September 30, 2021

Chris Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Substituted Compliance Application for Japanese Swap Dealers from CEA Sections 4s(e)–(f) and Rules 23.101 and 23.105(d)–(e)

Dear Mr. Kirkpatrick:

We are submitting this application to request that the Commodity Futures Trading Commission ("Commission") make a determination that compliance with the capital, financial reporting and related requirements of Japan specified herein (the "Japanese Capital & Reporting Framework") by a nonbank swap dealer ("SD") registered as a Type I Financial Instruments Business Operator ("FIBO") in Japan (a "Japanese nonbank SD") may satisfy the capital and financial reporting requirements applicable to a nonbank SD under Section 4s(e)–(f) of the Commodity Exchange Act (the "CEA") and Rules 23.101 and 23.105(d)–(e) thereunder (the "Commission Capital & Reporting Requirements").[1] As we describe in more detail below, the Japanese Capital & Reporting Framework is designed to ensure the safety and soundness of Japanese nonbank SDs in a manner comparable to the Commission Capital & Reporting Requirements.

I. Introduction

In making a substituted compliance determination pursuant to Rule 23.106 in regards to the Commission Capital & Reporting Requirements, the Commission will consider whether the capital and financial reporting requirements of the foreign regulatory system "are comparable to the Commission's corresponding capital adequacy and financial . . . reporting requirements."[2] The Commission has explained that its "approach to substituted compliance is a principles-based, holistic approach that focuses on whether the foreign regulations are designed with the objective of ensuring overall safety and soundness" in a manner that is comparable with the Commission's capital and financial reporting requirements, rather than a "line-by-line assessment or comparison" of the foreign jurisdiction's and the Commission's regulatory requirements.[3]

Rule 23.106 requires an applicant for substituted compliance to provide:

[1] As used herein, a "nonbank" SD refers to an SD that does not have a Prudential Regulator as defined in Section 1a(39) of the CEA.

[2] 17 C.F.R. § 23.106(a)(3).

[3] Capital Requirements of Swap Dealers and Major Swap Participants, 85 Fed. Reg. 57462, 57521 (Sept. 15, 2020) ("CFTC Capital Final Rule Release").

- "A description of the objectives of the relevant foreign jurisdiction's capital adequacy and financial reporting requirements";

- "A description (including specific legal and regulatory provisions) of how the relevant foreign jurisdiction's capital adequacy and financial reporting requirements address the elements of the [Commission Capital & Reporting Requirements] . . . including, at a minimum, the methodologies for establishing and calculating capital adequacy requirements and whether such methodologies comport with any international standards, including Basel-based capital requirements"; and

- "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."[4]

In accordance with the requirements set forth in Rule 23.106, this application is organized as follows: In Section II.A, we provide an overview addressing general comparability of the Japanese Capital & Reporting Framework's requirements and the Commission Capital & Reporting Requirements, including any general differences between the two sets of requirements and the consistency of the sets' objectives. In Section III, we address the specific information that Rule 23.106 requires.

II. For the reasons set forth below, the Japanese Capital & Reporting Framework is designed to ensure the safety and soundness of Japanese nonbank SDs in a manner comparable to the Commission Capital & Reporting Requirements. Overview

A. Nonbank SD Requirements

Under the Commission Capital & Reporting Requirements, a standalone, nonbank SD may elect the "Bank-Based Approach" or the "Net Liquid Assets Approach" for establishing its minimum capital requirements and computing its regulatory capital under Section 4s(e) of the CEA and Rule 23.101 thereunder (the "Commission Capital Requirements").[5] The Commission sought to provide this flexibility to SDs in order to allow an SD to choose the capital approach that best fits its business model and to mitigate competitive disparities that might otherwise arise were each SD required to follow the same capital approach.[6]

Bank-Based Approach. The "Bank-Based Approach" is based on the capital requirements established by the Federal Reserve Board ("FRB") for bank holding companies,

[4] 17 C.F.R. § 23.106(a)(2).F

[5] Rule 23.101(a)(2) permits a standalone SD that is "predominantly engaged in non-financial activities" to elect a third approach to comply with the Commission's capital requirements based on the tangible net worth of the SD. Because no currently registered Japanese SD would be eligible for this approach, we do not address it.

[6] See CFTC Capital Final Rule Release, 85 Fed. Reg. at 57480.

which are codified in the FRB's Part 217 regulations.[7] Under the Bank-Based Approach, an SD must maintain:

- Common equity tier one capital ("Common Equity Tier 1") of at least $20 million;
- Common Equity Tier 1 equal to at least 6.5 percent of the SD's risk-weighted assets ("RWAs");
- Common Equity Tier 1, additional tier one capital ("Additional Tier 1"), and tier 2 capital ("Tier 2" and collectively, "total capital") equal to at least 8 percent of the SD's RWAs; or
- Total capital equal to 8 percent of the SD's uncleared swap margin amount, i.e., the aggregate amount of initial margin ("IM") that the SD would be required to collect pursuant to the Commission's uncleared swap margin rules from each counterparty for each outstanding uncleared swap position (including exempt and excluded swaps) calculated on a counterparty-by-counterparty basis.

An SD that follows the Bank-Based Approach will calculate its Common Equity Tier 1, Additional Tier 1, Tier 2 and RWAs in accordance with the FRB's Part 217 requirements.

Net Liquid Assets Approach. The "Net Liquid Assets Approach" is based on the capital requirements adopted by the Securities and Exchange Commission ("SEC") for a security-based swap dealer that does not have a Prudential Regulator. These requirements, which are codified in SEC Rule 18a-1 ("Rule 18a-1"), mirror the net liquid assets approach that Rule 15c3-1 of the Securities Exchange Act of 1934 applies to securities broker-dealers, requiring a nonbank SD to compute its "net capital" requirement by determining its net worth according to U.S. generally accepted accounting principles ("GAAP") and then subtracting certain illiquid assets, adding certain subordinated liabilities, and making specified additional adjustments. These additional adjustments include certain standardized or model-based market and credit risk deductions, as well as penalty charges for operational risks. An SD that elects the Net Liquid Assets Approach must maintain net capital at the greater of $20 million or 2 percent of its uncleared swap margin amount. An SD permitted to use models to compute market or credit risk deductions is also required to maintain tentative net capital, as defined in SEC Rule 18a-1, of $100 million.

The Commission Financial Reporting Requirements. Pursuant to Rule 23.105(d), a nonbank SD must file with the Commission and a registered futures association of which it is a member monthly, unaudited financial reports as of the close of business each month. Rule 23.105(e) requires a nonbank SD to file with the Commission and a registered futures association of which it is a member annual, audited financial reports no later than 60 days after the close of the nonbank SD's fiscal year-end. These reports must include statements of financial condition, income/loss, changes in liabilities subordinated to the claims of general

[7] See 17 C.F.R. § 23.101(a)(1)(i); 12 C.F.R. Part 217.

creditors, changes in ownership equity and compliance with and calculation of the required net capital. In addition, the annual, audited financial report must include a reconciliation of any material differences between the year-end unaudited financial report and the audited financial report.

The Japanese Capital & Reporting Framework. The Japanese legal framework for financial regulation is mainly comprised of Acts, Cabinet Orders, Ministerial Orders and Financial Services Agency ("FSA") Notices. With regard to the Japanese Capital & Reporting Framework, Financial Instruments and Exchange Act (Act No. 25 of 1948) ("FIEA") and its related order, Cabinet Office Order on Financial Instruments Business (Cabinet Office Order No. 52 of 2007) ("COO") stipulate the prudential capital and financial reporting requirements applicable to Type I FIBOs, including Japanese nonbank SDs.[8] FIEA, COO and related FSA Notices impose mandatory capital and reporting requirements. Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc. ("Supervisory Guidelines for FIBO") also supplement the framework.[9] The technical requirements for FIBOs to calculate capital adequacy ratios are specified in the FSA Notice No.59 of 2007 ("Notice on Capital") in accordance with Article 177 (8) and Article 178 (1) of the COO.

The Japanese Capital Framework. The capital and related requirements of Japan (the "Japanese Capital Framework") require an FIBO, including a Japanese nonbank SD, to hold and maintain a "capital adequacy amount" equal to 120 percent or more of its "risk equivalent amount." [10][11] A Japanese nonbank SD's capital adequacy amount is calculated as the Japanese

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

[9] In order to implement and reinforce the legal framework, the FSA has developed and published supervisory guidelines. They are meant for FSA staff, but are public documents, which are expected to be followed by the applicable financial institutions. Financial institutions are consulted in connection with the establishment of, and any amendments to, the guidelines. Supervision and enforcement are conducted based on the supervisory guidelines.

[10] Article 46-6 (2) of the FIEA, Article 176 of the COO and Section IV-2-1 (Preciseness of Capital Adequacy Ratio) of the Supervisory Guidelines for FIBO

[11] Under the FIEA, there are three types of capital adequacy ratio applicable to FIBOs depending on their size and group structure and whether they have subsidiaries. The capital adequacy ratios that may be required to be calculated by FIBOs under the FIEA and the parties to which each type of standard applies are as follows:

(1) The capital adequacy ratio prescribed in Article 46-6 (1) of the FIEA ("Non-consolidated Capital Adequacy Ratio"): Applicable to all FIBOs

(2) Standards for indicating the soundness in the management of a Special Financial Instruments Business Operator as set forth in Article 57-5 (1) of the FIEA ("Consolidated Capital Adequacy Ratio"): Applicable to an FIBO which is a Special Financial Instruments Business Operator as set forth in Article 57-2 of the FIEA and has a Subsidiary Corporation, etc. as set forth in Article 57-2 (9) of the FIEA

(3) Standards for indicating the soundness in the management of a Highest Designated Parent Company as set forth in Article 57-17 (1) of the FIEA: Where an FIBO is a Special Financial Instruments Business Operator, and the parent company of the Special Financial Instruments Business Operator or its subsidiary corporation, etc. is designated as the Designated Parent Company as set forth in Article 57-12 (3) of the FIEA, and the Designated Parent Company is the Highest Designated Parent Company as set forth in Article 57-12 (3) of the FIEA, the standards shall apply to the Highest Designated Parent Company. (There

nonbank SD's equity, plus certain subordinated debt instruments issued by the SD (subject to a cap),[12] less the SD's fixed assets. The risk equivalent amount is calculated as the sum of (i) the credit risk weight charges applicable to the SD's assets and transactions (the "counterparty risk equivalent amount"), (ii) the market risk charges applicable to the SD's assets and transactions (the "market risk equivalent amount"), and (iii) charges to capture operational and similar risks arising from the SD's activities (the "basic risk equivalent amount").

The Japanese Financial Reporting Framework. The financial reporting and related requirements of Japan (the "Japanese Financial Reporting Framework") require an FIBO, including a Japanese nonbank SD, to submit reports on its business and financial conditions on a regular basis. Such reports include the financial status report, including a balance sheet and income statement, and a statement of the capital adequacy ratio.

General Comparability. Like the Commission Capital & Reporting Requirements, the Japanese Capital & Reporting Framework is designed to ensure the safety, soundness and financial strength of nonbank SDs.

Capital Requirements. In accordance with the capital framework issued by the Basel Committee on Banking Supervision ("BCBS"), the Bank-Based Approach and the Japanese Capital Framework both require a nonbank SD to maintain a quantity of high quality capital that is sufficient, based on the SD's activities, to absorb potential losses the SD may incur. Both the Net Liquid Assets Approach and the Japanese Capital Framework require that a nonbank SD maintains sufficiently liquid and high quality assets to meet its obligations to customers, counterparties and other creditors if the firm were to experience financial distress.

Market and Credit Risk Charges. For SDs with approval to calculate market risk using internal models, both the Commission Capital Requirements and the Japanese Capital Framework permit firms to apply risk-based market charges that are consistent with the value-at-risk ("VaR") specifications set forth in Basel 2.5 standards.[13] In addition, the Commission

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are only two holding companies designated as Highest Designated Parent Companies as of the date of this letter.)

All of the Japanese nonbank SDs subject to the Commission Capital & Reporting Requirements fall into the type (1) as of the date of this letter and we only refer to the articles related to the Non-consolidated Capital Adequacy Ratio in this letter thereafter.

[12] The subordinated debt instrument must satisfy following requirements in order to qualify as part of the capital adequacy amount:
(i) the instrument has special provisions setting forth subordinated conditions on the principal and interest payment;
(ii) the instrument is not secured;
(iii) the instrument has a minimum original maturity of more than 5 years ("long-term subordinated debt") or at least 2 years ("short-term subordinated debt");
(iv) if there are any special provisions on the early redemption, that such early redemption is made voluntarily by the FIBO and requires the prior approval of the FSA; and
(v) the instrument has special provisions setting forth that no interest payment is made if such payment by the FIBO would result in a breach of the provisions Article 46-6 (2) of the FIEA (i.e. the capital adequacy ratio falls below 120 percent).

[13] Compare 17 C.F.R. § 23.100 (providing for an SD that is approved to use internal models to calculate market and credit risk to calculate its RWAs using Subparts E and F of 12 C.F.R. Part 217), 12 C.F.R. § 217.205(b), 17 C.F.R. § 23.101(a)(1)(ii) (providing for an SD that elects the Net Liquid Assets Approach to calculate its net capital in

Capital Requirements and the Japanese Capital Framework permit firms with credit risk model approval to apply model-based credit risk charges to their derivatives counterparties.[14] For firms without model approval, both the Commission Capital Requirements and the Japanese Capital Framework provide for standardized approaches for market and credit risk charges and deductions, depending on the asset or exposures. In the case of derivatives transactions in particular, both the Commission Capital Requirements and the Japanese Capital Framework provide for an SD without model approval to use the current exposure method ("CEM") to calculate its exposure. Both rule sets also impose operational risk capital requirements.

Minimum Required Capital. The minimum capital levels required by the Japanese Capital Framework are robust and comparable to the minimum levels required by the Commission Capital Requirements. As noted above, a Japanese nonbank SD is required to maintain a capital adequacy amount that is equal to 120 percent of the SD's risk equivalent amount. This is substantially higher than the 8 percent of total RWAs required under the BCBS framework and the Bank-Based Approach. In light of this difference, the Japanese Capital Framework contains certain adjustments from the BCBS methodology for calculating the risk equivalent amount. A number of these adjustments are comparable to those provided for under the Net Liquid Assets Approach and in practice frequently yield higher requirements than the Bank-Based Approach.

For example, like the Net Liquid Assets Approach, the Japanese Capital Framework does not require a Japanese SD to multiply the market risk equivalent amount by 12.5 to obtain an RWA number and then maintain capital equal to 6.5 or 8 percent of those RWAs; instead, a Japanese nonbank SD must maintain capital equal to 120 percent of the market risk equivalent amount, which translates into an effective capital requirement of 9.6 percent of RWAs. Stated differently, although the Bank-Based Approach and the Japanese Capital Framework set forth substantially similar measures for calculating market risk using models, the Japanese Capital Framework requires an SD to hold capital equal to 120 percent of the amount the model yields, while the Bank-Based Approach requires capital equal to only 100 percent of that amount (i.e., 8 percent of the product of the amount and 12.5).

With respect to credit risk, the standardized counterparty credit risk weights under the Japanese Capital Framework range from 0 percent to 25 percent, while those applicable under the BCBS framework and the Bank-Based Approach generally range from 0 percent to 150 percent. But again due to the different approach taken towards minimum capital, the Japanese Capital Framework yields a higher effective capital requirement. For example, for an exposure to a counterparty that is subject to the highest counterparty credit risk weight, the Japanese Capital Framework requires an SD to hold capital equal to 30 percent of the exposure (i.e., 25 percent risk weight multiplied by 120 percent capital requirement). By contrast, the

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accordance with Rule 18a-1), 17 C.F.R. § 23.102a(a), (i) and 17 C.F.R. § 240.18a-1(e)(1) with Article 10 through 14-11 of the Notice on Capital.

[14] Compare 17 C.F.R. § 23.100 (providing for an SD to use internal models to calculate market and credit risk to calculate its RWAs using Subparts E and F of 12 C.F.R. Part 217), Subpart E of 12 C.F.R. part 217, 17 C.F.R. § 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 C.F.R. § 240.18a-1(e)(2) with Article 15-2 of the Notice on Capital.

Bank-Based Approach requires capital equal to only 12 percent of the exposure (i.e., 150 percent risk weight multiplied by 8 percent capital requirement).

The minimum capital levels required by the Japanese Capital Framework may also be compared in some respects to the 8 percent of the uncleared swap margin requirement under the Bank-Based Approach. As the Commission has noted, the uncleared swap margin requirement "provides a floor based on a measure of the risk of the positions, the volume of the positions, the number of counterparties and the complexity of the operations of the" SD.[15] The Commission further explained that the requirement covers "potential operational risk, legal risk, and liquidity risk."[16] As noted above, in calculating its risk equivalent amount for purposes of the Japanese Capital Framework, a Japanese nonbank SD must incorporate amounts designed to capture not only market and credit risk, but also risks which may arise in the course of executing ordinary business, such as errors in business handling. Because they cover the full range of a firm's exposures, not just those related to swaps, these exposures amounts will generally yield capital requirements that substantially exceed 8 percent of the SD's uncleared swap margin amount.[17] In addition, a Japanese nonbank SD is not permitted to count fixed assets toward its capital requirement and is subject to liquidity monitoring by the FSA. As a result, although the Japanese Capital Framework does not have a direct analogue to the 8 percent uncleared swap margin requirement, it has various other measures that achieve the same regulatory objective of ensuring that an SD maintains an amount of capital that is sufficient to cover the full suite of risks it may face.

Considering that all Japanese nonbank SDs would be eligible to elect the Bank-Based Approach, we think that the foregoing comparison to that approach should suffice to establish the comparability of the Japanese Capital Framework to the Commission Capital Requirements. But in addition, for the reasons discussed above, the minimum capital levels required by the Japanese Capital Framework may be compared in some respects to the sum of the 2 percent uncleared swap margin amount requirement and market and credit risk charges applicable under the Net Liquid Assets Approach.

Liquidity. Consistent with the approach of CFTC Rule 23.600, the FSA works with Japanese nonbank SDs to ensure they have a risk management program in place to manage liquidity risk. In addition, the Japanese Capital Framework requires a Japanese nonbank SD to deduct from its capital adequacy amount 100 percent of the carrying value of any fixed assets. This is similar to the Net Liquid Assets Approach, which, in lieu of a specific liquidity requirements, requires nonbank SDs to deduct from their net capital 100 percent of the carrying value of unsecured receivables (except that an SD with credit risk model approval may instead apply a credit risk weighted charge for receivables to certain derivatives counterparties) and other assets that cannot readily be converted into cash, as well as securities that have no ready market.[18]

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[15] CFTC Capital Final Rule Release, 85 Fed. Reg. at 57485.

[16] Id.

[17] Informal quantitative analysis by industry participants generally confirms this conclusion.

[18] 17 C.F.R. § 23.101(a)(ii)(A); 17 C.F.R. § 240.18a-1(a)(1)(iv).

In addition, liquidity risks are generally less significant to Japanese nonbank SDs than standalone U.S. SDs because, if a Japanese nonbank SD faces severe financial distress, it will be subject to an orderly resolution framework that is designed to provide the SD with sufficient liquidity to meet customer and counterparty obligations while winding down. Also, a Japanese SD will not be subject to liquidation as a commodity broker under the U.S. Bankruptcy Code.

Moreover, U.S. customer property should be at minimal risk if a Japanese nonbank SD were to experience financial distress, as a Japanese nonbank SD is required to segregate IM from its assets by either placing it with a third-party holder or custodian or via other legally binding arrangements, making the IM remote in the case of the firm's default or insolvency.[19]

Financial Reporting Requirements. The Commission's financial reporting requirements under Section 4s(f) of the CEA and Rule 23.105(d)–(e) thereunder (the "Commission Financial Reporting Requirements") and the Japanese Financial Reporting Framework provide the relevant regulatory authorities with audited information at regular intervals about the financial and capital positions of an SD in order to ensure the safety and soundness of the SD. Both the Japanese Financial Reporting Framework and the Commission Financial Reporting Requirements require a firm to disclose financial statements containing information on the firm's financial condition and compliance with capital requirements. In each case, the reporting requirements under the regimes provide a comprehensive view of the financial condition of a firm, including the firm's compliance with applicable capital requirements and overall financial health.

III. Comparability Analysis

A. Comparability of the Japanese Capital Framework and the Commission Capital Requirements

1. Comparability of Objectives

The Commission Capital Requirements and the Japanese Capital Framework have the same regulatory objectives. Both are aimed at ensuring the safety and soundness of nonbank SDs in order to protect counterparties and customers and the derivatives and financial markets more generally. The Bank-Based Approach, consistent with the Basel capital framework, achieves this goal by requiring a nonbank SD to maintain a sufficient cushion against losses. The Net Liquid Assets Approach, meanwhile, furthers safety and soundness by requiring a nonbank SD to maintain enough liquid assets to satisfy customer and counterparty claims in the event of a distress scenario.

The Japanese Capital Framework seeks to achieve the objectives of both the Bank-Based Approach and the Net Liquid Assets Approach.

[19] Article 40 (ii) of the FIEA and Article 123 (1) (xxi)-11 (d) of the COO

As with the Bank-Based Approach and the Basel capital framework, the Japanese Capital Framework is intended to ensure that a Japanese nonbank SD maintains a financial base sufficient to meet the risks to which it is exposed. In addition, as with the Net Liquid Assets Approach, the Japanese Capital Framework is also intended to ensure that a Japanese nonbank SD maintains sufficient liquid assets to withstand the losses that may arise even when various risks materialize and satisfy customer obligations even in the context of financial distress.

2. Comparability of Methodologies and Outcomes

i. Measurement of Assets and Total Risk Exposure

Japanese nonbank SDs are subject to bank-like capital requirements that, consistent with the BCBS framework, require a firm to hold sufficient amounts of equity and subordinated debt. The principal determinant of the amount of regulatory capital a Japanese nonbank SD must maintain is the firm's risk equivalent amount. To calculate this amount, a Japanese SD must risk weight its assets and exposures using specified standardized weights or approved internal model-based methodologies. More specifically, the risk equivalent amount consists of:

(i) the market risk equivalent amount, meaning the amount equivalent to possible risks which may accrue due to the fluctuations in the prices of the securities and other assets and transactions held or other reasons,[20] which corresponds to market risk in the BCBS framework;

(ii) the counterparty risk equivalent amount, meaning the amount equivalent to possible risks which may accrue due to the default in performance of contracts by the counterparties to transactions or any other reason,[21] which corresponds to credit risk in the BCBS framework; and

(iii) the basic risk equivalent amount, meaning the amount equivalent to possible risks which may accrue in the course of executing ordinary business, such as errors in business handling,[22] which corresponds to operational risk in the BCBS framework.

This approach is comparable to the Bank-Based Approach, which similarly subjects a nonbank SD to bank-like capital requirements that require the SD to hold sufficient regulatory capital based on the risk of its activities and positions.[23]

In addition, the Japanese Capital Framework requires a Japanese nonbank SD to deduct from its capital adequacy amount the carrying value of its fixed assets. [24] This approach is

[20] Article 178 (1) (i) of the COO and Article 10 through 14 of the Notice on Capital

[21] Article 178 (1) (ii) of the COO and Article 15 through 15-7 of the Notice on Capital. An FIBO is required to calculate the market risk equivalent and the counterparty risk equivalent each business day in a reasonable method (Article 178 (2) of the COO).

[22] Article 178 (1) (iii) of the COO and Article 16 of the Notice on Capital

[23] 17 C.F.R. § 23.101(a)(1)(i).

[24] The breakdown of the fixed assets, etc. to be deducted from the amount of capital are listed in Article 177 of the COO.

comparable to the Net Liquid Assets Approach, which requires an SD to deduct from net capital unsecured receivables and certain other illiquid assets.[25]

Additionally, considering the scope of exposures that must be taken into account in the risk equivalent amount and the way those exposures are calculated, the minimum capital levels required by the Japanese Capital Framework may be compared in some respects to the sum of the 2 percent uncleared swap margin amount requirement and market and credit risk charges applicable under the Net Liquid Assets Approach, as well as the 8 percent of the uncleared swap margin amount requirement under the Bank-Based Approach.

a. Derivative Instruments and Marketable Securities

Under the Japanese Capital Framework, as under the Commission Capital Requirements, derivative instruments and marketable securities are subject to charges for market and credit risk. As under the Bank-Based Approach and the BCBS capital framework more generally, these charges are added to the nonbank SD's risk exposure calculation. Although the Net Liquid Assets Approach incorporates market and credit risk by providing for deductions from net capital, the ultimate objective, which is to require greater capital to account for market and credit risk, is the same as under the Bank-Based Approach and the BCBS framework.

The comparability between the risk-weighted approach under the Japanese Capital Framework and the Commission Capital Requirements can be illustrated by comparing their respective approaches to market and credit risk.

1. Market Risk

In terms of market risk, the Bank-Based Approach requires a nonbank SD to calculate additions to its RWAs for derivatives positions and marketable securities using either the Commission's standardized haircuts or, if approved to use models, market-risk models. In either case, the SD must multiply the market risk amount by 12.5. This effectively requires a nonbank SD subject to the Bank-Based Approach to hold capital equal to the full amount of the market risk amount. The Net Liquid Assets Approach similarly requires a nonbank SD to take certain net capital deductions for its derivatives positions and marketable securities using either standardized haircuts or, if approved to use internal models, market risk models. The Net Liquid Assets Approach, however, does not require the SD to multiply the market risk amount by 12.5, since the amount is directly deducted from the SD's net capital.

Consistent with the Commission Capital Requirements, the Japanese Capital Framework requires Japanese nonbank SDs to calculate a market risk equivalent amount using either a standardized approach or, if approved to use models, market risk models. In view of the requirement that Japanese nonbank SDs maintain a capital adequacy amount of 120 percent of the risk equivalent amount, the market risk equivalent amount is directly added to the risk equivalent amount (without any multiplier). This effectively requires that a Japanese nonbank SD hold regulatory capital equal to no less than 120 percent of its market risk equivalent amount, instead of 100 percent as under the Bank-Based Approach. This translates into an effective

[25] See CFTC Capital Final Rule Release, 85 Fed. Reg. at 57572.

capital requirement of 9.6 percent of RWAs in relation to market risk, as compared to the 8 percent RWA requirement under the Bank-Based Approach.

The Bank-Based Approach requires that a nonbank SD that is approved to use models to calculate market risk do so in accordance with Subpart F of the FRB's Part 217 regulations ("Subpart F"), while Appendix A to Rule 23.102 specifies the model requirements for an SD that elects the Net Liquid Assets Approach. Both Subpart F and Appendix A to Rule 23.102 are based on the internal model approach under Basel 2.5.[26] The Commission will provisionally permit the use of models approved by a foreign regulator whose capital requirements are consistent with the Basel framework.[27]

Similarly, the Japanese Capital Framework's model-based methodology is based on the Basel 2.5 standard.[28] The Japanese Capital Framework, Subpart F and Appendix A to Rule 23.102 all incorporate relevant aspects of Basel 2.5 in terms of requiring firms with model approval to use a VaR model with a 99 percent, one-tailed confidence level with (i) price changes equivalent to a ten 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.[29] All three also implement aspects of Basel 2.5, such as requirements to calculate a "stressed" VaR.[30] All three also permit firms to calculate specific risk, incremental risk and comprehensive risk of correlation trading using a model-based approach, subject to approval.[31]

2. Credit Risk

In terms of credit risk, the Bank-Based Approach provides for the credit risk of a nonbank SD's positions to be incorporated into the calculation of its RWAs. Under the Bank-Based Approach, a nonbank SD that is not approved to use internal models to calculate credit

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[26] Compare 17 C.F.R. § 23.100 (providing for an SD that is approved to use internal models to calculate market and credit risk to calculate its RWAs using Subparts E and F of 12 C.F.R. Part 217), Subpart F of 12 C.F.R., § 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 C.F.R. § 23.102a, with Basel Committee on Banking Supervision, Revisions to the Basel II Market Risk Framework (2011), https://www.bis.org/publ/bcbs193.pdf (describing the revised internal model approach under Basel 2.5).

[27] 17 C.F.R. § 23.102(f).

[28] Compare Article 10 through 14-11 of the Notice on Capital with Revisions to the Basel II Market Risk Framework.

[29] Compare 17 C.F.R. § 23.100 (providing for an SD that is approved to use internal models to calculate market and credit risk to calculate its RWAs using Subparts E and F of 12 C.F.R. Part 217), 12 C.F.R. § 217.205(b), 17 C.F.R. § 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), 17 C.F.R. § 23.102a(a), (i) and 17 C.F.R. § 240.18a-1(e)(1) with Article 13 (3) (i), (ii) and (iv) of the Notice on Capital.

[30] 17 C.F.R. § 23.100 (providing for an SD that is approved to use internal models to calculate market and credit risk to calculate its RWAs using Subparts E and F of 12 C.F.R. Part 217); 12 C.F.R. § 217.206, 17 C.F.R. § 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); 17 C.F.R. § 23.102a(j); Article 10-2 of the Notice on Capital. See also CFTC Capital Final Rule Release, 85 Fed. Reg. at n.332 (citing the BCBS' Revisions to the Basel II Market Risk Framework for an explanation of the implementation of the stressed VaR requirement).

[31] Article 13-2 and 14-9 of the Notice on Capital

risk will compute its RWAs in accordance with Subpart D of the FRB's Part 217 regulations, which sets forth a standardized methodology for calculating the risk weights applicable to a bank holding company's assets. A nonbank SD approved to use internal models will calculate its RWAs in accordance with Subpart E of the FRB's Part 217 regulations, which sets forth a models-based methodology for calculating risk weights applicable to a bank holding company's assets. The Net Liquid Assets Approach, in turn, requires a nonbank SD to take a net capital deduction for unsecured current exposure and uncollected IM, but a firm with model approval may instead multiply that deduction by 8 percent and further by a credit risk weight.

Consistent with these approaches, the Japanese Capital Framework requires a Japanese nonbank SD to calculate its counterparty risk equivalent amount by multiplying its exposure under a given transaction by the specific risk weight applicable to the counterparty. Non-governmental financial institutions, general corporations and individuals carry risk weights between 1.2 and 25 percent depending, in the case of financial institutions and corporations, on the credit rating of the entity. If no credit rating is available for a general corporate counterparty (e.g., one not subject to derivatives margin requirements), the SD must generally apply a 25 percent risk weight.[32] This effectively results in a capital requirement equal to 30% of the exposure to the counterparty, as compared to an 8% capital requirement that would apply to a general corporate counterparty under the Bank-Based Approach.[33]

With respect to calculating the amount of the exposure arising under a derivative transaction, the Japanese Capital Framework requires a Japanese nonbank SD that is not approved to use credit risk models to calculate its exposure using the CEM, which is one of the standardized methods that a nonbank SD may use to calculate its credit exposure under a derivative transaction pursuant to the Bank-Based Approach. If a Japanese nonbank SD is permitted to use models for calculating credit risk, the SD may, as under the Bank-Based Approach, use its internal model to calculate the credit exposure amount.[34]

Accordingly, the Japanese Capital Framework prescribes an approach for calculating credit risk charges that is largely comparable to (and in many instances will result in higher capital requirements than) the approaches set forth in the Commission Capital Requirements.

3. Additional Measures and Supervision

Although the FSA does not impose liquidity requirements on Japanese nonbank SDs, it closely assesses and monitors whether they are properly managing their liquidity risk. Through monthly off-site monitoring reports and hearings based on these reports, the FSA strives to identify and keep track of the status of a Japanese nonbank SD's liquidity risk and its risk

[32] Article 15 (3) of the Notice on Capital

[33] See 12 C.F.R. § 217.32(f).

[34] Article 15-2 of the Notice on Capital

management, and when necessary, request submission of reports pursuant to Article 56-2 (1) of the FIEA and encourage efforts for improvement.[35]

In addition to that, an Early Warning System based on Pillar II of the BCBS framework has been introduced by the FSA. The Early Warning System is a framework whereby remedial actions are prompted to Japanese nonbank SDs with capital adequacy ratios that are above the required minimum as well as the thresholds for prompt corrective action (described below), but that meet specified criteria, such as a significant change in capital adequacy. For such SDs, the FSA will look to quickly identify risks to which the SD is exposed and order steps to mitigate those risks.[36]

b. Other Types of Assets and Exposures

Under the Net Liquid Assets Approach, other types of proprietary assets and exposures are generally subject to a 100 percent deduction to net capital in order to address liquidity risk. Conversely, the Bank-Based Approach subjects each asset to the risk weight approach described above.

As noted above, considering that all Japanese nonbank SDs would be eligible to elect the Bank-Based Approach, we think that a comparison to that approach should suffice to establish the comparability of the Japanese Capital Framework to the Commission Capital Requirements. But, to the extent that a comparison to the Net Liquid Assets Approach is relevant, we note that the Japanese Capital Framework requires fixed assets to be deducted from the capital adequacy amount. This requirement, like the 100 percent deduction for illiquid assets under the Net Liquid Assets Approach, is designed to ensure that a Japanese nonbank SD has sufficient liquid assets to withstand the losses that may arise even when various risks materialize and is not forced into insolvency or other default by engaging in a fire sale of fixed assets necessary for operations. In addition, as noted above, the FSA closely monitors such SDs' liquidity risks and works with them to ensure that they are property managing that risk. This approach is consistent with the Commission's approach under Regulation 23.600.[37]

Furthermore, Japan has implemented margin requirements[38] that require a Japanese nonbank SD to segregate IM posted by counterparties by way of trust or other similar methods so that the posting party will be able to recover the IM without delay if the receiving

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[35] IV-2-5 (Control Environment for Managing Liquidity Risk) of the Supervisory Guidelines for FIBO

[36] IV-2-6 (Early Warning System) of the Supervisory Guidelines for FIBO and "Implementation Framework of the Second Pillar of Basel II" published by the FSA on November 22, 2005. <https://www.fsa.go.jp/news/newse/e20051122/01.pdf>

[37] Moreover, the resolution framework in Japan is distinguishable from that in the U.S. Specifically, a Japanese nonbank SD that is in deterioration will be subject to an orderly resolution arrangement that contemplates the provision of liquidity while the Japanese nonbank SD winds down its operations. Article 126-2(3) of the Deposit Insurance Act. We consider this distinction to be relevant because a key rationale for the 100 percent deduction for unsecured receivables and certain other assets under the Net Liquid Assets Approach is the absence of a similar liquidity facility for U.S. nonbank SDs.

[38] Article 40 (ii) of the FIEA and Article 123 (1) (xxi)-11 (d) of the COO

party becomes insolvent. This may help to ensure a counterparty is able to recover its IM in the event of the SD's failure.

ii. ***Qualifying Components of Capital***

1. Minimum Capital Requirements

The Net Liquid Assets Approach permits a nonbank SD to include both equity capital and satisfactory subordinated debt as net capital by permitting the SD to exclude subordinated liabilities from the net worth calculation, with satisfactory subordinated debt allowed to comprise up to 70 percent of the sum of the SD's subordinated debt and equity.[39]

Under the Bank-Based Approach, an SD must maintain the following components of regulatory capital:[40]

- Common Equity Tier 1, which is generally limited to retained earnings and common equity; and
- Additional Tier 1 and Tier 2 capital, which include certain preferred stock and subordinated debt instruments.[41]

Under the Japanese Capital Framework, the components of capital are similar to the components of regulatory capital required under the Bank-Based Approach, as they include:

- Basic items, which are composed of the stated capital, the payment for an application for new shares, the capital surplus, the earned surplus, the negative valuation difference on available-for-sale securities,[42] and own treasury stocks;[43] and
- Supplemental items, which provide an additional layer of supplementary capital that includes the positive valuation difference on available-for-sale securities[44] and certain subordinated debt instruments.[45]

Furthermore, consistent with both the Bank-Based Approach, the Japanese Capital Framework requires that no less than half of the capital adequacy amount consist of

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[39] 17 C.F.R. § 240.18a-1(c)(1), (g).

[40] See 17 C.F.R. § 23.101(a)(1)(i); 12 C.F.R. §§ 217.20(b) (Common Equity Tier 1), 217.20(c) (Additional Tier 1), 217.20(d) (Tier 2).

[41] See generally 12 C.F.R. § 217.20. An SD that follows the Bank-Based Approach can only include subordinated debt in its regulatory capital if such subordinated debt would be eligible to be treated as net capital under the Net Liquid Assets Approach. 17 C.F.R. § 23.101(a)(1)(i)(B).

[42] i.e. unrealized holding loss on securities

[43] Article 176 (1) (i) through (vi) of the COO

[44] i.e. unrealized holding gains on securities

[45] Article 176 (1) (vii) of the COO

equity (i.e., the basic items) and further puts caps[46] on the aggregate amount of subordinated debt instruments that a Japanese nonbank SD may count towards its capital adequacy amount.

Accordingly, each approach permits firms to count both equity and certain subordinated debt towards their capital requirements, with the Japanese Capital Framework and the Bank-Based Approach requiring firms to maintain a larger portion of their required capital as high-quality equity, as compared to the Net Liquid Assets Approach.

iii. ***Required Minimum Amounts of Capital***

As noted above, the Bank-Based Approach requires nonbank SDs to maintain:

- Common Equity Tier 1 of at least $20 million;
- Common Equity Tier 1 equal to at least 6.5 percent of the SD's RWAs;
- Total capital equal to at least 8 percent of the nonbank SD's RWAs; or
- Total capital equal to 8 percent of its uncleared swap margin.[47]

The Net Liquid Assets Approach requires a nonbank SD without model approval to maintain net capital, subject to the adjustments described above, at the higher of $20 million or 2 percent of its uncleared swap margin amount.[48] Under the Net Liquid Assets Approach, a nonbank SD with model approval is also required to maintain tentative net capital, which is the net capital *before* taking certain market and credit risk deductions, of at least $100 million.[49]

The Japanese Capital Framework stipulates a minimum capital adequacy ratio of 120 percent for Japanese nonbank SDs, calculated by the sum of basic items and supplement items less the amount of fixed assets and other assets divided by the risk equivalent amount.[50] Although the FIEA sets a minimum required capital adequacy ratio of 120 percent or higher as stated above, both of the current account holding eligibility criteria at the Bank of Japan ("BOJ")[51] and the requirements for clearing qualification of the Japan Securities Clearing

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[46] For long-term subordinated debt, the cap equals 50 percent of the amount of the Japanese nonbank SD's basic items; for short-term subordinated debt, the cap equals 200 percent of the amount of the Japanese nonbank SD's basic items after deduction of the amount of fixed assets (Article 176 (1) (vii) of the COO).

[47] 17 C.F.R. § 23.101(a)(1)(i).

[48] 17 C.F.R. § 23.101(a)(1)(ii).

[49] Id.

[50] Article 46-6 (2) of the FIEA

[51] The eligibility criteria stipulates that in case that an applicant who has requested the BOJ to commence a current account transaction is a FIBO, its capital adequacy ratio at the end of the latest interim fiscal year or the latest fiscal year calculated in accordance with the FIEA shall be 200% or more. In practice, this requirement is considered as not only a requirement for commencing transactions with BOJ, but also a requirement for continuing transactions with BOJ through on-site examinations and off-site monitoring by the BOJ.

Corporation ("JSCC")[5253] require such SDs to have a capital adequacy ratio of 200 percent or higher in principle. Therefore, capital adequacy ratio of 200 percent is recognized as the *de facto* minimum required level for Japanese nonbank SDs and other FIBOs.

Although the Japanese Capital Framework does not articulate different ratios for the various components of capital, it does provide that the total amount of supplemental items shall be less than the total amount of basic items.[54] Thus, as under the Bank-Based Approach, the Japanese Capital Framework effectively requires that approximately half of an SD's capital adequacy amount consist of high-quality equity. Furthermore, Article 176 (1) (vii) of the COO puts caps on the subordinated debt that a Japanese nonbank SD may count towards its capital adequacy amount.

Although the Japanese Capital Framework does not contain a capital ratio that is expressly tied to the IM required for a Japanese nonbank SD's uncleared swap transactions, the capital adequacy ratio under the Japanese Capital Framework incorporates many of the same risks that the uncleared swap margin requirement is designed to address. For example, the exposure calculation incorporates the potential future exposure arising from the SD's OTC derivatives transactions. Although the methodology for calculating this potential future exposure may differ from the methodology for calculating the IM required under the Commission's margin rules, in many instances the former will lead to *greater* capital requirements, for example in instances where a Japanese nonbank SD does not have counterparty credit risk models for all OTC derivatives and accordingly must apply a standardized approach. Moreover, unlike the uncleared swap margin requirement, the capital adequacy incorporates market, operational and other risks. As a result, the capital adequacy ratio under the Japanese Capital Framework generally yields substantially higher capital requirements than the uncleared swap margin requirement.

B. Comparability of the Japanese Financial Reporting Framework and the Commission Financial Reporting Requirements

1. Comparability of Objectives

The Japanese Financial Reporting Framework and the Commission Financial Reporting Requirements are intended to enable the relevant regulatory authorities to assess the financial condition and safety and soundness of firms subject to their respective regulation. Specifically, as discussed below, both regimes require firms to report their compliance with applicable capital requirements and their financial position. These disclosures serve to provide regulatory authorities with a comprehensive view of the financial health and activities of the firms.

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[52] JSCC is a central counterparty for the Japanese securities market. Its clearing businesses include exchange-traded products, OTC Japanese government bonds, credit default swaps and interest rate swaps. JSCC operates its businesses in Japan under the supervision and regulation of the FSA in accordance with the FIEA.

[53] See JSCC's Criteria for Clearing Qualification, https://www.jpx.co.jp/jscc/en/participant/participant/participant.html

[54] Article 176 (1) (vii) of the COO

2. Comparability of Methodologies and Outcomes

The Commission Financial Reporting Requirements require that a nonbank SD file with the Commission and with a registered futures association of which it is a member monthly, unaudited financial reports as of the close of business of each month and annual, audited financial reports as of the close of its fiscal year.[55] The monthly financial reports must be filed no later than 17 business days after the date for which the report is made, and the annual financial reports must be filed no later than 60 days after the close of the nonbank SD's fiscal year.[56] The annual financial report must be audited and accompanied by an opinion of an independent certified public accountant or independent licensed accountant in good standing.[57]

A nonbank SD must prepare its monthly and annual financial reports in the English language, denominated in U.S. dollars and in accordance with U.S. GAAP.[58] If the nonbank SD is not otherwise required to prepare financial statements in accordance with U.S. GAAP, it may prepare its monthly and annual financial reports in accordance with the International Financial Reporting Standards. The financial reports must include the following statements:

- Financial condition;
- Income/loss;
- Changes in liabilities subordinated to the claims of general creditors;
- Changes in ownership equity; and
- Compliance with and calculation of the nonbank SD's applicable regulatory capital requirements under Rule 23.101.[59]

In addition to the above elements, the annual financial report must also contain:

- A statement of cash flows;
- Appropriate footnote disclosures; and
- A reconciliation of any material differences from the SD's unaudited financial report prepared as of its year-end date and its annual financial report.

The Japanese Financial Reporting Framework imposes similar requirements on a Japanese nonbank SD. Specifically, Article 46-3 (1) of the FIEA and Article 172 of the COO

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[55] 17 C.F.R. §§ 23.105(d), (e).

[56] 17 C.F.R. §§ 23.105(d)(1), (e)(1) .

[57] 17 C.F.R. § 23.105(e)(2).

[58] 17 C.F.R. §§ 23.105(d)(2), (e)(3) .

[59] 17 C.F.R. §§ 23.105(d)(2), (e)(4) .

require a Japanese nonbank SD to submit a business report to the Commissioner of the FSA within three months after the end of each fiscal year. The business report must include a balance sheet, profit and loss statement, statement of changes in shareholders' equity, balance of subordinated debt and statement of capital adequacy ratio.[60] In addition, the FSA has, pursuant to Article 56-2 (1) of the FIEA, ordered Japanese nonbank SDs to submit monthly monitoring reports on the SD's balance sheet, profit and loss statement, capital adequacy ratio, market risk, counterparty risk and liquidity risk.[61]

Furthermore, Article 435 (2) of the Companies Act (Act No. 86 of 2005) requires a Japanese nonbank SD to prepare financial statements and business reports every business year. The financial statements include a balance sheet, profit and loss statement, and statement of changes in shareholders' equity and, if the Japanese nonbank SD is a Large Company,[62] the reports must be audited by an accounting auditor.[63]

As a result, a Japanese nonbank SD is required to provide substantially similar information to the FSA as that required by the Commission Financial Reporting Requirements.

C. Enforcement and Supervision of the Japanese Capital & Reporting Framework and Japanese Bank Financial Reporting Requirements

Japanese prudential regulators (*i.e.*, the FSA and BOJ)[64] have ample supervision, audit, and investigation powers, which include the power to require Japanese SDs to provide all necessary information in order to carry out their supervisory tasks, require submission of documents, examine, conduct all necessary inspections at the business premises of Japanese SDs and other group entities. [65]

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[60] Appended Forms No.12 of the COO.

[61] According to II-1-4 (General Supervisory Processes) of the Supervisory Guidelines for FIBO, as part of offsite monitoring, supervisors shall require FIBOs to submit a monitoring survey report regarding the following matters: Capital Adequacy Ratio, Status of business operations and accounting (including a balance sheet and profit and loss statement), Status of segregated management of customer assets, Market risk, Counterparty risk, Operational risk, and Liquidity risk.

[62] "Large Company" means any stock company which satisfies any of the following requirements: (a) that the amount of the stated capital in the balance sheet as of the end of its most recent business year is JPY 500 million or more; or (b) that the total sum of the amounts in the liabilities section of the balance sheet as of the end of its most recent business year is JPY 20 billion or more. (Article 2 (vi) of the Companies Act). Each Japanese nonbank SD subject to the Commission's reporting requirements qualifies as a Large Company.

[63] Article 328 (1) and (2) and Article 435 (2) and 436 (2) (i) of the Companies Act, and Article 59 of Rules of Corporate Accounting (Ordinance of the Ministry of Justice No. 13 of 2006)

[64] Both the BOJ and the FSA conduct day to day supervision of financial institutions using both onsite inspections and off-site monitoring, and regular interactions with officials of the supervised entities. Formally, and based upon Article 44 of the Bank of Japan Act, the FSA may request BOJ to submit the inspections reports describing the results of the onsite examinations and other related materials with respect to concerned financial institutions. With regard to off-site analyses and at senior management level, there exists more regular information exchange between the FSA and BOJ.

[65] For the Japanese nonbank SDs, Article 56-2 of the FIEA and for the Japanese bank SDs, Article 24 and 25 of the BA.

Under the Japanese Capital Framework, the FSA monitors the capital adequacy ratios of Japanese nonbank SDs through supervisory measures even before they fall below the minimum level, and has a variety of measures in place to deal with actual cases where an SD's capital adequacy ratio falls below the minimum level.

- Before a Japanese nonbank SD breaches minimum capital requirements, the FSA will react under the Early Warning System.

- When a Japanese nonbank SD's capital adequacy ratio falls below 140 percent, the SD must submit a notification to the FSA pursuant to Article 179 (3) of the COO. The notification must include a Plan Regarding Specific Voluntary Measures to Be Taken in Order to Maintain the Capital Adequacy Ratio, which the FSA will review. In addition, the FSA will examine the future outlook on the business operator's capital adequacy ratio through hearings and urge it to make voluntary improvement efforts.[66]

- When a Japanese nonbank SD's capital adequacy ratio falls below 120 percent, the SD must submit a notification to the FSA, including a Plan Regarding Specific Voluntary Measures to Be Taken in Order to Improve the Capital Adequacy Ratio. The FSA will review the plan and, when necessary, identify the specific method by which to bring the capital adequacy ratio back above the prescribed level and the estimated date of the recovery. The FSA will also examine the status of segregated management of customer assets and fund-raising. If the FSA finds it to be necessary and appropriate in the public interest or for the protection of investors, the Commissioner of the FSA may order a change of business methods, order assets to be deposited, or issue orders with respect to matters that are otherwise necessary from a supervisory perspective (Article 53 (1) of the FIEA).[67]

- When an Japanese nonbank SD's capital adequacy ratio falls below 100 percent, if the FSA finds it to be necessary and appropriate in the public interest or for the protection of investors, the Commissioner of the FSA,

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[66] IV-2-2 (Supervisory Response to Cases of Financial Instruments Business Operators' Capital Adequacy Ratio Falling Below Prescribed Level) (1) of the Supervisory Guidelines for FIBO

[67] IV-2-2 (Supervisory Response to Cases of Financial Instruments Business Operators' Capital Adequacy Ratio Falling Below Prescribed Level) (3) of the Supervisory Guidelines for FIBO indicates four examples of the order:

(i) To draft and implement measures (including the drafting of specifics and the implementation schedule) to bring the capital adequacy ratio back above the legally prescribed level and maintain the ratio above that level on a permanent basis;

(ii) To implement measures to ensure the protection of investors in preparation for an unexpected event, through appropriate management of securities and cash and careful management of fund-raising;

(iii) To avoid activities that could lead to wasteful use of corporate assets; and

(iv) To compile the projections of the balance sheet and fund-raising status on a daily basis and the projection of capital adequacy ratio in ways to reflect the specific measures to be implemented, in order to bring the capital adequacy ratio back above the legally prescribed level.

within the scope of this necessity, may order the suspension of all or a part of business activities during a fixed period of no longer than three months.[68] If the FSA finds that the capital adequacy ratio of the SD as of the day on which three months have elapsed since the day of the order continues to be less than 100 percent and that the SD's capital adequacy ratio status is not likely to recover, the Commissioner of the FSA may rescind the Article 29 registration of that SD.[69]

- In addition to these measures, if the FSA finds it to be necessary and appropriate in the public interest or for the protection of investors as concerns a Japanese nonbank SD's business operations or the state of its assets, the Commissioner of the FSA, within the scope of this necessity, may order the SD to change its business methods or to otherwise take measures that are necessary for improving its business operations or the state of its assets.[70]

If a Japanese nonbank SD falls under one of the following items, the Prime Minister may rescind its Article 29 registration or order the suspension of all or a part of business activities during a fixed period of no longer than six months:

- it violates a disposition by a government agency;[71] or
- in light of the state of its business or assets, it is likely to become insolvent.[72]

With regard to Japanese Financial Reporting Framework, a person that fails to submit documents that are required by law to be submitted is subject to punishment by imprisonment for not more than one year, a fine of not more than three million yen, or both.[73]

IV. Conclusion

Taken together, the Japanese Capital & Reporting Framework reflects similar regulatory concerns and leads to comparable regulatory outcomes as the Commission Capital & Reporting Requirements. Rather than require Japanese nonbank SDs to comply with two different approaches to capital and liquidity, the Commission should grant this application for the Japanese nonbank SDs to satisfy their requirements under the Commission Capital & Reporting Requirements by continuing to comply with the Japanese Capital & Reporting Framework.

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[68] Article 53 (2) of the FIEA

[69] Article 53 (3) of the FIEA

[70] Article 51 of the FIEA

[71] Article 52 (1) (vii) of the FIEA

[72] Article 52 (1) (viii) of the FIEA

[73] Article 198-6 of the FIEA