonbank SD files a notice within 24 hours with the Commission and NFA if it fails to maintain regulatory capital in the form of common equity tier 1 capital as defined in Article 26 of UK CRR, equal to or in excess of the U.S. dollar equivalent of \$20 million using a commercially reasonable and observable British pound/U.S. dollar exchange rate;

(17) The PRA-designated UK nonbank SD provides the Commission and NFA with notice within 24 hours of filing a capital conservation plan with the PRA pursuant to PRA Rulebook, CRR Firms, Capital Buffers Part, Chapter 4 Capital Conservation Measures, Rule 4.4, indicating that the firm has breached its combined capital buffer requirement;

(18) The PRA-designated UK nonbank SD provides the Commission and NFA with notice within 24 hours if it is required by the PRA to maintain additional capital or additional liquidity requirements, or to restrict its business operations, or to comply with other requirements pursuant to Financial Services and Markets Act 2000, Part 4A or the Capital Requirements Regulation 2013, Regulation 35B;

(19) The PRA-designated UK nonbank SD files a notice with the Commission and NFA within 24 hours if it fails to maintain its minimum requirement for own funds and eligible liabilities (“MREL”), if the PRA-designated UK nonbank SD is subject to such requirement as set forth by the Bank of England pursuant to the Banking Act 2009, Section 3A and the Bank Recovery and Resolution (No. 2) Order 2014, Part 9;

(20) The PRA-designated UK nonbank SD files a notice with the Commission and NFA within 24 hours of when the firm knew or should have known that its regulatory capital fell below 120 percent of its minimum capital requirement, comprised of the firm’s core capital requirements and any applicable capital buffer requirements.

For purposes of the calculation, the 20 percent excess capital must be in the form of common equity tier 1 capital;

(21) The PRA-designated UK nonbank SD files a notice with the Commission and NFA within 24 hours if it fails to make or keep current the financial books and records;

(22) The PRA-designated UK nonbank SD files a notice with the Commission and NFA within 24 hours of the occurrence of any of the following:

(i) A single counterparty, or group of counterparties under common ownership or control, fails to post required initial margin or pay required variation margin on uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 25 percent of the PRA-designated UK nonbank SD’s minimum capital requirement;

(ii) Counterparties fail to post required initial margin or pay required variation margin to the PRA-designated UK nonbank SD for uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 50 percent of the PRA-designated UK nonbank SD’s minimum capital requirement;

(iii) The PRA-designated UK nonbank SD fails to post required initial margin or pay required variation margin for uncleared swap and non-cleared security-based swap positions to a single counterparty or group of counterparties under common ownership and control that, in the aggregate, exceeds 25 percent of the PRA-designated UK nonbank SD’s minimum capital requirement; or

(iv) The PRA-designated UK nonbank SD fails to post required initial margin or pay required variation margin to counterparties for uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 50 percent of the PRA-designated UK nonbank SD’s minimum capital requirement;

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

(24) The PRA-designated UK nonbank SD or an entity acting on its behalf

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

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

Issued in Washington, DC, on January 29, 2024, by the Commission.

**Christopher Kirkpatrick,**  
*Secretary of the Commission.*

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

**Appendices to Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Subject to Capital and Financial Reporting Requirements of the United Kingdom and Regulated by the United Kingdom Prudential Regulation Authority—Commission Voting Summary, Chairman's Statement, and Commissioners' Statements**

**Appendix 1—Commission Voting Summary**

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

**Appendix 2—Statement of Support of Chairman Rostin Behnam**

I support the Commission's proposed order and request for comment on an application for a preliminary capital comparability determination on behalf of six nonbank swap dealers that are domiciled in the United Kingdom (UK) and registered with the CFTC. All six of these UK nonbank SDs are subject to, and comply with, the UK capital and financial reporting rules as implemented by the UK Prudential Regulation Authority, which the Commission has preliminarily

determined are comparable to certain capital and financial reporting requirements under the Commodity Exchange Act and the Commission's regulations, subject to certain conditions. This preliminary capital comparability determination for these UK nonbank SDs is the fourth proposed order and request for comment to come before the Commission since it adopted its substituted compliance framework for non-U.S. domiciled nonbank swap dealers in July 2020.

I greatly appreciate the work of staff in the Market Participant Division, the Office of the General Counsel, and the Office of International Affairs on this matter.

I look forward to reviewing the public's comments on the proposed rule. The 60-day comment period will begin upon the Commission's publication of the proposed rule on its website.

**Appendix 3—Statement of Support of Commissioner Kristin N. Johnson**

I support the Commodity Futures Trading Commission's (Commission or CFTC) issuance of the proposed conditional capital comparability determination order for comment (Proposed Comparability Determination) pursuant to Commission Regulation 23.106.<sup>1</sup> The Proposed Comparability Determination, if approved, will allow registered nonbank swap dealers (SDs) organized and domiciled in the United Kingdom (UK) and designated for prudential supervision by the UK Prudential Regulation Authority (PRA-designated non-bank SDs) to satisfy certain capital and financial reporting requirements under the Commodity Exchange Act (CEA) by complying with comparable capital and financial reporting requirements under UK laws and regulations.

It is imperative that we carefully review the capital and financial reporting requirements for PRA-designated non-bank SDs in a manner consistent with the Commission's mandate under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to ensure that foreign swap activities that have a "direct and significant" effect on U.S. markets are subject to regulatory requirements as sufficiently robust as our own.<sup>2</sup>

<sup>1</sup> The application here is by three trade associations (the Institute of International Bankers, the International Swaps and Derivatives Association, and the Securities Industry and Financial Markets Association). There are currently six PRA-designated non-bank SDs eligible to take advantage of a comparability determination, if the Commission approves the Proposed Comparability Determination. These six PRA-designated non-bank SDs include Citigroup Global Markets Limited, Goldman Sachs International, Merrill Lynch International, Morgan Stanley & Co. International Plc, MUFG Securities EMEA Plc, and Nomura International Plc.

<sup>2</sup> 7 U.S.C. 2(i). Section 2(i)(1) of the CEA applies the swaps provisions of both the Dodd-Frank Act and Commission regulations promulgated under those provisions to activities outside the United States that have a direct and significant connection with activities in, or effect on, commerce of the United States.

In 2010, the Dodd-Frank Act amended the CEA to create a new regulatory framework for swaps, including adding Section 2(i) to address the cross-border application of the CEA's swap provisions. In recognition of the value of global regulatory coordination in the swaps markets and international comity, the Commission in 2020 set out a framework for substituted compliance and comparability determinations for a given foreign jurisdiction that afforded "due consideration [to] international comity principles" while being "consistent with . . . the Commission's interest in focusing its authority on potential significant risks to the U.S. financial system."<sup>3</sup>

Sections 4s(e) and 4s(f) of the CEA instruct the Commission to impose capital requirements on non-bank SDs and financial condition reporting obligations on all registered SDs, which have been codified by the Commission.<sup>4</sup> These requirements aim to ensure the integrity of domestic and foreign entities operating in our markets, to facilitate the rapid identification and remediation of liquidity crises, and to mitigate the threat of systemic risks that may threaten the stability of domestic and global financial markets. As I previously stated:

The Commission's capital and financial reporting requirements adopted pursuant to these sections of the CEA are critical to ensuring the safety and soundness of our markets by addressing and managing risks that arise from a firm's operation as an SD. Ensuring necessary levels of capital, as well as accurate and timely reporting about financial conditions, helps to protect [SDs] and the broader financial markets ecosystem from shocks, thereby ensuring solvency and resiliency. This, in turn, protects the financial system as a whole, reducing the risk of contagion that could arise from uncleared swaps. Financial reporting requirements work with the capital requirements by allowing the Commission to monitor and assess an SD's financial condition, including compliance with minimum capital requirements. The Commission uses the information it receives pursuant to these requirements to detect potential risks before they materialize. Capital adequacy and financial reporting are pillars of risk management oversight for any business, and, for firms operating in our markets, it is of the utmost importance that rules governing these risk management tools are effectively calibrated, continuously assessed, and fit for purpose.<sup>5</sup>

<sup>3</sup> Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 FR 56924, 56924 (Sept. 14, 2020); see Capital Requirements of Swap Dealers and Major Swap Participants, 85 FR 57462 (Sept. 15, 2020).

<sup>4</sup> 7 U.S.C. 6s(e), (f); 17 CFR part 23, subpart E.

<sup>5</sup> Kristin N. Johnson, Commissioner, CFTC, Statement in Support of Notice and Order on EU Capital Comparability Determination (June 7, 2023), <https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement060723c>.

Systemic risks transcend national borders. Successful mitigation of systemic risks, therefore, requires careful, engaged collaboration.

I support acknowledging market participants' compliance with the laws and regulations of their UK regulator when the requirements lead to an outcome that is comparable to the outcome of complying with the CFTC's corresponding requirements. Mutual understanding and respect for partner regulators in other countries advances the Commission's goal of setting a global standard for sound derivatives regulation that both enhances market stability and is also deeply rigorous, reflecting the Commission's commitment to safe swaps markets.

As global standard setting authorities and federal prudential regulators refine and reinforce the regulatory framework for capital requirements globally, it will be important to ensure continued alignment among jurisdictions, as with the ongoing implementation of the Basel III capital framework (Basel III).

While prudential regulators continue to debate the implementation of a final set of regulations under Basel III, the Commission's capital comparability determinations closes a gap in our regulatory framework. Today's successful adoption of the Proposed Comparability Determination enables the Commission to deploy an enforceable regime immediately in the context of our UK-based registrants and is reflective of a desire to engage and harmonize regulation globally.

I commend the work of the staff of the Market Participants Division—Amanda Olear, Tom Smith, Rafael Martinez, Liliya Bozhanova, Joo Hong, and Justin McPhee, as well as the members of the Office of International Affairs—for their careful consideration of this application.

The Commission's efforts in considering the Proposed Comparability Determination reflect thoughtful evaluation of the comparability of relevant standards and an attempt to coordinate our efforts to bring transparency to the swaps market and reduce its risks to the public. I look forward to reviewing the comments that the Commission will receive in response to the Proposed Comparability Determination.

#### Appendix 4—Statement of Commissioner Christy Goldsmith Romero

Today [January 23, 2024], the Commission considers a proposal intended to safeguard the resilience of six swap dealers in the United Kingdom (“UK”) supervised by the Prudential Regulation Authority (“PRA”).<sup>1</sup> The proposal is part of the Commission's “substituted compliance” framework.

Substituted compliance must leave U.S. markets at no greater risk than full compliance with our rules. It is a framework that promotes global harmonization with

like-minded foreign regulators that have rules, supervision, and enforcement that are comparable in purpose and effect to the CFTC. Our capital rules are a critical pillar of the Dodd-Frank Act reforms, ones that continue to evolve with the risks that our financial system faces. We must ensure that our comparability assessments are sound and do not increase risk to U.S. markets.

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

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

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

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

The Commission has to proceed cautiously in making a substituted compliance determination given the importance of capital to financial stability and the complexity of capital frameworks. The Commission also has to consider the interconnected nature of global derivatives markets, and the speed of contagion in the global financial system.

Four of the swap dealers who would be able to avail themselves of our determination today are affiliated with the largest Troubled Asset Relief Program recipients. That fact alone is a good reminder of what is at stake in terms of risk. It is not just danger to financial institutions, but also American families and businesses. Under this proposal in addition to the Commission's three prior capital comparability proposals,<sup>5</sup> 16 of 106

registered swap dealers would be eligible to rely on substituted compliance.<sup>6</sup> We have a responsibility to ensure that our substituted compliance framework recognizes only those frameworks that are legitimately a *substitute* for the capital protections provided by U.S. law.

The fact that a foreign regulator may have comparable capital rules will not be enough on its own. We have to look beyond the four corners of rules. Substituted compliance requires a like-minded foreign regulator with comparable supervision and enforcement to the CFTC. The CFTC and the Prudential Regulation Authority (PRA) are already cooperating on supervision and oversight of clearinghouses.<sup>7</sup> The PRA also has a long history of regulatory and supervisory coordination with the U.S. banking regulators. I am cognizant that the PRA recently received a secondary mandate to promote the UK economy's international competitiveness and growth. The PRA issued a statement that it will only advance this mandate when it does not conflict with safety and soundness of regulated entities.<sup>8</sup> I expect our staff will continue to work closely with the PRA to understand how it will implement this mandate, and work with the PRA to safeguard the safety and soundness of non-bank swap dealers and the stability of our global financial system.

Our substituted compliance decisions should not allow for regulatory arbitrage for swap dealers to escape strong U.S. capital rules—a situation that could erode Dodd-Frank Act post-crisis reforms. Today's determination is grounded in the PRA's capital rules being comparable to the CFTC's “Bank-Based Capital Approach” to swap dealer capital requirements, which reflects requirements the Federal Reserve imposes for bank holding companies.

The Federal Reserve and other U.S. prudential banking regulators have proposed updates to the U.S. capital rules to implement international standards known as “Basel Endgame” or Basel 3.1.<sup>9</sup> The U.S.

Commodity Futures Trading Commission, *Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on behalf of Nonbank Swap dealers subject to Regulation by the Mexican Comision Nacional Bancaria y de Valores*, 87 FR 76374 (Dec. 13, 2022); see also *Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Domiciled in the French Republic and Federal Republic of Germany and Subject to Capital and Financial Reporting Requirements of the European Union*, 88 FR 41774 (June 27, 2023).

<sup>6</sup> 55 of the 107 swap dealers are subject to U.S. prudential regulatory capital requirements.

<sup>7</sup> See CFTC, CFTC and BoE Sign New MOU for Supervision of Cross-Border Clearing Organizations, <https://www.cftc.gov/PressRoom/PressReleases/8289-20> (Oct. 20, 2020).

<sup>8</sup> Prudential Regulation Authority, *The Prudential Regulation Authority's Approach to Policy*, DP4/22, <https://www.bankofengland.co.uk/prudential-regulation/publication/2022/september/prudential-approach-to-policy> (Sept. 2022).

<sup>9</sup> Federal Reserve System, *Federal Deposit Insurance Corporation, and Comptroller of the Currency, Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity*, 88 FR 64028 (Sept. 18, 2023).

<sup>2</sup> 7 U.S.C. 6s(e)(3)(A).

<sup>3</sup> 7 U.S.C. 6s(e)(3)(A)(i). The capital requirements also must “be appropriate to the risk associated with non-cleared swaps.” 7 U.S.C. 6s(e)(3)(A)(ii).

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

<sup>5</sup> See Commodity Futures Trading Commission, *Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination from the Financial Services Agency of Japan*, 87 FR 48092 (Aug. 8, 2022); see also

<sup>1</sup> The six swap dealers are Citigroup Global Markets Limited, Goldman Sachs International, Merrill Lynch International, Morgan Stanley & Co. International Plc, MUFG Securities EMEA Plc, and Nomura International Plc. The determination does not cover other UK nonbank swap dealers supervised by the Financial Conduct Authority.

updates are also informed by the failure of several banks in early 2023.<sup>10</sup> The current proposal includes proposed changes that could affect capital requirements for swap dealers subject to prudential regulation. I would expect the Commission to monitor these changes and update its own capital rules for swap dealers to remain harmonized with the U.S. prudential regulators. The PRA is also updating its capital requirements to implement the Basel standards.<sup>11</sup> As updates are finalized in the U.S. and globally, the Commission should review whether capital requirements imposed by jurisdictions with comparability determinations remain aligned with capital requirements imposed by other U.S. financial regulators and with the changes that the Commission makes to align its own capital requirements.

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

All six of the UK swap dealers are dual-registered with the U.S. Securities and Exchange Commission (“SEC”). The SEC has issued final comparability determination orders permitting them to satisfy certain SEC capital requirements through substituted compliance with applicable UK requirements.<sup>12</sup>

In conducting the CFTC’s own analysis, it is important to remember that substituted compliance is not an all-or-nothing proposition. The Commission retains examinations and enforcement authority and it can, should, and will, impose any conditions and take all actions appropriate to protect the safety and soundness of swap dealers and the U.S. financial system. Today, the Commission proposes 25 conditions, including conditions requiring capital

reporting and Commission notification that are essential to monitoring the financial condition and capital adequacy of swap dealers.

Just as with swap dealers in Japan, Mexico and the European Union,<sup>13</sup> one of the most important conditions is that the Commission will continue to require compliance with the CFTC’s minimum capital requirement of \$20 million in common equity tier 1 capital.<sup>14</sup> This is one of the most critical components of the CFTC’s capital requirements. It helps to ensure that each nonbank swap dealer, whether current or a future new entrant, maintains at all times, \$20 million of the highest quality capital to meet its financial obligations without becoming insolvent.

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

There are proposed deviations from the Commission’s bank-based capital requirements that should be closely scrutinized. Some of these deviations are similar to those raised by commenters to other proposed determinations.<sup>15</sup> For example, the Commission proposes to permit compliance with UK capital rules that are not necessarily anchored by a threshold percentage of uncleared swap margin as the CFTC requires. The proposed determination discusses that UK capital rules address liquidity, operational risks, as well as other risks arising from derivatives exposures, through other mechanisms. I look forward to public comment on the comparability of the approaches and expect the Commission to publish additional analysis to address concerns raised by commenters as part of any final determination.

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

<sup>10</sup> See Statement by Vice Chair for Supervision Michael S. Barr, <https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20230727.htm> (July 27, 2023) (“Additionally, following the banking turmoil in March 2023, the proposal seeks to further strengthen the banking system by applying a broader set of capital requirements to more large banks.”).

<sup>11</sup> Prudential Regulation Authority, PS17/23—Implementation of the Basel 3.1 standards near-final part 1, <https://www.bankofengland.co.uk/prudential-regulation/publication/2023/december/prudential-regulation-of-the-basel-3-1-standards-near-final-policy-statement-part-1> (Dec. 12, 2023).

<sup>12</sup> See *Order Granting Conditional Substituted Compliance in Connection with Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the United Kingdom*, 86 FR 43318 (July 30, 2021); *Amended and Restated Order Granting Conditional Substituted Compliance in Connection with Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the Federal Republic of Germany; Amended Orders Addressing Non-U.S. Security-Based Swap Entities Subject to Regulation in the French Republic or the United Kingdom; and Order Extending the Time to Meet Certain Conditions Relating to Capital and Margin*, 86 FR 59797 (Oct. 28, 2021); and *Order Specifying the Manner and Format of Filing Unaudited Financial and Operational Information by Security-Based Swap Dealers and Major Security-Based Swap Participants that are not U.S. Persons and are Relying on Substituted Compliance with Respect to Rule 18a–7*, 86 FR 59208 (Oct. 26, 2021).

<sup>13</sup> See CFTC Commissioner Christy Goldsmith Romero, *Proposal for Strong Capital Requirements and Financial Reporting for Swap Dealers in Japan*, <https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement072722b> (July 27, 2022); See also CFTC Commissioner Christy Goldsmith Romero, *Promoting the Resilience of Swap Dealers in Mexico Through Strong Capital Requirements and Financial Reporting*, <https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatment11022b> (Nov. 10, 2022); CFTC Commissioner Christy Goldsmith Romero, *Promoting the Resilience of Swap Dealers in Europe Through Strong Capital Requirements and Financial Reporting*, <https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatment060723e> (June 7, 2023).

<sup>14</sup> This CFTC capital rule substantially exceeds the EUR 5 million minimum capital required under EU capital rules.

<sup>15</sup> See *Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination Submitted on Behalf of Nonbank Swap Dealers Domiciled in the French Republic and Federal Republic of Germany and Subject to Capital and Financial Reporting Requirements of the European Union*, 88 FR 41774 (June 27, 2023) (Comment of Better Markets).

## Appendix 5—Statement of Support of Commissioner Caroline D. Pham

I support the Commission’s proposed order and request for comment on a comparability determination for nonbank swap dealers subject to capital and financial reporting requirements of the United Kingdom and regulated by the United Kingdom Prudential Regulation Authority (PRA). I would like to thank Justin McPhee, Joo Hong, Liliya Bozhanova, Rafael Martinez, Tom Smith, and Amanda Olear in the Market Participants Division (MPD) for their hard work on these technical and detailed requirements.

This proposal is the staff’s fourth proposed capital adequacy and financial reporting comparability determination.<sup>1</sup> Each involves significant engagement with the corresponding authority, in this case the UK Prudential Regulation Authority, as well as CFTC registrants. As I have previously said, the Commission, its staff, and our regulatory counterparts around the world need to adhere to the recommendations in IOSCO’s 2020 report on *Good Practices on Processes for Deference*, which was developed to provide solutions to the challenges and drivers of market fragmentation.<sup>2</sup> As set forth in the IOSCO 2020 report, such processes for deference<sup>3</sup> are typically outcomes-based; risk sensitive; transparent; cooperative; and sufficiently flexible.

I continue to stress that this work by CFTC staff creates the underpinnings of global markets that enable governments, central banks and commercial banks, asset managers and investors, and companies to manage the risks inherent in international flows of capital that fuel economic growth and prosperity in both developed and developing economies.<sup>4</sup> I am pleased to continue to support this work, and also encourage staff to finalize these proposals in 2024.

[FR Doc. 2024–02070 Filed 2–2–24; 8:45 am]

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<sup>1</sup> The prior three were for Japan, Mexico, and the EU. The Commission maintains its list of comparability determinations for substituted compliance purposes at <https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm>.

<sup>2</sup> Statement of Commissioner Caroline D. Pham in Support of Proposed Order and Request for Comment on Comparability Determination for EU Nonbank Swap Dealer Capital and Financial Reporting Requirements (June 9, 2023); IOSCO Report, “Good Practices on Processes for Deference” (June 2020).

<sup>3</sup> IOSCO uses “deference” as an “overarching concept to describe the reliance that authorities place on one another when carrying out regulation or supervision of participants operating cross-border.” *Id.* at 1. The CFTC’s use of substituted compliance for swaps regulation is an example of regulatory deference mechanisms.

<sup>4</sup> Statement of Commissioner Caroline D. Pham in Support of Proposed Order and Request for Comment on Comparability Determination for EU Nonbank Swap Dealer Capital and Financial Reporting Requirements (June 9, 2023); see also Concurring Statement of Commissioner Caroline D. Pham Regarding Proposed Swap Dealer Capital and Financial Reporting Comparability Determination (July 27, 2022); Concurring Statement of Commissioner Caroline D. Pham Regarding Proposed Order and Request for Comment on an Application for a Capital Comparability Determination (Nov. 10, 2022).