Voting Copy – As approved by the Commission on 11/10/2022
(subject to pre-publication technical corrections)

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 Regulation by the Mexican Comision Nacional Bancaria y de Valores

AGENCY: Commodity Futures Trading Commission.

ACTION: Proposed order and request for comment.

SUMMARY: The Commodity Futures Trading Commission is soliciting public comment on a joint request submitted by Morgan Stanley Mexico, Casa de Bolsa, S.A. de C.V., Goldman Sachs Mexico, Casa de Bolsa, S.A. de C.V., and Casa de Bolsa Finamex, S.A. de C.V. requesting that the Commission determine that the capital and financial reporting laws and regulations of Mexico applicable to CFTC-registered swap dealers organized and domiciled in Mexico, and licensed with the Mexican Banking and Securities Commission (Comision Nacional Bancaria y de Valores) as broker-dealers (casa de bolsa), provide a sufficient basis 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 also is 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 **[INSERT 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: You may submit comments, identified by "Mexico 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 Regulation 145.9.[1]

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

[1] 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 at https://www.cftc.gov/LawRegulation/CommodityExchangeAct/index.htm.

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: Amanda L. Olear, Director, 202-418-5283, *aolear@cftc.gov*; Thomas Smith, Deputy Director, 202-418-5495, *tsmith@cftc.gov*; Rafael Martinez, Associate Director, 202-418-5462, *rmartinez@cftc.gov*; Joshua Beale, Associate Director, 202-418-5446, *jbeale@cftc.gov*; Warren Gorlick, Associate Director, 202-418-5195, *wgorlick@cftc.gov*; Jennifer Bauer, Special Counsel, 202-418-5472, *jbauer@cftc.gov*; Carmen Moncada-Terry, Special Counsel, 202-418-5795, *cmoncadaterry@cftc.gov*; Liliya Bozhanova, Special Counsel, 202-418-6232, lbozhanova@cftc.gov; Joo Hong, Risk Analyst, 202-418-6221, *jhong@cftc.gov*; Justin McPhee, Risk Analyst, 202-418-6223, *jmchpee@cftc.gov,* Market Participants Division; Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

SUPPLEMENTARY INFORMATION: The Commodity Futures Trading Commission ("Commission" or "CFTC") is soliciting public comment on an application dated September 28, 2021 (the "Mexico Application") and submitted jointly by Morgan Stanley Mexico, Casa de Bolsa, S.A. de C.V., Goldman Sachs Mexico, Casa de Bolsa,

S.A. de C.V., and Casa de Bolsa Finamex, S.A. de C.V. (the "Applicants").[2] The Applicants' Mexico Application requests that the Commission issue an order finding that registered nonbank[3] swap dealers ("SDs") organized and domiciled in Mexico ("Mexican nonbank SDs") may satisfy certain capital and financial reporting requirements under the Commodity Exchange Act ("CEA")[4] by being subject to, and complying with, comparable capital and financial reporting requirements under Mexican laws and regulations. The Commission also is soliciting public comment on a proposed order that would permit Mexican nonbank SDs, subject to certain conditions, to comply with certain CFTC 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[5] directs the Commission and "prudential regulators" [6] to impose capital requirements on all SDs and major swap participants ("MSPs") registered with the Commission. Section 4s(e) of the CEA also directs the Commission and

---

[2] The Mexico Application was submitted by Colin D. Lloyd, Cleary Gottlieb Steen & Hamilton LLP, on behalf of the Applicants. The Mexico Application is available on the Commission's website at:https://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm.

[3] As discussed in Section I.A. immediately below, the U.S. prudential regulators have capital jurisdiction over registered swap dealers that are subject their regulation ("bank SDs") and the Commission has capital jurisdiction over registered SDs that are not subject to the regulation of a U.S. prudential regulator (i.e., nonbank SDs).

[4] 7 U.S.C. 1 *et seq.* The CEA may be accessed through the Commission's website, *www.cftc.gov*.

[5] 7 U.S.C. 6s(e).

[6] The term "prudential regulators" is defined in the CEA to mean the Board of Governors of the Federal Reserve System ("Federal Reserve Board"); the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Farm Credit Administration; and the Federal Housing Finance Agency. *See* 7 U.S.C. 1a(39).

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.[7] Therefore, the Commission's authority to impose capital requirements and margin requirements for uncleared swap transactions extends to nonbank SDs and nonbank MSPs, including nonbank subsidiaries of bank holding companies regulated by the Federal Reserve Board.[8]

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.[9] The Commission adopted final rules imposing initial and variation margin obligations on nonbank SDs and nonbank MSPs for

[7] 7 U.S.C. 6s(e)(2).

[8] 7 U.S.C. 6s(e)(1) and (2).

[9] *See Margin and Capital Requirements for Covered Swap Entities*, 80 FR 74840 (Nov. 30, 2015).

uncleared swap transactions on January 6, 2016.[10] 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").[11]

Section 4s(f) of the CEA addresses SD and MSP financial reporting requirements.[12] 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.[13] The Commission's financial reporting obligations were adopted with the Commission's nonbank SD and nonbank MSP capital requirements, and also had a compliance date of October 6, 2021 ("CFTC Financial Reporting Rules").[14]

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

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

---

[10] *See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 FR 636 (Jan. 6, 2016).

[11] *See Capital Requirements of Swap Dealers and Major Swap Participants*, 85 FR 57462 (Sept. 15, 2020).

[12] 7 U.S.C. 6s(f).

[13] 7 U.S.C. 6s(f)(1)(A).

[14] *See* 85 FR 57462.

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").[15] 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").[16]

The Commission's approach for conducting a comparability determination with respect to the CFTC Capital Rules and the CFTC Financial Reporting Rules is a principles-based, holistic approach that focuses on whether the applicable foreign jurisdiction's capital and financial reporting requirements achieve comparable outcomes to the corresponding CFTC requirements.[17] In this regard, the approach is not a line-by-

---

[15] 17 CFR 23.106. 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. 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 Regulation 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 Regulation 23.105(p) (17 CFR 23.105(p)). Commission staff has issued, however, a time-limited no-action letter stating 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 Regulation 23.105(p). *See* CFTC Staff Letter 21-18, issued on August 31, 2021.

[16] 17 CFR 23.106(a)(3).

[17] 17 CFR 23.106(a)(3)(ii). *See also* 85 FR 57462 at 57521.

line assessment or comparison of a foreign jurisdiction's regulatory requirements with the Commission's requirements.[18] 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 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.[19]

---

[18] *See* 85 FR 57521.

[19] 17 CFR 23.106(a)(2).

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.[20]

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

[20] *See* 17 CFR 23.106(a)(3) and 85 FR 57520-57522.

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 a foreign nonbank MSP,[21] the Commission's review will include the extent to which the foreign jurisdiction's requirements address: (1) 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

[21] Regulation 23.101(b) requires a nonbank MSP to maintain positive tangible net worth. There are no MSPs currently registered with the Commission.

foreign jurisdiction's surveillance program for monitoring a nonbank MSP's compliance with such capital adequacy and financial reporting requirements, and the disciplinary process imposed on an MSP that fails to comply with such requirements.

Regulation 23.106 further provides that the Commission may impose any terms or conditions that it deems appropriate in issuing a Capital Comparability Determination.[22] 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

[22] *See* 17 CFR 23.106(a)(5).

Determination in lieu of all or parts of the CFTC Capital Rules and/or CFTC Financial Reporting Rules.[23] Notices must be filed electronically with the Commission's Market Participants Division ("MPD").[24] 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,[25] 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 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 all of the 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

---

[23] 17 CFR 23.106(a)(4).

[24] Notices must be filed in electronic form to the following email address: MPDFinancialRequirements@cftc.gov.

[25] *See* 17 CFR 140.91(a)(11).

Commission to be in compliance with the corresponding CFTC Capital Rules and/or CFTC Financial Reporting Rules.[26] Accordingly, if a nonbank SD or nonbank MSP fails to comply with the foreign jurisdiction's capital adequacy and/or financial reporting requirements, the Commission may initiate an action for a violation of the corresponding CFTC Capital Rules and/or CFTC Financial Reporting Rules.[27] 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.[28]

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.[29] 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

---

[26] 17 CFR 23.106(a)(4)(ii). Confirmation will be issued by MPD under authority delegated by the Commission. *See* 17 CFR 140.91(a)(11).

[27] *Id.*

[28] *Id*.

[29] The Commission has provided the Applicants with an opportunity to review for accuracy and completeness, and comment on, the Commission's description of relevant Mexican 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. A comparability determination based on an inaccurate description of foreign laws and regulations may not be valid.

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 Capital Comparability Determination and the Capital Comparability Determination Order.

C. Mexico Application for a Capital Comparability Determination for Mexico-Domiciled Nonbank Swap Dealers

The Applicants submitted the Mexico Application to request that the Commission issue a Capital Comparability Determination finding that compliance with the capital requirements of Mexico and the financial reporting requirements of Mexico, as specified in the Mexico Application, by a Mexican nonbank SD 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 Regulations 23.101 and 23.105.[30]

The Applicants have represented that the Securities Market Law (Ley del Mercado de Valores, the "Law")[31] and the General Provisions Applicable to Broker-Dealers (Disposiciones de Caracter General Aplicables a las Casa de Bolsa the "General Provisions")[32] issued by the Mexican Banking and Securities Commission ("Mexican Commission")[33] contain the capital adequacy requirements ("Mexican Capital Rules")

---

[30] Mexico Application, p. 1.

[31] Published in the Federal Official Gazette (Diario Oficial de la Federacion) on December 30, 2005, as amended.

[32] Published in the Federal Official Gazette on September 6, 2004, as amended.

[33] The Applicants represented that the Mexican Commission is a governmental agency that is part of the Ministry of Finance, and has independent technical and executive powers. The Applicants further

and financial reporting requirements ("Mexican Financial Reporting Rules") that apply to broker-dealers,[34] including Mexican nonbank SDs.[35] The Law and General Provisions impose mandatory capital and liquidity requirements that address quantifiable discretionary risks (credit risk, liquidity risk, and market risk), quantifiable non-discretionary risks (legal risk, operational risk, and technological risk), and non-quantifiable risks.[36] The Applicants currently are the only Mexican nonbank SDs registered with the Commission as SDs, and they represent that they are licensed with the Mexican Commission as broker-dealers subject to the Mexican Capital Rules and Mexican Financial Reporting Rules.

represented that the Mexican Commission is in charge of the supervision and regulation of financial entities, such as Mexican nonbank SDs, with the purpose of ensuring their stability and sound performance, as well as maintaining a safe and sound financial system. The Mexico Application provides that: (i) the scope of the Mexican Commission's authority includes inspection, supervision, prevention, and correction powers; (ii) the primary financial entities regulated by the Mexican Commission are commercial banks, national development banks, regulated multiple purpose financial institutions, and broker-dealers, such as Mexican nonbank SDs; and (iii) the Mexican Commission is also in charge of granting and revoking broker-dealer licenses in Mexico. *See*, Mexico Application, p. 4 (footnote 10).

[34] The Applicants represented that pursuant to the provisions set forth in Article 113 of the Law, broker-dealers, such as Mexican nonbank SDs, among other entities, are the only financial institutions that may conduct securities intermediation transactions. Under Article 2 of the Law, securities intermediation is defined as the customary and professional performance of any of the following activities in Mexico: (i) actions for the purpose of facilitating the contact between the supply and demand of securities; (ii) the execution of transactions with securities for the account of third parties as commission agent, attorney-in-fact, or in any other capacity, participating in the relevant legal transactions either personally or on behalf of third parties; and (iii) the negotiation of securities on an intermediary's own account with the general public or with other intermediaries acting on their own account or on behalf of third parties. The organization and operation of broker-dealers, such as Mexican nonbank SDs, is governed by the Law and General Provisions. *See* Mexico Application, p. 4 (footnote 11).

[35] Mexico Application, p. 4.

[36] *Id.*

II. General Overview of Commission and Mexican 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").[37]

Nonbank SDs that are "predominantly engaged in non-financial activities" may elect the TNW Approach.[38] The TNW Approach requires a nonbank SD to maintain a level of "tangible net worth"[39] equal to or greater than the higher of: (i) $20 million plus the amount of the nonbank SD's "market risk exposure requirement"[40] and "credit risk

---

[37] 17 CFR 23.101.

[38] 17 CFR 23.101(a)(2). The term "predominantly engaged in non-financial activities" is defined in Regulation 23.100 (17 CFR 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.

[39] The term "tangible net worth" is defined in 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.

[40] The terms "market risk exposure" and "market risk exposure requirement" are defined in Regulation 23.100 (17 CFR 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. Market risk exposure is the sum of: (i) general market risks including changes in the market value of a particular asset that result 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.

exposure requirement"[41] 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;[42] or (iii) the amount of capital required by a registered futures association of which the nonbank SD is a member.[43] 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 exposure requirement using standardized capital charges set forth in Securities and Exchange Commission ("SEC") Rule 18a-1[44] that are applicable to entities registered with the SEC as security-based swap dealers ("SBSDs") or standardized capital charges set forth in Regulation 1.17 applicable to entities registered as FCMs or entities dually-registered as an FCM and nonbank SD.[45] Nonbank SDs that

---

[41] The term "credit risk exposure requirement" is defined in Regulation 23.100 (17 CFR 23.100) and generally reflects the amount at risk if a counterparty defaults before the final settlement of a swap transaction's cash flows.

[42] The term "uncleared swap margin" is defined in Regulation 23.100 (17 CFR 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. 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.

[43] 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.

[44] 17 CFR 240.18a-1.

[45] 17 CFR 23.101(a)(2)(ii)(A).

have received Commission or NFA approval pursuant to 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.[46]

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.[47] 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.[48] 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.[49]

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.[50] A nonbank SD that is approved to

---

[46] *Id.*

[47] 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."

[48] *See* 17 CFR 240.18a-1(c) and (d).

[49] *See* 17 CFR 23.101(a)(1)(ii).

[50] *See* 17 CFR 23.102.

use internal market risk and/or credit risk models is further required to maintain a minimum of $100 million of "tentative net capital."[51]

The Commission's NLA Approach is consistent with the SEC's SBSD 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.[52] The Bank-Based Approach also is consistent with the Basel Committee on Banking Supervision's ("BCBS") international framework for bank capital requirements.[53] 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-

[51] 17 CFR 23.101(a)(1)(ii)(A)(*1*). The term "tentative net capital" is defined in 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.

[52] *See* 17 CFR 23.101(a)(1)(i).

[53] 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.

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.[54] 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.[55] 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.[56] The term "additional tier 1 capital" is defined to include the nonbank SD's common equity tier 1 capital and further includes such additional equity instruments as preferred stock.[57] 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).[58] 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

---

[54] 17 CFR 23.101(a)(1)(i).

[55] *Id*. Regulation 23.101(a)(1)(i) references Federal Reserve Board Rule 217.20 (12 CFR 217.20) for purposes of defining the terms used in establishing the minimum capital requirements under the Bank-Based Approach.

[56] *See* 12 CFR 217.20(b).

[57] *See* 12 CFR 217.20(c).

[58] *See* 12 CFR 217.20(d).

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.[59]

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 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 Regulation 1.17 and SEC Rule 18a-1, and must compute their credit risk charges using

[59] 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).

the standardized capital charges set forth in regulations of the Federal Reserve Board for bank holding companies contained in Subpart D of 17 CFR Part 217.[60]

Standardized market risk charges are computed under 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.[61] 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 17 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.[62] 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 17 CFR Part 217.[63] 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

---

[60] *See* 17 CFR 23.101(a)(1)(i)(B) and the definition of the term BHC risk-weighted assets in 17 CFR 23.100.

[61] *See* 17 CFR 1.17(c)(5) and 17 CFR 240.15c3-1(c)(2).

[62] *See* 17 CFR 23.102.

[63] Nonbank SDs electing the Bank-Based Approach that have been approved to use internal credit risk models may also be required to include a calculation of operational risk in its risk-weighted assets calculation.

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 Mexican Capital Rules for Mexican Nonbank SDs

The Mexican Capital Rules impose bank-like capital requirements on a Mexican nonbank SD that are consistent with the BCBS framework for international bank-based capital standards.[64] The Mexican Capital Rules are intended to require each Mexican nonbank SD to hold a sufficient amount of qualifying equity and subordinated debt 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.[65]

The Mexican Capital Rules require each Mexican nonbank SD to hold and maintain: (i) common equity tier 1 capital equal to at least 4.5 percent of the Mexican nonbank SD's risk-weighted assets; (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 Mexican nonbank SD's risk-weighted assets; (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 Mexican nonbank SD's risk-weighted assets; and (iv) a capital conservation buffer[66] equal to 2.5 percent of the Mexican nonbank SD's risk-weighted assets, which must be

[64] *See* Mexico Application, p. 9.

[65] *See* Mexico Application, pp. 4-5.

[66] *See* Mexico Application, p. 5.

met with common equity tier 1 capital.[67] Therefore, a Mexican nonbank SD is effectively required to maintain total qualifying regulatory capital equal to or greater than 10.5 percent of the firm's risk-weighted assets, with common equity tier 1 capital comprising a minimum of 7 percent of the 10.5 percent total.[68] The Mexican Capital Rules also restrict the types of equity instruments that qualify as regulatory capital as follows: (i) common equity tier 1 capital may be comprised of retained earnings and common equity instruments; (ii) additional tier 1 capital may be comprised of other capital instruments and certain long-term convertible subordinated debt instruments; and (iii) tier 2 capital may include certain subordinated debt instruments.[69]

The amount of regulatory capital required to be held by a Mexican nonbank SD is determined by calculating and aggregating the firm's total risk exposures, including market risk, credit risk, and operational risk.[70] The methods of calculating such exposures are based on the BCBS bank capital framework.[71]

---

[67] Articles 172 and 173 of the Law and Article 162 of the General Provisions. Notably, the Mexico Capital Rules employ different terminology to refer to the components of total capital than the CFTC Capital Rules and the BCBS bank capital framework. For example, the Mexican Capital Rules refer to total capital as "net capital," common equity tier 1 capital as "fundamental capital," and the 8 percent requirement is described as a "capitalization index" requirement. For ease of reference between the capital regimes, and to avoid confusion, this Capital Comparability Determination and the proposed Capital Comparability Determination Order use the same terminology that is used in the Commission's Bank-Based Approach and in the BCBS bank capital framework.

[68] As noted above, the total capital requirement is the sum of the capital requirement equal to 8 percent of the firm's risk-weighted assets, plus the capital conservation buffer of 2.5 percent of the firm's risk-weighted assets.

[69] Article 162 Bis and 162 Bis 1 of the General Provisions.

[70] Mexican Application, p. 9.

[71] *Id.*

Mexican nonbank SDs compute the capital charges for market risk exposure and credit risk exposure using standardized approaches.[72] In this regard, the Mexican Capital Rules do not permit Mexican nonbank SDs to use internal models to compute credit risk charges.[73] Also, although the Mexican Capital Rules permit a Mexican nonbank SD to calculate market risk charges using internal models that comply with guidelines issued by the Mexican Commission, no Mexican nonbank SD is currently approved to use internal market risk models nor do any Mexican nonbank SDs have model applications pending with the Mexican Commission.[74] Therefore, the Commission, in performing this Capital Comparability Determination and in proposing the Capital Comparability Determination Order, has not reviewed or evaluated the use of internal models to compute market risk or credit risk charges under the Mexican Capital Rules. Accordingly, any Mexican nonbank SD that subsequently obtains the approval of the Mexican Commission to use internal models to compute market risk or credit risk charges, and seeks to use such models in lieu of the standardized charges set forth in the Mexican Capital Rules in meeting the CFTC capital requirements, may do so only after the Commission has reviewed and evaluated whether the Mexican Capital Rules impose conditions and requirements on the use of models that are comparable in purpose and effect as the conditions and requirements imposed on the use of models under the CFTC Capital Rules, and whether the use of the models under the Mexican Capital Rules and the CFTC Capital Rules achieve comparable outcomes. The Commission is further proposing to condition the

[72] Article 150 Bis of the General Provisions.

[73] Mexican Application, p. 11.

[74] *Id.*, p. 9 (footnote 23).

order to require a Mexican nonbank SD to notify the Commission and NFA at the time it initiates the process to request approval to use internal models for capital purposes. The request to use internal market or credit risk models in lieu of standardized capital charges may require the Commission to amend an existing Capital Comparability Determination Order.

Standardized market risk and credit risk charges are calculated under the Mexican Capital Rules using a methodology that is consistent with the BCBS bank capital framework for standardized market risk and credit risk charges. With respect to market risk, the Mexican Capital Rules require a Mexican nonbank SD to multiply the market value or carrying value of its on-balance sheet and off-balance sheet market exposures by standard percentages established by the Mexican Commission and set forth in the Mexican Capital Rules.[75] With respect to credit risk, the Mexican Capital Rules require the assignment of a scheduled risk-weight[76] to each counterparty based on external risk assessments. For derivatives positions, the Mexican Capital Rules provide for the exposures to be computed based on the instruments underlying the derivatives positions[77] with strict limitations on the recognition of offsetting risks.[78] The resulting market risk exposure amount and credit risk exposure amount are multiplied by a factor of 12.5 to cancel the effect of the 8 percent multiplication factor applied to all of the Mexican nonbank SD's risk-weighted assets, which effectively requires a Mexican nonbank SD to

[75] Articles 150 to 158 Bis of the General Provisions.

[76] Articles 159, 160 and 161 of the General Provisions.

[77] Article 151 of the General Provisions.

[78] Article 152 of the General Provisions.

hold qualifying regulatory capital equal to or greater than 100 percent of the total amount of its market risk and credit risk exposures.[79]

A Mexican nonbank SD calculates its capital charges for operational risk exposure using the basic method set forth in the General Provisions.[80] The basic method calculates operational risk exposure as an amount equal to 15 percent of Mexican nonbank SD's average annual net positive income for the last three years,[81] taking into account insurance coverage for operational risk, subject to strict limitations and conditions.[82] The amount of the operational risk exposure is also subject to a floor equal to 5 percent and a ceiling equal to 15 percent of the monthly average sum of market risk and credit risk exposure amounts, calculated over the prior 36 months, on a rolling basis.[83] The resulting operational risk exposure amount is also multiplied by a factor of 12.5 to cancel the effect of the 8 percent multiplication factor applied to all of the Mexican nonbank SD's risk-weighted assets, which effectively requires a Mexican nonbank SD to hold qualifying regulatory capital equal to or greater than 100 percent of its total operational risk exposure amount.[84]

The Mexican Capital Rules also impose liquidity requirements on Mexican nonbank SDs in addition to minimum capital requirements.[85] The liquidity provisions require each Mexican nonbank SD to hold or invest at least 20 percent of its total capital

[79] Articles 158 Bis and 161 of the General Provisions.

[80] Article 161 Bis of the General Provisions.

[81] Article 161 Bis 1 of the General Provisions.

[82] Article 161 Bis 2 of the General Provisions.

[83] Article 161 Bis 3 of the General Provisions.

[84] Article 161 Bis 5 of the General Provisions.

[85] *See* Article 146 of the General Provisions.

in any of the following: (i) bank deposits; (ii) highly liquid debt securities registered in Mexico; (iii) shares of debt investment funds; (iv) reserve funds created to maintain funds available to cover contingencies, as set forth by the applicable regulation issued by self-regulatory organizations (organismos autorregulatorios), such as the securities central clearinghouse (Contraparte Central de Valores De Mexico, S.A. de C.V.) and the central derivatives clearinghouse (Asigna, Compensacion y Liquidacion F/30430),[86] as well as the Mexican Association of Securities Intermediaries (Asociacion Mexicana de Intermediarios Bursatiles, A.C. or AMIB);[87] and (v) high and medium marketability shares to which a market value discount of 20 percent and 25 percent, respectively, is applied, provided that they are registered as "trading" or "available for sale" securities.[88]

A Mexican nonbank SD also must follow specified procedures in monitoring its liquidity to ensure that it has sufficient liquid assets to meet anticipated needs.[89] When monitoring and managing liquidity risk, a Mexican nonbank SD must, among other things: (i) measure, assess and monitor risk caused by differences between forecast cash flows on various dates; (ii) consider the assets and liabilities of the firm in Mexican pesos and foreign currency; (iii) assess the diversification of sources of financing to which the firm has access; (iv) quantify the potential loss from early or obligatory sale of assets at an unusual discount in order to meet immediate obligations; and (v) estimate the potential

[86] Article 228 of the Law recognizes the stock exchange and the securities central clearinghouse as self-regulatory organizations and indicates that other entities that comply with certain requirements (such as Asigna and the AMIB) may be recognized as self-regulatory organizations.

[87] Reserve funds represent funds deposited with a self-regulatory organization to cover potential losses, and are not freely available to a Mexican nonbank SD.

[88] Article 146 of the General Provisions.

[89] *See* Article 137 of the General Provisions.

loss if it is not possible to renew liabilities or contract others under normal conditions.[90] The liquidity requirements supplement the minimum capital requirements by obligating a Mexican nonbank SD to maintain a defined amount of liquid assets to cover current liabilities and other current obligations to counterparties, including margin obligations, and obligations to other third parties.

III. Commission Analysis of the Comparability of the Mexican Capital Rules with CFTC Capital Rules, and Mexican Financial Reporting Rules with CFTC Financial Reporting Rules

The following section provides a description and comparative analysis of the regulatory requirements of the Mexican Capital Rules and Mexican 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 Mexico's corresponding laws, regulations, or rules. The Commission then provides a comparative analysis of the Mexican Capital Rules or the Mexican Financial Reporting Rules with the corresponding CFTC Capital Rules or CFTC Financial Reporting Rules. The Commission identifies any material differences between the respective rules.

The Commission performed this proposed Capital Comparability Determination by assessing the comparability of the Mexican Capital Rules for Mexican nonbank SDs, as set forth in the Mexico Application and in the English language translation of certain Mexican laws and regulations, with the Commission's Bank-Based Approach. For

[90] *Id.*

clarity, the Commission did not assess the comparability of the Mexican Capital Rules to the Commission's TNW Approach or NLA Approach as the Commission understands that the Applicants, as of the date of the Mexico Application, are subject to the current bank-based capital approach of the Mexican Capital Rules. Accordingly, when the Commission makes a preliminary determination herein about the comparability of the Mexican Capital Rules with the CFTC Capital Rules, the determination pertains to the comparability of the Mexican Capital Rules with the Bank-Based Approach under the CFTC Capital Rules.

As described below, it is proposed that any material changes to the Mexican Capital Rules will require notification to the Commission. Therefore, if there are subsequent material changes to the Mexican 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.[91]

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 BCBS 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

[91] The Commission also may amend or supplement the 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.

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 key categories that focus the analysis on whether the Mexican capital and financial reporting requirements are comparable to the Commission's SD requirements in purpose and effect, and not whether the Mexican 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 Mexican 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 Mexican nonbank SD to its relevant regulatory

authorities to effectively monitor the financial condition of the firm; and (iv) the regulatory notices and other communications between the Mexican nonbank SD and its relevant regulatory authorities that detail potential adverse financial or operational issues that may impact the firm. The Commission also reviewed the manner in which compliance by a Mexican nonbank SD with the Mexican Capital Rules and Mexican Financial Reporting rules is monitored and enforced. The Commission invites public comment on all aspects of the Mexico Application and on the Commission's Capital Comparability Determination discussed below.

A. Regulatory Objectives of CFTC Capital Rules and CFTC Financial Reporting Rules and Mexican Capital Rules and Mexican Financial Reporting Rules

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

The regulatory objectives of the CFTC Capital Rules and 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.[92] 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

[92] *See* 7 U.S.C. 6s(e)(3)(A).

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 swaps market, or impact the firm's solvency.[93]

2. *Regulatory Objective of Mexican Capital Rules and Mexican Financial Reporting Rules*

The regulatory objective of the Mexican Capital Rules is to ensure the safety and soundness of Mexican financial firms, including Mexican nonbank SDs. The Mexican Capital Rules are designed to preserve the financial stability and solvency of a Mexican nonbank SD by requiring the firm to maintain a sufficient amount of quality equity and

[93] *See* 17 CFR 23.105.

subordinated debt to absorb decreases in the value of firm assets, increases in the value of firm liabilities, and to cover losses from business activities, including counterparty defaults and margin collateral shortfalls associated with the firm's swap dealing activities.[94] The Mexican Capital Rules also are designed to ensure that a Mexican nonbank SD can meet its financial obligations to counterparties and other creditors during stressed market conditions by requiring each firm to maintain a minimum of 20 percent of its total capital in specified liquid assets.[95]

The objective of the Mexican Financial Reporting Rules is to enable the Mexican Commission and other relevant Mexican regulatory authorities to assess the financial condition and safety and soundness of Mexican nonbank SDs.[96] The Mexican Financial Reporting Rules aim to achieve this objective by requiring each Mexican nonbank SD to provide financial reports and other financial position and capital information to the Mexican Commission and Mexican Central Bank on a regular basis.[97] The financial reporting by a Mexican nonbank SD provides the Mexican Commission and Mexican Central Bank with information necessary to effectively monitor the Mexican nonbank SD's overall financial condition and its ability to meet its regulatory obligations as a Mexican licensed broker-dealer.

3. Commission Analysis

The Commission has reviewed the Mexico Application and the relevant Mexican laws and regulations, and has preliminarily determined that the overall objectives of the

[94] Article 146 of the General Provisions.

[95] *Id*.

[96] *See* Article 173 of the Law.

[97] *See* Articles 201, 202, and 203 of the General Provisions.

Mexican 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 Mexican Capital Rules and CFTC Capital Rules are also based on, and consistent with, the BCBS international bank capital framework, which was designed to ensure that banking entities hold sufficient levels of capital to absorb losses, decreases in the value of assets, and increases in the value of liabilities without the banks becoming insolvent.[98]

The Mexican Capital Rules are comparable in purpose and effect to the CFTC Capital Rules in that both regulatory approaches compute the minimum capital requirements based on the level of a nonbank SD's on-balance sheet and off-balance sheet exposures, with the objective and purpose of ensuring that the nonbank SD's capital is adequate to absorb losses resulting from such exposures. The Mexican Capital Rules and CFTC Capital Rules also provide for a comparable approach to the calculation of on-balance sheet and off-balance sheet risk exposures using non-model, standardized approaches that result in comparable risk exposure amounts. The Mexican Capital Rules' and CFTC Capital Rules' requirements for identifying and measuring on-balance sheet and off-balance sheet exposures under standardized approaches are also consistent with

[98] The BCBS's mandate is to strengthen the regulation, supervision and practices of banks with the purpose of enhancing financial stability. *See Basel Committee Charter* available on the Bank for International Settlement website: www.bis.org/bcbs/charter.htm.

the requirements set forth under the BCBS international bank capital framework for identifying and measuring on-balance sheet and off-balance sheet exposures.

The Mexican Capital Rules and CFTC Capital Rules achieve comparable outcomes and are comparable in purpose and effect in that both limit the types of capital instruments that may qualify as regulatory capital to cover the on-balance sheet and off-balance sheet risk exposures to high quality equity capital and qualifying subordinated debt instruments that meet conditions designed to ensure that the holders of the debt have effectively subordinated their claims to other creditors of the nonbank SD. Both the Mexican Capital Rules and the CFTC Capital Rules define high quality capital by the degree to which the capital represents permanent capital that is contributed, or readily available to a nonbank SD, on an unrestricted basis to absorb unexpected losses, including losses from swaps trading and other activities, decreases in the value of firm assets, and increases in the value of firm liabilities without the nonbank SD becoming insolvent.

The Mexican Financial Reporting Rules are also comparable in purpose and effect with the CFTC Financial Reporting Rules as both the Mexican Commission and CFTC require nonbank SDs to file periodic financial reports, including unaudited financial reports and an annual audited financial report, detailing their financial operations and demonstrating their compliance with minimum capital requirements. In addition to providing the CFTC and Mexican Commission with information necessary to comprehensively assess the financial condition of a nonbank SD on an ongoing basis, the financial reports further provide the CFTC and Mexican Commission 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 Mexican Commission in meeting their respective objectives of ensuring the safety and soundness of nonbank SDs. In this connection, the early identification of potential financial issues provides the Commission and Mexican Commission with an opportunity to address such issues with the nonbank SD before they develop to a state where the financial condition of the firm is 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 Mexico Application and relevant Mexican 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 Regulation 23. 101.[99] 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.[100] The Commission's requirement for a nonbank SD to maintain a minimum amount of defined qualifying capital and subordinated debt is intended to 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.[101] 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.[102] Total tier 1 capital is composed

---

[99] *See* 17 CFR 23.101(a)(1)(i), which requires a nonbank SD electing the Bank-Based Approach to maintain regulatory capital equal to or in excess of each of the following: (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.

[100] 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.

[101] 12 CFR 217.20.

[102] *Id.*

of common equity tier 1 capital and further includes additional tier 1 capital.[103] Tier 2 capital includes certain types of instruments that include both debt and equity characteristics such as qualifying subordinated debt.[104]

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.[105]

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. Mexican Capital Rules: Qualifying Capital

The Mexican Capital Rules require each Mexican nonbank SD to maintain a level of regulatory capital that equals or exceeds 8 percent of the firm's risk-weighted assets,

---

[103] *Id*.

[104] *Id*.

[105] The subordinated debt must meet the requirements set forth in SEC Rule 18a-1d (17 CFR 240.18a-1d). *See* Regulation 23.101(a)(1)(i)(B); 17 CFR 23.101(a)(1)(i)(B).

which is the sum of the Mexican nonbank SD's market risk, credit risk, and operational risk charges.[106] The Mexican 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.[107] In this regard, the Mexican Capital Rules provide that: (i) common equity tier 1 capital may generally be composed of retained earnings and common equity instruments; (ii) additional tier 1 capital may include other capital instruments and certain long-term convertible debt instruments; and (iii) tier 2 capital may include certain qualifying subordinated debt instruments.[108]

Furthermore, with respect to tier 2 capital, qualifying subordinated debt may not be short-term debt and the Mexican nonbank SD must retain the right to cancel the payment of interest on the debt.[109] Specifically, qualifying subordinated debt under the Mexican Capital Rules must have an initial minimum term of 10 years and the Mexican nonbank SD must have the right to cancel interest payments, subject to certain conditions, or to convert the debt to common equity of the firm.[110] In addition, the proceeds received by the Mexican nonbank SD from the issuance of the subordinated debt must be immediately available to the firm for use as it deems appropriate, with no restrictions.[111]

---

[106] Articles 172 and 173 of the Law and Article 162 of the General Provisions.

[107] *See* Article 162 of the General Provisions (setting forth components of regulatory capital (*i.e.*, capital fundamental, capital basico no fundamental, and capital complementario) equivalent to common equity tier 1 capital, additional tier capital and tier 2 capital).

[108] Articles 162 Bis and 162 Bis 1 of the General Provisions.

[109] Articles 162 Bis and 163 of the General Provisions.

[110] *Id*.

[111] Article 163 of the General Provisions.

A Mexican nonbank SD must also maintain a capital conservation buffer equal to 2.5 percent of the firm's risk-weighted assets in addition to the requirement to maintain qualifying regulatory capital in excess of 8 percent of its risk-weighted assets. The 2.5 percent capital conservation buffer must be met with common equity tier 1 capital.[112] Common equity tier 1 capital, as noted above, is limited to the Mexican nonbank SD's common equity and retained earnings, and represents a more conservative or permanent form of capital than equity instruments that qualify as additional tier 1 capital and tier 2 capital.

The Mexican Capital Rules also impose different ratios for the various components of regulatory capital that are consistent with the BCBS bank capital framework.[113] In this regard, the Mexican Capital Rules provide that a Mexican nonbank SD's minimum regulatory capital must satisfy the following requirements: (i) common equity tier 1 capital must equal or exceed 4.5 percent of the firm's risk-weighted assets; (ii) total tier 1 capital (*i.e.*, common equity tier 1 capital plus additional tier 1 capital) must equal or exceed 6 percent of the firm's risk-weighted assets; and (iii) total capital (*i.e.*, an aggregate amount of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital) must equal or exceed 8 percent of the firm's risk-weighted assets. A Mexican nonbank SD also must maintain a capital conservation buffer of 2.5 percent of its total risk-weighted assets that must be met with common equity tier 1 capital.[114] With the addition of the capital conservation buffer, each Mexican nonbank SD is required to

[112] Article 162 of the General Provisions.

[113] *See Id.*

[114] *See supra* note 66.

maintain minimum regulatory capital that equals or exceeds 10.5 percent of the firm's risk-weighted assets, with common equity tier 1 capital comprising at least 7 percent of the 10.5 percent minimum regulatory capital requirement.

3. Commission Analysis

The Commission has reviewed the Mexico Application and the relevant Mexican laws and regulations, and has preliminarily determined that the Mexican Capital Rules are comparable in purpose and effect to CFTC Capital Rules with regard to the types and characteristics of a nonbank SD's equity that qualifies as regulatory capital in meeting its minimum requirements. The Mexican Capital Rules and the CFTC Capital Rules for nonbank SDs both require a nonbank SD to maintain a quantity of high-quality and permanent capital, 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 Mexican 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 to the distribution of firm assets or income with respect to other shareholders or creditors of the firm, which makes this equity available to a nonbank SD to absorb unexpected losses, including counterparty defaults.

In addition, the Commission has preliminarily determined that the conditions imposed on subordinated debt instruments under the Mexican 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 capital purposes. The conditions include, in the case of the CFTC Capital Rules, regulatory requirements that effectively subordinate the claims of debt holders to interest and repayment of the debt to the claims of other creditors of the nonbank SD, and, in the case of the Mexican Capital Rules, regulatory requirements that provide Mexican nonbank SDs with the right to cancel scheduled interest payments and to convert the debt to common equity of the firm.[115]

Having reviewed the Mexico Application and the relevant Mexican laws and regulations, the Commission has made a preliminary determination that the Mexican Capital Rules and CFTC Capital Rules impose comparable requirements on Mexican 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 Mexico Application and the relevant Mexican laws and regulations

B. 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;

[115] *See* 17 CFR 240.18a-1d and Articles 162 and 162 Bis of the General Provisions.

(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.[116]

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 in order 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.[117] The Commission adopted this minimum requirement as it believed that the role a nonbank SD performs in the financial 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 that the firm meets its financial commitments to swap counterparties and creditors without the firm becoming insolvent.[118]

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

---

[116] 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.

[117] 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).

[118] *See, e.g.,* 85 FR 57492.

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.[119]

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

[119] *See*, 85 FR 57462.

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 credit risk charges, unless the nonbank SD has been approved by the Commission or NFA to use internal models.[120] For standardized market risk charges, the Commission incorporates by reference the standardized market risk charges set forth in Regulation 1.17 for FCMs and SEC Rule 18a-1 for nonbank SBSDs.[121] The standardized market risk charges under 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.[122] 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.[123]

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

---

[120] *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.

[121] *See* paragraph (3) of the definition of the term *BHC equivalent risk-weighted assets* in 17 CFR 23.100.

[122] *See* 17 CFR 240.18a-1(c)(1).

[123] *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.

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.[124] 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.[125] 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.[126]

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").[127] Both CEM and SA-CCR are non-model, rules-based, approaches to calculating counterparty credit risk for derivatives positions. Credit risk 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.[128] Credit risk under SA-CCR is defined as the exposure at default amount of a

---

[124] *See* 17 CFR 23.101(a)(1)(i)(B) and the paragraph (1) of the definition of the term *BHC equivalent risk-weighted assets* in 17 CFR 23.100.

[125] *See* 17 CFR 217.32.

[126] *See* 17 CFR 217.33.

[127] *See* 17 CFR 217.34. *See also* Regulation 23.100 (17 CFR 23.100) defining the term BHC Risk Equivalent Amount, 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 derivatives contracts with regard to the status of its affiliate entities under the Federal Reserve Board's capital rules.

[128] *See* 12 CFR 217.34.

derivatives contract, which is computed as the sum of: (i) the replacement costs of the contract (*i.e.*, the positive mark-to market); and (ii) the potential futures exposure of the contract multiplied by a factor of 1.4.[129]

A nonbank SD also may obtain the approval of 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 application to the Commission or NFA.[130] 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 deductions for 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").[131] Subpart F is based on models that are consistent with the BCBS Basel 2.5 capital framework.[132] The Commission's qualitative and quantitative requirements for internal capital models also are comparable to the SEC's

---

[129] *See* 12 CFR 217.132(c).

[130] *See* 17 CFR 23.102(c).

[131] *See* paragraph (4) of the definition of *BHC equivalent risk-weighted assets* in 17 CFR 23.100.

[132] *Compare* 17 CFR 23.100 (providing for a nonbank SD that is approved to use internal models to calculate credit and market 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 NLA Approach to calculate its net capital in accordance with SEC Rule 18a-1) and Appendix A to Subpart E of 17 CFR Part 23, 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).

existing internal capital model requirements for BDs and SBSDs,[133] which are also broadly based on the BCBS Basel 2.5 capital framework.

A nonbank SD approved to use internal models to compute credit risk is required to perform such computation in accordance with Subpart E of the Federal Reserve Board's Part 217 regulations.[134] These internal credit risk modeling requirements are also based on the Basel 2.5 capital framework or the Basel 3 capital framework.

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

---

[133] The SEC internal model requirements for SBSDs are listed in 17 CFR 240.18a-1(d). *See also* SEC FOCUS Report Part II, Computation of Net Capital (Filer Authorized to Use Models) (providing for inclusion of a market risk exposure section for Basel 2.5 firms).

[134] 12 CFR 217 Subpart E. A nonbank SD is provided with alternative approaches to computing is capital under the Federal Reserve Board's rules. As noted when the Commission adopted the SD capital rules, the Commission understands that some alternatives may include charges or deductions for risks not otherwise part of market and credit risk models described or explicitly required under the Commission's rule (*e.g.*, operational risk), however, the Commission was not prepared to accept partial application of alternative calculation methods or to compensate this inclusion by reducing other charges calculated per this rule outside of the market and credit risk models. Therefore, such chargers or deductions must be factored into the calculation of the nonbank SD's minimum capital requirements. *See* 85 FR 57462 at 57496.

update frequency.[135] 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.[136]

In addition, BCBS standards for market risk models include a series of 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. Mexican Capital Rules: Mexican Nonbank Swap Dealer Minimum Capital Requirements

The Mexican Capital Rules impose bank-like capital requirements on a Mexican nonbank SD that, consistent with the BCBS international bank capital framework, require the Mexican nonbank SD to hold a sufficient amount of qualifying equity capital and subordinated debt to absorb decreases in the value of firm assets and increases in the value of firm liabilities, and to cover losses from its activities, including possible

[135] *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/bcbs193.pdf

[136] 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/bcbs193.pdf

counterparty defaults and margin collateral shortfalls associated with its swap dealing activities, without the firm becoming insolvent. Specifically, the Mexican Capital Rules require each Mexican nonbank SD to maintain qualifying regulatory capital to satisfy the following capital ratios, expressed as a percentage of the firm's total risk-weighted assets: (i) common equity tier 1 capital equal to at least 4.5 percent of the firm's risk-weighted assets; (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 firm's risk-weighted assets; (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 firm's risk-weighted assets; and (iv) an additional capital conservation buffer of 2.5 percent of the firm's risk-weighted asset that must be met with common equity tier 1 capital.[137] Thus, a Mexican nonbank SD is required to maintain regulatory capital equal to at least 10.5 percent of its total risk-weighted assets, 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).

The Mexican nonbank SD's risk-weighted assets are calculated as the sum of the firm's market risk, credit risk, and operational risk charges. The risk charges are computed using standardized (*i.e.,* non-model) approaches that are based on the same principles and methodology as the BCBS bank capital framework. The Applicants also represent that a Mexican nonbank SD is required to compute its risk-weighted assets using standardized approaches in a manner similar to the standardized approaches

[137] Articles 172 and 173 of the Law and Article 162 of the General Provisions.

adopted by the Federal Reserve Board for bank holding companies and set forth in 12 CFR Part 217 of the Federal Reserve Board's rules.[138]

A Mexican nonbank SD is required to take a deduction from capital for market risk based on standardized charges published by the Mexican Commission,[139] which include market risk deductions for interest rate, foreign exchange, precious metals and equity price risks.[140] The Mexican Capital Rules do not have market risk charges specific to commodity price risk as Mexican nonbank SDs are not permitted to engage in physical commodity transactions.[141]

For derivatives positions, a Mexican nonbank SD is required to take standardized market risk charges based on the nature of the instrument underlying the derivatives position.[142] The market risk charges are based on cumulative calculations for individual derivatives positions with limited recognition of offsets.[143]

The resulting total market risk exposure amount, including market risk exposure for derivative positions, is multiplied by a factor of 12.5 to adjust the 8 percent multiplication factor applied to all of the Mexican nonbank SD's risk-weighted assets, which effectively requires a Mexican nonbank SD to hold qualifying regulatory capital equal to or greater than 100 percent of the firm's market risk exposure amount.

---

[138] Mexican Application, p. 7.

[139] Market risk models may be used if authorized by the Mexican Commission. The Mexican Commission, however, has not authorized the use of market risk models for any of the Mexican nonbank SDs, and no Mexican nonbank SD is currently seeking model authorization.

[140] Article 150 Bis of the General Provisions.

[141] *See,* Mexico Application, p. 10, footnote 26.

[142] Article 151 of the General Provisions.

[143] Article 152 of the General Provisions.

The Mexican Capital Rules also require a Mexican nonbank SD to calculate credit risk exposure under a standardized approach by taking the accounting value of each of its on-balance sheet and off-balance sheet positions and exposures, determining a conversion value to credit risk determined pursuant to Mexican regulation,[144] and then applying a specific risk-weight based on the type of issuer or counterparty, as applicable, and the assets' credit quality.[145] The resulting credit risk exposure amount is also multiplied by a factor of 12.5 to adjust the 8 percent multiplication factor applied to all of the firm's risk-weighted assets, which effectively requires the Mexican nonbank SD to hold regulatory capital equal to or greater than 100 percent of the firm's total credit risk exposure.

The Mexican Capital rules further require a Mexican nonbank SD to retain qualifying regulatory capital to cover operational risk. Operational risk is computed using the basic method set forth in the Mexican Capital Rules.[146] The basic method calculates operational risk exposure as an amount equal to 15 percent of Mexican nonbank SD's average annual net positive income for the last three years,[147] taking into account insurance coverage for operational risk, subject to strict limitations and conditions.[148] The amount of the operational risk exposure is subject to a floor equal to 5 percent and a ceiling equal to 15 percent of the monthly average sum of market and credit

[144] Article 160 of the General Provisions.

[145] Articles 159, 160, and 161 of the General Provisions. Mexican nonbank SDs are required to use a standardized approach to computing all credit risk charges as the Mexican Capital Rules do not authorize the use of internal credit risk models. *See*, Mexico Application, p. 11.

[146] Article 161 Bis of the General Provisions.

[147] Article 161 Bis 1 of the General Provisions.

[148] Article 161 Bis 2 of the General Provisions.

risk exposure amounts, calculated over the prior 36 months, on a rolling basis.[149] The resulting operational risk exposure amount is multiplied by a factor of 12.5 to adjust the effect of the 8 percent multiplication factor applied to all of the Mexican nonbank SD's risk-weighted assets, which effectively requires a Mexican nonbank SD to hold qualifying regulatory capital equal to or greater than 100 percent of the amount of its operational risk exposure.[150]

The Mexican Capital Rules also require a Mexican nonbank SD to comply with minimum paid-in capital requirements depending on the services or activities to be performed by the firm.[151] The minimum paid-in capital is a fixed value of capital that a Mexican nonbank SD is required to maintain. The minimum paid-in-capital requirement is indexed to Inflation Indexed Units ("UDIs"), so a different minimum capital is required each year depending on the UDI equivalence. In the context of the Mexican nonbank SDs, which perform the broadest array of activities, the requirement was 12,500,000 UDIs, which for 2022 equaled approximately MXN $90,000,000 (or USD $4,300,000).[152]

In addition to the minimum paid-in-capital requirement, the Mexican Central Bank also imposes limits on a Mexican nonbank SD's overall leverage.[153] The leverage

[149] Article 161 Bis 3 of the General Provisions.

[150] Article 161 Bis 5 of the General Provisions.

[151] Article 10 of the General Provisions.

[152] Considering an exchange rate per USD of MXN $20.7882 as published by the Mexican Central Bank in the Federal Official Gazette (Diario Oficial de la Federacion) on July 12, 2022.

[153] Section C.B1 of Circular 115/2002, issued by the Mexican Central Bank on November 11, 2002, as amended.

rules are based principally on volume and counterparties without regard to risk-weighting.[154]

The Mexican Commission may also require a Mexican nonbank SD to satisfy additional capital requirements, considering the composition of the firm's capital, the composition of the firm's assets, the efficiency of the firm's internal control systems, the firm's compliance with its remuneration system and, in general, the firm's exposure and risk management.[155] The Mexican Commission also quarterly publishes on its website the classification of broker-dealers, including Mexican nonbank SDs, according to categories based on their respective capital ratios as an additional measure to incentivize firms to maintain sufficient levels of capital.[156]

The Mexican Capital Rules also impose liquidity requirements on Mexican nonbank SDs[157] The liquidity provisions require each Mexican nonbank SD to invest or hold at least 20 percent of its total capital in defined cash accounts, investments, reserve

---

[154] *Id.* Mexican nonbank SDs may not have positions in securities and debt instruments acquired with financing that exceed specified limits, including issuer limits and global capital thresholds.

[155] Article 169 of the General Provisions.

[156] Article 204 Bis 1, Article 204 Bis 2, and Article 204 Bis 3 of the General Provisions. The Mexican Commission classifies each broker-dealer into categories based on the firm's common equity tier 1 capital ratio, basic capital ratio (*i.e.*, common equity tier 1 capital plus additional tier 1 capital ratios), and total capital ratio as reported to the Mexican Commission. The categories range from 1 to 5, with 1 being the highest classification category and 5 being the lowest classification category. The classification categories for common equity tier 1 capital ratios are: (i) less than 4.5%; (ii) equal to or greater than 4.5% and less than 7%; and (iii) equal to or greater than 7%. The classifications for the basic capital ratio are: (i) less than 6%; (ii) equal to or greater than 6% and less than 8.5%; and (iii) equal to or greater than 8.%. The classifications for a firm's total capital ratio are: (i) less than 4.5%; (ii) equal to or greater than 4.5% and less than 7%; (iii) equal to or greater than 7% and less than 8%; (iv) equal to or greater than 8% and less than 10.5%; and (v) equal to or greater than 10.5%. The Mexican Commission announces the classification categories for each broker-dealer, including the Mexican nonbank SDs, on a quarterly basis and makes the classifications publicly available on the Mexican Commission's website.

[157] *See* Article 146 of the General Provisions.

funds set forth by regulations of applicable self-regulatory organizations or clearing organizations.[158]

A Mexican nonbank SD also must follow specified procedures in monitoring its liquidity and to ensure that it has sufficient liquid assets to meet anticipated needs.[159] When monitoring and managing liquidity risk, a Mexican nonbank SD must, among other things: (i) measure, assess and monitor risk caused by differences between forecast cash flows on various dates; (ii) consider the assets and liabilities of the firm in Mexican pesos and foreign currency; (iii) assess the diversification of sources of financing to which the firm has access; (iv) quantify the potential loss from early or obligatory sale of assets at an unusual discount in order to meet immediate obligations; and (v) estimate the potential loss if it is not possible to renew liabilities or contract others under normal conditions.[160] The liquidity requirements supplement the minimum capital requirements by obligating a Mexican nonbank SD to maintain a defined amount of liquid assets to cover current liabilities and other current obligations to counterparties, including margin obligations, and obligations to other third parties.

Lastly, a Mexican nonbank SD is required to conduct annual stress tests to ensure that the firm retains sufficient capital.[161] The stress test assessments are designed to determine whether a Mexican nonbank SD's capital would be sufficient to cover losses

[158] Article 228 of the Law recognizes the stock exchange and the securities central clearinghouse as self-regulatory organizations and indicates that other entities that comply with certain requirements may be recognized as self-regulatory organizations. *See, also,* Article 146 of the General Provisions.

[159] *See* Article 137 of the General Provisions.

[160] *Id.*

[161] Article 214 of the General Provisions.

under the supervisory scenarios identified by the Mexican Commission, whether the Mexican nonbank SD would remain in its current capital category, and whether the Mexican nonbank SD would comply with the minimum capital requirements.[162] To this end, a Mexican nonbank SD must submit annually to the Mexican Commission a report containing the results of its stress test assessments.[163] A Mexican nonbank SD also must file a preventive action plan if the stress tests indicate that the firm's capital ratios are not sufficient.[164]

3. Commission Analysis

The Commission has reviewed the Mexico Application and the relevant Mexican laws and regulations, and has preliminarily determined that the Mexican Capital Rules are comparable in purpose and effect to CFTC Capital Rules with regard to the establishment of a nonbank SD's minimum capital requirement and the calculation of the nonbank SD's amount of regulatory capital. Although there are differences in the minimum capital requirements and calculation of regulatory capital between the Mexican Capital Rules and the CFTC Capital Rules, as discussed below, the Commission preliminary believes that the Mexican 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 its swap dealing

[162] *See id.*

[163] Article 216 of the General Provisions.

[164] Article 217 of the General Provisions.

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 CFTC Capital Rules require a nonbank SD electing the Bank-Based Approach to maintain regulatory capital in an amount that meets or exceeds each of the following requirements: (i) $20 million of common equity tier 1 capital; (ii) 8 percent of the nonbank SD's uncleared swap margin amount; (iii) 8 percent of the nonbank SD's risk-weighted assets (with common equity tier 1 capital comprising at least 6.5 percent of the 8 percent); and (iv) the amount of capital required by NFA.[165]

Prong (i) of the CFTC Capital Rules recited above 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.[166]

The Mexican Capital Rules also contain a requirement that each Mexican nonbank SD maintain a fixed amount of minimum paid-in capital that is based on the services or activities performed by the firm.[167] The minimum paid-in capital requirement is a fixed value of capital that is indexed annually to UDIs. Mexican nonbank SDs that

---

[165] 17 CFR 23.101(a)(1)(i). NFA has not adopted additional capital requirements for nonbank SDs and, therefore, an analysis of the comparability of this element of the CFTC Capital Rules with the Mexican Capital Rules is not applicable.

[166] 85 FR 57492.

[167] Article 10 of the General Provisions.

performed the broadest array of activities as of the year ending December 31, 2021 were subject to a minimum paid-in capital requirement that equaled approximately MXN $90,000,000 (or USD $4,300,000).[168]

The Mexican Capital Rules and the CFTC 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. The Commission, however, preliminarily believes that CFTC-registered nonbank SDs should maintain a minimum amount of $20 million of common equity tier 1 capital irrespective of the volume of its dealing activities to help ensure that the firm satisfies its regulatory obligations to market participants, including meeting its financial commitments to swap counterparties and creditors, without the firm becoming insolvent. The Commission recognizes that the $20 million of common equity tier 1 capital required under the CFTC Capital Rules is substantially higher than the estimated $4.3 million of minimum paid-in capital required under the Mexican Capital Rules and 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. Since the Commission preliminarily finds fundamental capital, as defined in Article 162 and Article 162 Bis of the General Provisions, to be comparable to common equity tier 1 capital required under the CFTC Capital Rules, the Commission is proposing to condition the Capital Comparability Determination Order to require each Mexican nonbank SD to maintain, at all times, a

[168] Considering an exchange rate per USD of MXN $20.7882 as published by the Mexican Central Bank in the Federal Official Gazette (Diario Oficial de la Federacion) on July 12, 2022.

minimum level of $20 million of fundamental capital.[169] The proposed condition would require each Mexican nonbank SD to maintain an amount denominated in pesos that is equivalent to $20 million in U.S. dollars. The Commission is also proposing that a Mexican nonbank SD may convert the peso-denominated amount of this minimum capital requirement to the U.S. dollar equivalent based on a commercially reasonable and observed exchange rate.

The Commission preliminarily believes that the Mexican Capital Rules and CFTC Capital Rules are also comparable in that both impose minimum capital requirements on nonbank SDs that are based on the BCBS bank capital framework, which requires a banking entity to hold qualifying capital, including subordinated debt, in an amount in excess of certain percentages of the banking entity's risk-weighted assets (*i.e.*, its on-balance sheet and off-balance sheet exposures). In this regard, prong (iii) of the CFTC Capital Rules recited above 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 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.[170] 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

[169] Each of the three current Mexican nonbank SDs currently maintains fundamental 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 Mexican nonbank SDs currently registered with the Commission. Nonetheless, the Commission requests comment on the proposed condition.

[170] 17 CFR 23.101(a)(1)(B).

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 Mexican Capital Rules contain capital requirements for Mexican nonbank SDs that the Commission preliminarily believes are comparable to the requirements contained in prong (iii) of the CFTC Capital Rules. Specifically, the Mexican Capital Rules require each Mexican nonbank SD to maintain: (i) common equity tier 1 capital equal to at least 4.5 percent of the Mexican nonbank SD's risk-weighted assets; (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 Mexican nonbank SD's risk-weighted assets; 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 Mexican nonbanks SD's risk-weighted assets.[171] In addition, the Mexican Capital Rules further require each Mexican nonbank SD to maintain an additional capital conservation buffer[172] equal to 2.5 percent of the Mexican nonbank SD's risk-weighted assets, which must be met with common equity tier

[171] Articles 172 and 173 of the Law and Article 162 of the General Provisions.

[172] *See* Mexico Application, p. 5.

1 capital.[173] Thus, a Mexican nonbank SD is effectively required to maintain total qualifying regulatory capital equal to or greater than 10.5 percent of the firm's risk-weighted assets, which is a higher percentage than the 8 percent required of nonbank SDs under prong (iii) of the CFTC Capital Rules.[174]

The Commission also preliminarily believes that the Mexican Capital Rules and CFTC Capital Rules are comparable with respect to the calculation of market risk and credit risk in determining a nonbank SD's risk-weighted assets. As noted above, Mexican nonbank SDs currently are not authorized by the Mexican Commission to use models to compute market risk or credit risk exposures and, therefore, must compute their risk-weighted assets using standardized market risk and credit risk charges set forth in the Mexican Capital Rules, which generally produce charges that are higher than model-based charges.[175]

The Commission preliminarily believes that the approach to computing the standardized market risk and credit risk charges set forth in the Mexican Capital Rules is comparable to the standardized approach set forth in the CFTC Capital Rules, and is also consistent with the approach for calculating standardized market risk and credit risk charges under the BCBS bank capital framework. Specifically, the standardized

---

[173] Articles 172 and 173 of the Law and Article 162 of the General Provisions.

[174] As noted above, the total capital requirement is the sum of the capital requirement equal to 8 percent of the firm's risk-weighted assets, plus the capital conservation buffer of 2.5 percent of the firm's risk-weighted assets. *See* Articles 162 and 162 Bis of the General Provisions.

[175] For clarity, the Commission notes that it has not reviewed or evaluated the use of internal models to compute market or credit risk charges under the Mexican Capital Rules. Therefore, a Mexican nonbank SD that obtains the approval of the Mexican Commission to use models to compute market risk or credit risk charges and seeks to use such models in lieu of the standardized charges, may do so only after the Commission has reviewed and evaluated the use of the subject models for purpose of comparison to the corresponding CFTC requirements.

approaches under the Mexican Capital Rules and CFTC Capital Rules for calculating market and credit risk follow the same structure that is now the common global standard: allocating assets to categories according to risk and assigning each category a risk-weight; allocating counterparties according to risk assessments and assigning each a risk factor; calculating gross exposures based on valuation of assets; calculating a net exposure allowing offsets following well defined procedures and subject to clear limitations; adjusting the net exposure by the market risk-weights; and finally, for credit risk exposures, multiplying the sum of net exposures to each counterparty by their corresponding risk factor.

The Mexican Capital Rules, however, differ from the CFTC Capital Rules with respect to a nonbank SD's computation of its market risk exposures and credit risk exposures that are included in the firm's risk-weighted assets. As noted above, the CFTC Capital Rules and Mexican Capital Rules both require a nonbank SD to maintain regulatory capital equal to or greater than 100 percent of the firm's market risk exposure amount.[176] The Mexican Capital Rules, however, also require a Mexican nonbank SD to maintain regulatory capital equal to or greater than 100 percent of its credit risk exposure amount.[177] The CFTC Capital Rules only require a nonbank SD to maintain regulatory capital equal to or greater than 8 percent of the firm's total credit risk exposure amount.

[176] The CFTC Capital Rules and the Mexican Capital Rules both require a nonbank SD to maintain regulatory capital equal to or in excess of 8 percent of the firm's total risk-weighted assets. Both sets of rules further require that the nonbank SD multiply its total market risk exposure amount by a factor of 12.5 and add the resultant amount to its total risk-weighted assets, which has the effect of requiring the nonbank SD to hold regulatory capital equal to or greater than 100 percent of its market risk exposure amount.

[177] The Mexican Capital Rules require a Mexican nonbank SD to multiply its total credit risk exposure amount by a factor of 12.5 and to add the resultant amount to its total credit risk-weighted assets, which has the effect of requiring the Mexican nonbank SD to hold regulatory capital equal to or greater than 100 percent of its credit risk exposure amount. In contrast, the CFTC Capital Rules require a nonbank SD to maintain regulatory capital sufficient to cover 8 percent of its credit risk exposure amount.

The difference in approaches to computing risk-weighted assets would result in a nonbank SD having a larger amount of risk-weighted assets, and a higher minimum capital requirement based on risk-weighted assets, under the Mexican Capital Rules as compared to the CFTC Capital Rules.

The Commission also preliminarily believes that the Mexican Capital Rules and CFTC Capital Rules are comparable in that nonbank SDs are required to account for operational risk, in addition to market risk and credit risk, in computing their minimum capital requirements. In this connection, the Mexican Capital Rules require a Mexican nonbank SD to calculate an operational risk exposure amount equal to 15 percent of a Mexican nonbank SD's average annual net positive income for the last three years, on a rolling basis.[178] The Mexican nonbank SD is then required to multiply the operational risk exposure amount by a factor of 12.5 and add the resultant amount to the total operational risk-weighted assets, which has the effect of requiring the Mexican nonbank SD to hold regulatory capital equal to or greater than 100 percent of its operational risk exposure amount.

The CFTC Capital Rules address operational risk as a stand-alone, separate minimum capital requirement that a nonbank SD is required to meet under prong (ii) of the Bank-Based Approach recited above, and not as an additional risk exposure element in the calculation of the nonbank SD's total risk weighted assets.[179] Specifically, the

[178] The amount of the operational risk exposure is also subject to a floor equal to 5 percent and a ceiling equal to 15 percent of the monthly average sum of market and credit risk exposure amounts, calculated over the prior 36 months, also on a rolling basis. *See*, Article 161 Bis 3 of the General Provisions.

[179] As noted in footnote 134 above, nonbank SDs may be required to include operational risk in computing its risk-weighted assets if they elect certain alternatives set forth in the rules of Federal Reserve Board.

CFTC Capital Rules require 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.[180] As noted above, 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 a SD to market participants, and to cover potential operational, legal, and liquidity risks.[181]

CFTC rules also require a SD to maintain a risk management program to address certain risks associated with operating as SD, including operational, liquidity, legal, market, credit, foreign currency, settlement, and other applicable risks.[182] 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,

---

[180] The term "uncleared swap margin" is defined by Regulation 23.100 (17 CFR 23.100) as the amount of initial margin, computed in accordance with the Commission's margin rules for uncleared swaps (17 CFR 23.154), that a nonbank SD would be required to collect from each counterparty for each outstanding swap position of the nonbank SD. 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 Regulation 23.150 (17 CFR 23.150), exempt foreign exchange swaps or foreign exchange forwards, or netting set of swaps or foreign exchange swaps, for each counterparty, as if that counterparty was an unaffiliated swap dealer. Furthermore, in computing the uncleared swap margin amount, a nonbank SD may not exclude any de minis thresholds contained in Regulation 23.151 (17 CFR 23.151).

[181] *See* 85 FR 57462 at 57485.

[182] 17 CFR 23.600.

physical commodities, and other derivatives.[183] 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.[184] With respect to operational risk, the risk management program must take into account, among other operational risks: (i) secure and reliable operating and information systems with adequate, scalable capacity; (ii) safeguards to detect, identify, and promptly correct deficiencies in operating and information systems; and (iii) the reconciliation of all data and information in operating and information systems.[185]

The Mexican Capital Rules and CFTC rules also impose liquidity requirements on Mexican nonbank SDs and nonbank SDs, respectively. The Mexican Capital Rules require Mexican nonbank SDs to meet quantitative liquidity requirements, which require a Mexican nonbank SD to hold or invest at least 20 percent of the firm's total capital in liquid assets comprised of: (i) bank deposits; (ii) highly liquid debt securities registered in Mexico; (iii) shares of debt investment funds; (iv) reserve funds created to maintain funds available to cover contingencies; and (v) high and low marketability shares subject to market value discounts of 20 and 25 percent, respectively.[186]

The CFTC Capital Rules do not include a specific, quantifiable, liquidity component. The CFTC rules, however, address liquidity risks through the SD risk

[183] 17 CFR 23.600(b).

[184] 17 CFR 23.600(c)(1).

[185] 17 CFR 23.600(c)(4)(vi).

[186] Article 146 of the General Provisions.

management program. Specifically, the SD's risk management program must take into account, among other things, the daily measurement of liquidity needs, the assessment of the procedures to liquidate all non-cash collateral in a timely manner without a significant effect on price, and the application of appropriate haircuts that accurately reflect market risk and credit risk of the noncash collateral.[187]

The CFTC SD risk management requirements also address legal risk. Regulation 23.600(c)(4)(v) requires a SD to take into account, among other things, determinations that transactions and netting arrangements entered into have a sound legal basis, and the establishment of documentation tracking procedures designed to ensure the completeness of relevant documentation and procedures to resolve any documentation exceptions on a timely basis.[188]

The Commission has reviewed the Mexico Application and the relevant Mexican laws and regulations, and has preliminarily determined that the Mexican Capital Rules are comparable in purpose and effect to CFTC Capital Rules with regard to the establishment of a nonbank SD's minimum capital requirement and the calculation of the nonbank SD's amount of regulatory capital to meet that requirement. As previously noted, the Commission's approach for conducting a comparability determination is a principles-based, holistic approach that focuses on whether the applicable foreign jurisdiction's capital requirements for nonbank SDs achieve comparable outcomes to the corresponding CFTC requirements for nonbank SDs.[189] The focus of the comparability

[187] 17 CFR 23.600(c)(4)(iii).

[188] 17 CFR 23.600(c)(4)(v).

[189] *See* 85 FR 57520, 57521.

determination is on whether the foreign jurisdiction's capital requirements are comparable to the Commission's in purpose and effect, and not on whether the foreign jurisdiction's capital requirements are comparable in every aspect or contain identical elements based on a line-by-line assessment or comparison of the foreign jurisdiction's regulatory requirements with the Commission's regulatory requirements.[190] Although there are differences between the Mexican Capital Rules and the CFTC Capital Rules, as discussed above, the Commission preliminary believes that the differences do not preclude a finding that the Mexican Capital Rules and CFTC Capital Rules, taken as a whole, produce comparable regulatory outcomes. In this connection, the Commission preliminarily finds that, subject to the proposed condition of a $20 million capital requirement, as discussed above, the Mexican Capital Rules and CFTC Capital Rules are comparable in purpose and effect, and are designed to ensure that nonbank SDs maintain appropriate levels of regulatory capital in order to meet their obligations as swap market participants and to absorb losses, including unexpected losses, without the firms becoming insolvent.

The Commission invites comment on the Mexico Application, Mexican laws and regulations, and the Commission's analysis above regarding its preliminary determination that, subject to the $20 million minimum capital requirement, the Mexican 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 requirement under the Mexican

[190] *Id.*

Capital Rules for a Mexican nonbank SD to hold qualifying capital in an amount equal to 15 percent of its average annual net positive income from the last three years, taking into account insurance coverage for operational risk, and subject to a floor equal to 5 percent and a ceiling of 15 percent of the monthly average sum of market risk and credit risk exposures amounts, calculated over the prior 36 months, on a rolling basis, is sufficiently comparable in purpose and effect to the CFTC's requirement for a nonbank SD to hold qualifying capital in amount equal to at least 8 percent of the nonbank SD's uncleared swap margin amount.

D. Nonbank Swap Dealer Financial Reporting Requirements

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

The CFTC Financial Reporting Rules imposes 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.[191] 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.[192]

[191] 17 CFR 23.105(b).

[192] *Id*.

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.[193] A nonbank SD that elects the TNW Approach is required to file unaudited financial statements within 17 business day of the close of each quarter, and its annual audited financial statements within 90 days of the end of its fiscal year-end.[194] 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 the end of its fiscal year.[195]

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.[196] The annual audited 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

[193] 17 CFR 23.105(d) and (e).

[194] 17 CFR 23.105(d)(1) and (e)(1).

[195] *Id*.

[196] 17 CFR 23.105(d)(2).

calculation of the applicable regulatory 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.[197]

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.[198] 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.[199] 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.[200]

The 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.[201] The individual making the oath or affirmation must

[197] 17 CFR 23.105(e)(4).

[198] 17 CFR 23.105 (k) and (l) and Appendix B to Subpart E of Part 23.

[199] 17 CFR 23.105(l) and Appendix B to Subpart E of Part 23.

[200] 17 CFR 23.105(l) in Schedules 2, 3, and 4, respectively.

[201] 17 CFR 23.105(f).

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.[202]

The CFTC Financial Reporting Rules further require each nonbank SD to make certain financial information publicly available by posting the information on its public website.[203] 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.[204] 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.[205] A nonbank SD also must obtain written approval from NFA to change the date of its fiscal year-end for financial reporting.[206]

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").[207] The Margin Report contains: (i) the name and address of each custodian holding initial margin or variation margin that is

---

[202] *Id.*

[203] 17 CFR 23.105(i).

[204] *Id.*

[205] *Id*.

[206] 17 CFR 23.105(g).

[207] 17 CFR 23.105(m).

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.[208] 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 monitoring 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. Mexican Nonbank Swap Dealer Financial Reporting Requirements

The Mexican Financial Reporting Rules impose financial recordkeeping and reporting requirements on Mexican nonbank SDs that enable the Mexican Commission to assess the financial condition and safety and soundness of the Mexican nonbank SDs.

[208] *Id.*

Consistent with that purpose, a Mexican nonbank SD must periodically report its financial position and capital levels to the Mexican Commission and other Mexican regulatory authorities. The reporting of financial position and capital level information, along with other reporting requirements, provide the Mexican Commission with a comprehensive view of the activities and financial condition of each Mexican nonbank SD.

Specifically, the Mexican Financial Reporting Rules require a Mexican nonbank SD to submit to the Mexican Commission quarterly consolidated financial reports and an annual consolidated financial report.[209] The quarterly consolidated financial reports must be for the quarters ending March, June, and September of each year, and must be filed with the Mexican Commission within the month following the last day of each quarter.[210] The annual consolidated financial report must be filed within 90 calendar days of the Mexican nonbank SD's fiscal year end, and must contain an audit report issued by an independent external auditor.[211] The quarterly and annual financial reports are required to be denominated in millions of Mexican pesos and prepared in accordance with the Accounting Criteria for Broker-Dealers.[212]

The Mexican nonbank SD's quarterly consolidated financial reports and annual audited consolidated financial report must contain a balance sheet, a statement of income/loss, a statement of changes in equity, a statement of cash flows, and a statement

[209] Article 203 of the General Provisions.

[210] *Id.*

[211] *Id.*

[212] *See* Article 176 and Exhibit 5 of the General Provisions.

showing the firm's compliance with minimum capital requirements.[213] The annual audited consolidated report also must contain appropriate footnote disclosures relating to, among other topics, nominal amounts of derivatives contracts by type of instrument and by underlying valuation results, as well as the results obtained in the assessment of the adequacy of the firm's regulatory capital in relation to credit, market and operational risk requirements.[214] Each quarterly and annual consolidated financial report also must be approved by the Mexican nonbank SD's board of directors and internal audit committee, and signed by at least the chief executive officer, the chief accountant, and the internal auditor, or their equivalent.[215]

In addition to the above consolidated financial reports, each Mexican nonbank SD must provide the Mexican Commission, on a monthly basis, with a balance sheet and income statement, along with additional financial information.[216] Such reports are due within 20 days following the end of the respective month.[217] On a quarterly basis, each Mexican nonbank SD also must provide the Mexican Commission additional financial information regarding deferred income taxes, consolidation with respect to balance sheet and income statements, stockholders equity statements, and cash flow statements.[218]

A Mexican nonbank SD licensed to enter into derivatives transactions for its own account is also required to file with the Mexican Central Bank, during May of each year,

---

[213] Article 180 of the General Provisions.

[214] *Id.*

[215] Articles 175, 176, and 179 of the General Provisions.

[216] Article 202 of the General Provisions.

[217] *Id.*

[218] Article 202 and Exhibit 9 of the General Provisions.

a written communication issued by the Mexican nonbank SD's internal audit committee evidencing compliance in the performance of its derivatives transactions with each and all applicable legal provisions and, when required by the Mexican Central Bank, a Mexican nonbank SD also must provide the Mexican Central Bank with all the information related to the derivatives transactions performed by the firm.[219] Furthermore, a Mexican nonbank SD licensed to perform derivatives transactions is required to file a report with the Mexican Central Bank on a daily basis containing all the derivatives transactions performed by the Mexican nonbank SD.[220]

A Mexican nonbank SD is also required to make certain financial condition information publicly available by posting the information on a publicly accessible website. Specifically, a Mexican nonbank SD is required to provide its quarterly financial statements to the general public along with information related to the firm's regulatory capital structure, including the main components of the firm's regulatory capital structure, the capital adequacy level, and the amount of the assets subject to risk.[221] A Mexican nonbank SD must also disclose its risk level,[222] according to the

[219] Provision 3.1.3 of the Rule 4/2012 issued by the Mexican Central Bank.

[220] Mexico Application, p. 19.

[221] Article 180 of the General Provisions.

[222] Pursuant to Article 144 of the General Provisions, broker-dealers shall make available to investors, through notes in their annual financial statements and on their websites, the information related to the policies, methodologies, levels of risk assumed and other relevant measures adopted for the management of each type of risk, including qualitative and quantitative information in connection with such risks.

credit rating issued by two credit rating agencies authorized by the Mexican Commission, including for such purposes both ratings, in their notes to their financial statements.[223]

3. Commission Analysis

The Commission has reviewed the Mexico Application and the relevant Mexican laws and regulations, and has preliminarily determined that the financial reporting requirements of the Mexican Financial Reporting Rules, subject to the conditions specified below, are comparable to the CFTC Financial Reporting Rules in purpose and effect as they are intended to provide the Mexican Commission and Mexican Central Bank, as applicable, and the Commission, respectively, with financial information to monitor and assess the financial condition of nonbank SDs and their ongoing ability to absorb decreases in the value of firm assets and increases in the value of firm liabilities, and to cover losses from business activities, including swap dealing activities, without the firm becoming insolvent.

The Mexican Financial Reporting Rules require each Mexican nonbank SD to prepare and submit to the Mexican Commission on a quarterly basis an unaudited financial report, and on an annual basis an audited financial report, that includes: (i) a statement of financial condition; (ii) a statement of profit and loss; (iii) a statement of changes in equity; (iv) a statement of cash flows; and (v) a statement showing the firm's compliance with minimum capital requirements. In addition, a Mexican nonbank SD is required to file a statement of financial condition and a statement of profit/loss as of the end of each month with the Mexican Commission. The Commission preliminarily finds that these financial reporting requirements are comparable with respect to overall form

[223] Article 169 Bis of the General Provisions.

and content to the CFTC Financial Reporting Rules, which require each nonbank SD to file monthly unaudited financial reports with the Commission and NFA that contain: (i) a statement of financial condition; (ii) statement of profit/loss; (iii) a statement of changes in liabilities subordinated to the claims of general creditors; (iv) a statement of changes in ownership equity; and (v) a statement demonstrating compliance with the capital requirements. Accordingly, the Commission has preliminarily determined that a Mexican nonbank SD may comply with the financial reporting requirements contained in Regulations 23.105 by complying with the corresponding Mexican Financial Reporting Rules, subject to the conditions set forth below.[224]

The Commission is proposing to condition the Capital Comparability Determination Order on a Mexican nonbank SD providing the Commission and NFA with copies of the monthly financial information, including a copy of its balance sheet and income statement, that is filed with the Mexican Commission pursuant to Article 202 and Exhibit 9 of the General Provisions. It is further proposed that a Mexican nonbank SD must provide the Commission and NFA with copies of its quarterly consolidated financial reports and annual audited financial reports that are filed with the Mexican Commission pursuant to Article 203 of the General Provisions. In addition, the Commission is proposing that the Mexican nonbank SD also provide as part of its monthly filing a statement of regulatory capital. The Commission is also proposing to condition the Capital Comparability Determination Order on the Mexican nonbank SD translating the annual audited and unaudited monthly and quarterly financial reports into

[224] A Mexican nonbank SD that qualifies and elects to seek substituted compliance with Mexican Capital Rules must also seek substituted compliance with the Mexican Financial Reporting Rules.

the English language with balances contained in the unaudited financial reports converted to U.S. dollars. The annual audited financial report may be presented in U.S. dollars or Mexican pesos. The monthly financial information and the unaudited and audited financial reports must be filed with the Commission and NFA within 15 business days of the earlier of the date the respective reports are filed with the Mexican Commission or the date that the respective reports are required to be filed with the Mexican Commission.

The Commission is proposing to impose these conditions as financial reporting is a critical and central component of the Commission's ongoing obligation to monitor and assess the safety and soundness of nonbank SDs as required under Section 4s(e) of the CEA. For nonbank SDs registered with the Commission, it is necessary for the Commission to effectively monitor the ongoing financial condition of all nonbank SDs, including Mexican 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 believes that its approach of requiring Mexican nonbank SDs to provide the Commission and NFA with copies of the monthly financial information, and the quarterly and annual financial reports, that the firms currently file with the Mexican Commission 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 Mexican Commission including its financial reporting requirements. Under the proposed conditions, the Mexican nonbank SD would not be required to prepare separate financial statements or reports for filing with the Commission, but would be required to translate its current financial statements and reports into the English

language with balances converted to U.S. dollars so that Commission staff may properly understand and efficiently analyze the financial information. The proposed conditions also provide the Mexican nonbank SDs with 15 days from the date the reports are provided to the Mexican Commission to translate the documents into English and to convert balances to U.S. dollars.

The Commission is also proposing to condition the Capital Comparability Determination Order on a Mexican nonbank SD 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.[225] The Commission is proposing to require that Schedule 1 be filed with the Commission and NFA as part of the Mexican nonbank SD's monthly financial information that it prepares pursuant to Article 202 and Exhibit 9 of the General Provisions. Schedule 1 provides the Commission and NFA with detailed information regarding the financial positions that a nonbank SD holds as of the end of the month, which will allow for closer supervision and monitoring of the types of investment and other activities that the firm engages in, which will enhance the Commission's and NFA's ability to monitor the safety and soundness of the firm.

The Commission is further proposing to condition the Capital Comparability Determination Order on a Mexican nonbank SD submitting with each monthly and quarterly financial report and each annual audited financial report, as well as the applicable Schedule 1, a statement by an authorized representative or representatives of

[225] 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.

the Mexican nonbank SD that to the best knowledge and belief of the representative or representatives the information contained in the respective report is true and correct, including the translation of the report into the English language and conversion of balances in the reports to U.S. dollars. The statement by the authorized representative or representatives of the Mexican nonbank SD would be in lieu of the oath or affirmation required of nonbank SDs under Regulation 23.105(f),[226] and is intended to ensure that reports 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 Mexican nonbank SD filing the Margin Report specified in Regulation 23.105(m) with the Commission and NFA. The Margin Report is required to contain: (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.[227]

The Commission preliminarily believes that receiving this margin information from Mexican nonbank SDs will assist in the Commission's assessment of the safety and soundness of the Mexican nonbank SDs. Specifically, the Margin Report would provide

[226] 17 CFR 23.105(f).

[227] 17 CFR 23.105(m).

the Commission with information regarding a Mexican 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 firm's and counterparties' swaps collateral, 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 proposing to require that the Margin Report be filed with the Commission as part of the Mexican nonbank SD's monthly financial information that it prepares pursuant to Article 202 and Exhibit 9 of the General Provisions. Therefore, it is being proposed that each Mexican nonbank SD must file a monthly Margin Report within 15 business days of the earlier of the date the monthly financial reports are filed with the Mexican Commission or the date that the respective reports are required to be filed with the Mexican Commission. The Commission is also proposing that the Margin Report must be prepared in the English language with balances reported in U.S. dollars.

The Commission is not proposing to require a Mexican nonbank SD to file the monthly model metric information contained in Regulation 23.105(k) with the Commission or NFA.[228] 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. This information is not applicable as the Mexican Commission, as previously noted, has not approved the Mexican nonbank SDs to use internal models to compute market risk or credit risk.

[228] 17 CFR 23.105(k).

The Commission is also not proposing to require a Mexican nonbank SD to file the monthly counterparty credit exposure information specified in Regulation 23.105(l) and Schedules 2, 3, and 4 of Appendix B to Subpart E of Part 23 with the Commission or NFA. 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. The Commission preliminarily believes that, under a substituted compliance regime, the Mexican Commission is best positioned to monitor a Mexican nonbank SD's credit exposures, which may be comprised of credit exposures to primarily other Mexican counterparties, as part of the Mexican Commission's overall monitoring of the financial condition of the firm.

Furthermore, the Commission, in making the preliminary determination to not require a Mexican nonbank SD to file the counterparty exposures required by Regulation 23.105(l), recognizes that NFA's current risk monitoring program requires each bank SD and each nonbank SD, including each Mexican nonbank SD, to file risk metrics addressing market risk and credit risk with NFA on a monthly basis. NFA's risk metric information includes a list of the 15 largest swaps counterparty exposures providing for each counterparty: (i) current exposure by counterparty before collateral; and (ii) current exposure by counterparty net of collateral. The NFA risk metric information also includes a SD's total current exposure before collateral for the firm across all

counterparties, as well as, total current exposure net of collateral.[229] Although there are differences in the information required under Regulation 23.105(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 to such firms. 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 bank SDs and nonbank SDs (including Mexican nonbank SDs) under NFA rules, provide the appropriate balance of recognizing the comparability of the Mexican 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 nonbank Mexican SDs.

The Commission notes that the proposed financial reporting conditions in the Mexican Capital Comparability Determination Order are consistent with the proposed conditions set forth in the Commission's proposed Japan Capital Comparability Determination Order,[230] and reflects the Commission's approach in that proposal of permitting non-U.S. nonbank SDs to meet their financial statement reporting obligations to the Commission by filing copies of existing financial reports currently prepared for home country regulators provided such reports are translated into English and, in certain circumstances, balances expressed in U.S. dollars. The Commission's proposed conditions also include certain financial information and notices that the Commission

[229] *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).
[230] *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).

believes are necessary for effective monitoring of Mexican nonbank SDs that are not currently part of the Mexican Commission's supervision regime.

The Commission invites public comment on its analysis above, including comment on the Mexico Application and relevant Mexican Financial Reporting Rules. The Commission also invites comment on the proposed conditions listed above and on the Commission's proposal not to require Mexican nonbank SDs to submit to the Commission and NFA the information set forth in Regulation 23.105(l) outlined above. Are there specific elements of the data required under Regulations 23.105(l) that the Commission should require of Mexican nonbank SDs for purposes of monitoring the financial condition of the firm?

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 Mexican nonbank SDs to prepare the reports, translate the reports into English, 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 the reporting conditions that the proposed Capital Comparability Determination Order would impose on Mexican nonbank SDs. In this connection, if the Commission were to require Mexican nonbank SDs to file the Margin Report discussed above and included in the proposed Order below, how much time would Mexican nonbank SDs need to develop new systems or processes to capture information that is required? Would Mexican nonbank SDs need a period of time to develop any systems or processes to meet any other reporting conditions in the proposed Capital Comparability

Determination Order? If so, what would be an appropriate amount of time for a Mexican 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.[231] The notice provisions are intended to provide the Commission and NFA with an opportunity to assess whether the information contained in the written notices indicates the existence of actual or potential financial and/or operational issues at a nonbank SD, and, when necessary, allow 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.

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.[232] 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.[233] A nonbank SD also is required to provide notice if the firm fails to post or collect initial

[231] 17 CFR 23.105(c).

[232] 17 CFR 23.105(c)(1), (2), and (3).

[233] 17 CFR 23.105(c)(4).

margin for uncleared swap and non-cleared security-based swap transactions or exchange variation margin for uncleared swap or 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 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 Regulation 23.101 calculated for all of the firm's counterparties.[234]

The CFTC Financial Reporting Rules further require a nonbank SD to provide advance notice of an intention to withdraw capital by an equity holder that would exceed 30 percent of the firm's excess regulatory capital.[235] Finally, a nonbank SD that is dually-registered with the SEC as an SBSD or major security based swap participant ("MSBSP") must file a copy of any notice with the Commission and NFA that the SBSD or MSBSP is required to file with the SEC under SEC Rule 18a-8 (17 CFR 240.18a-8).[236] SEC Rule 18a-8 requires SBSDs and MSBSPs to provide written notice to the SEC for comparable reporting events as the CFTC Capital Rule in Regulation 23.105(c),

[234] 17 CFR 23.105(c)(7).

[235] 17 CFR 23.105(c)(5).

[236] 17 CFR 23.105(c)(6).

including if a SBSD or MSBSP is undercapitalized or fails to maintain current books and records.

2. Mexican Nonbank Swap Dealer Notices

The Mexican Financial Reporting Rules do not include explicit notice provisions that require a Mexican nonbank SD to report certain predefined events to the relevant Mexican regulatory authorities. Specifically, the Mexican Capital Rules do not include provisions requiring a Mexican nonbank SD to notify the Mexican Commission or other relevant regulatory authority if the firm fails to maintain current books and records, fails to meet minimum capital requirements, or experiences a decrease in excess capital from a previous amount reported by the Mexican nonbank SD.

3. Commission Analysis

The Commission has reviewed the Mexico Application and Mexican laws and regulations, and has preliminarily determined that the Mexican Financial Reporting Rules related to notice provisions are not comparable to the notice requirements set forth in in Regulation 23.105(c) of the CFTC Financial Reporting Rules. Therefore, the Commission is proposing to condition the Capital Comparability Determination Order to require Mexican nonbank SDs to file certain notices contained in Regulation 23.105(c) with the Commission as discussed below.

The notice provisions contained in 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 nonbank SD's ability to meet its obligations to counterparties, other creditors, and the general swaps market. Upon the receipt of a

notice from a nonbank SD under Regulation 23.105(c), the Commission and NFA will initiate reviews of the facts and circumstances that caused the notice to be filed including, as appropriate, engaging in conversations with personnel of the nonbank SD. The review of the facts and the interaction with the nonbank SD provide the Commission and NFA with information to initiate an assessment of whether it is necessary for the nonbank SD to take remedial 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 and 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.

As noted above, the Mexican Financial Reporting Rules do not include explicit, predefined notice provisions that require a Mexican nonbank SD to file prompt notice with the Mexican Commission or other relevant Mexican regulatory authority in a manner that is comparable to the notice provisions set forth in Regulation 23.105(c). Therefore, the Commission is proposing to condition the Capital Comparability Determination Order to require Mexican nonbank SDs to file certain defined notices with the Commission and NFA. Specifically, pursuant to the proposed conditions, a Mexican nonbank SD would be required to file a notice with the Commission and NFA, within the timeframe set forth in the proposed conditions, if the firm: (i) failed to keep current books and records; (ii) maintained regulatory capital at a level that is below the minimum capital requirement set by the Mexican Capital Rules; (iii) maintained regulatory capital

at a level that is below 120 percent of the minimum capital requirement set by the Mexican Capital Rules; (iv) experienced a 30 percent or more reduction in the firm's excess regulatory capital from the amount previously reported in its financial forms filed with the Mexican Commission pursuant to Article 202 and Exhibit 9 of the General Provisions; and (v) failed to exchange initial margin or variation margin required under Mexican law and/or regulations or CFTC margin rules to be exchanged for uncleared swaps and non-cleared security-based swaps in amounts that exceed defined thresholds.[237]

The Commission is proposing these conditions so that it will be alerted to the occurrence of any of the defined events in a prompt manner, which will allow the Commission to communicate with the impacted Mexican nonbank SD and NFA to assess the seriousness of the matter and the effectiveness of any actions that the Mexican nonbank SD may have taken to remediate the matter. As noted above, the notices are intended to provide the Commission with "early warning" of potential adverse financial and operational issues at a nonbank SD. The receipt of "early warning" notices are an important component of the Commission's and NFA's programs for effectively overseeing the safety and soundness of nonbank SDs.

The Commission invites public comment on its analysis above, including comment on the Mexico Application and the relevant Mexican Financial Reporting Rules. The Commission also invites comment on the proposed conditions to the Capital

[237] The Commission understands that the Mexican Commission intends to issue final rules addressing the margin requirements for uncleared swaps by September 2022. The Mexican nonbank SDs, however, are currently subject to the CFTC margin requirements for uncleared swap transactions as set forth in Regulation 23.160 for cross-border transactions.

Comparability Determination Order that are listed above and set forth in the proposed Order below.

The Commission requests comment on the timeframes set forth in the proposed conditions for Mexican nonbank SDs to file notices with the Commission and NFA. In this regard, the proposed conditions would require Mexican 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 Mexican Commission. These notices would have to be translated into English prior to being filed with the Commission and NFA. The Commission request comment on the issues Mexican nonbank SDs may face meeting the filing requirements given translation and other issues.

The Commission requests specific comment regarding the setting of compliance dates for the notice reporting conditions that the proposed Capital Comparability Determination Order would impose on Mexican 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 NFA also conduct periodic examinations as part of their supervision of nonbank SDs, including

routine on-site examinations of nonbank SDs' books, records, and operations to ensure compliance with CFTC and NFA requirements.[238]

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.[239] 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.[240]

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

---

[238] Section 17(p)(2) of the CEA (7 U.S.C. 21(p)(2)) 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. 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.

[239] *See* 17 CFR 23.105(c).

[240] *See* 17 CFR 23.105(h).

the CEA[241] provides the Commission with exclusive authority to enforce the capital requirements imposed on nonbank SDs adopted under Section 4s(e) of the CEA.[242]

2. Mexican Commission's Supervision and Enforcement of Mexican Nonbank SDs

The Mexican Commission has supervisory, inspection, and surveillance powers,[243] which include the authority to require a Mexican nonbank SD to provide the Mexican Commission with all necessary information and documentation to verify the Mexican nonbank SD's compliance with Mexican Law and General Provisions. The Mexican Commission also has the authority to require a Mexican nonbank SD to adopt any necessary measures to correct irregular activities, and the Mexican Commission has the authority to conduct all necessary on-site inspections of a Mexican nonbank SD.[244]

As noted in section D.2 above, Mexican broker-dealers, including Mexican nonbank SDs, are required to submit financial reports to the Mexican Commission detailing their financial condition and operations. Specifically, Mexican nonbank SDs are required to submit to the Mexican Commission monthly balance sheet and income

[241] 7 U.S.C. 6b-1(a).

[242] 7 U.S.C. 6s(e).

[243] Article 350 of the Law, Articles 5 and 19 of the Mexican Commission Law and the Supervision Regulations of the Mexican Commission.

[244] Pursuant to Article 358 of the Law, the Mexican Commission is entitled to provide foreign financial authorities with all kinds of information that it deems appropriate within the scope of its competence, such as documents, records, declarations and other evidence that the Mexican Commission has in its possession by virtue of having obtained the information it in the exercise of its powers and duties; provided that the Mexican Commission must have executed an agreement with the relevant foreign financial authorities for the exchange of information, in consideration of the principle of reciprocity.

statements,[245] as well as quarterly and annual financial reports.[246] In addition, Mexican nonbank SDs must conduct annual stress tests and provide the Mexican Commission with a report containing the results of the stress test assessments.[247] The stress test assessments are designed to determine, among other things, whether a Mexican nonbank SD's capital would be sufficient to cover losses under the supervisory scenarios identified by the Mexican Commission and whether the firm would comply with the minimum capital requirements.[248] The financial reports and stress test filed by each Mexican nonbank SD provides the Mexican Commission with information necessary to monitor the firm's compliance with the Mexican Capital Rules and to assess the firm's overall safety and soundness and its ability to meet financial obligations to customers, counterparties, and creditors.

The Mexican Commission also uses financial reporting from Mexican nonbank SDs as a component of its risk-bases methodology in setting the frequency and scope of its examinations of Mexican nonbank SDs. The Mexican Commission generally engages in examinations of broker-dealers, including Mexican nonbank SDs, as part of its general supervision and oversight program to assess firms' compliance with relevant laws and regulations.[249] The Mexican Commission uses defined risk metrics in its risk-based methodology to assist with the selection of firms to be examined each year. The Mexican

[245] Article 202 and Exhibit 9 of the General Provisions.

[246] Article 203 of the General Provisions.

[247] Article 214 of the General Provisions.

[248] *See id.* A Mexican nonbank SD also must file a preventive action plan if the stress tests indicate that the firm's capital ratios are not sufficient. *See,* Article 217 of the General Provisions.

[249] Staff of the Mexican Commission provided an overview of its broker-dealer surveillance program to Commission staff on August 10, 2022.

Commission generally conducts an examination, including on-site visits, of each firm at least once every two years. The Mexican Commission will also conduct an examination of a firm, including an on-site visit, to the extent that its daily, routine surveillance indicates a need for an immediate review. The Mexican Commission also uses information obtained from the Mexican Central Bank regarding broker-dealers, including Mexican nonbank SDs, in its supervision process.

The Mexican Commission also may impose fines against Mexican nonbank SDs for failing to comply with relevant Mexican laws and regulations. Fines may range from approximately $130,000 to $432,000 for failing to maintain sufficient regulatory capital in relation to the risks in the Mexican nonbank SD's operations.[250] The Mexican Commission may also impose fines ranging from approximately $43,000 to $432,000 if a Mexican nonbank SD fails to comply with applicable information or documentation requirements made by the Mexican Commission, or if the Mexican nonbank SD fails to provide the Mexican Commission with required periodic informational filings.[251]

In addition to imposing fines, the Mexican Commission also may order a Mexican nonbank SD that fails to comply with the applicable regulatory capital ratios, including the 2.5 percent common equity tier 1 capital buffer, to take corrective measures including the following:[252] (i) a prohibition on entering into transactions whose execution would cause a total capital ratio to be less than 8 percent of the risk-weighted assets; (ii) a requirement that the Mexican nonbank SD submit for the approval of the Mexican

[250] Article 392 paragraph III, subparagraph v) of the Law.

[251] Article 392 paragraph I, subparagraph a) of the Law.

[252] Articles 204 Bis 7 to 204 Bis 21 of the General Provisions.

Commission a recovery capital plan, previously approved by the board of directors, which must contain at least: the sources of the resources to increase the capital and/or reduce the assets subject to risk, the period in which the Mexican nonbank SD will reach the level of the regulatory capital required, a calendar with the objectives that would be achieved in each period, and a detailed list of the information that the Mexican nonbank SD must provide periodically to the Mexican Commission to enable the Mexican Commission to monitor compliance of the Mexican nonbank SD's plan; (iii) a suspension of the payment of dividends, as well as any mechanism or acts involving a transfer of patrimonial benefits; (iv) a suspension of the programs of acquisition of shares of the capital stock of the Mexican nonbank SD; (v) a suspension of payments of compensation, extraordinary bonuses, or other remuneration in addition to the salary of the chief executive officer ("CEO") and officials of the two hierarchical levels below the CEO, as well as a requirement to refrain from granting new compensation in the future for the CEO and officials; (vi) an engagement with external auditors or other specialized third parties to carry out special audits on specific issues; and (vii) a limitation on the execution of new transactions that may cause an increase in risk-weighted assets and/or cause greater impairment in the Mexican nonbank SD's regulatory capital ratios. Finally, the Mexican Commission may revoke a Mexican nonbank SD's license to operate as a broker-dealer if the firm fails to comply with the above corrective measures or if the firm reports losses that reduce its capital to a level below the minimum required.[253]

3. Commission Analysis

[253] Article 153 of the Law.

Based on the above, the Commission preliminarily finds that the Mexican Commission has the necessary powers to supervise, investigate, and discipline entities for compliance with its capital, financial and reporting requirements, and to detect and deter violations of, and ensure compliance with, the applicable capital and financial reporting requirements in Mexico.[254]

The Commission also has a history of regulatory cooperation with the Mexican Commission and would expect to communicate and consult with the Mexican Commission regarding the supervision of the financial and operational condition of the Mexican nonbank SDs. An appropriate MOU or similar arrangement with the Mexican Commission would facilitate cooperation and information sharing in the context of supervising the Mexican nonbank SDs.[255] Such an arrangement would enhance communication with respect to entities within the arrangement's scope ("Covered Firms"), as appropriate, 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 also would provide for the Commission and Mexican Commission to inform each other of certain events, including any material

[254] Both the Commission and the Mexican Commission are signatories to the *IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information* (revised May 2012), which covers primarily information sharing in the context of enforcement matters.

[255] The Commission entered into a *Memorandum of Understanding Concerning Cooperation and the Exchange of Information Related to the Supervision of Cross-Border Central Counterparties and Trade Repositories* (Aug. 31, 2016) with the Mexican Commission and the Banco de México, which does not include entities such as SDs within its scope. *See* the Commission's website at https://www.cftc.gov/International/MemorandaofUnderstanding/index.htm.

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.

The Commission invites comment on the Mexico Application, Mexican laws and regulations, and the Commission's analysis above regarding its preliminary determination that Mexican Commission and 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 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 Mexico Application and the Commission's review of applicable Mexican laws and regulations, is that the Mexican Capital Rules and the Mexican 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 Mexican Capital Rules and CFTC Capital Rules and certain differences between the Mexican 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 rule sets would not be inconsistent with providing a substituted compliance framework for Mexican 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 Mexican Capital Rules to the Bank-Based Approach under the CFTC Capital Rules. As noted previously, the Applicants have not requested, and the Commission has not performed, a comparison of the Mexican Capital Rules to the Commission's NLA Approach or TNW Approach.

B. Proposed Capital Comparability Determination Order

The Commission invites comments on all aspects of the Mexico Application, relevant Mexican laws and regulations, the Commission's preliminary views expressed above, the question of whether requirements under the Mexican 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 Mexican Nonbank Swap Dealers

IT IS HEREBY DETERMINED AND ORDERED, pursuant to Commodity Futures Trading Commission ("CFTC" or "Commission") Regulation 23.106 (17 CFR 23.106) under the Commodity Exchange Act ("CEA") (7 U.S.C. 1 *et seq.*) that a swap dealer ("SD") organized and domiciled in Mexico and subject to the Commission's capital and financial reporting requirements under Sections 4s(e) and (f) of the CEA (7

U.S.C. 6s(e) and (f)) may satisfy the capital requirements under Section 4s(e) of the CEA and Commission Regulation 23.101(a)(1)(i) (17 CFR 23.101(a)(1)(i)) ("CFTC Capital Rules"), and the financial reporting rules under Section 4s(f) of the CEA and Commission Regulation 23.105 (17 CFR 23.105) ("CFTC Financial Reporting Rules"), by complying with certain specified Mexican 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 Mexico and is domiciled in Mexico (a "Mexican nonbank SD");

(3) The Mexican nonbank SD is a licensed casa de bolsa (broker-dealer) with the Mexican Comision Nacional Bancaria y de Valores (Mexican Banking and Securities Commission) (the "Mexican Commission");

(4) The Mexican nonbank SD is subject to and complies with: Articles 2, 113, 153, 172, 173, 228, 350, 358, and 392 of the Ley del Mercado de Valores (Securities Market Law) (referred to as "the Law"); Articles 5 and 19 of the Mexican Commission Law, the Supervision Regulations of the Mexican Commission; Articles 10, 137, 144, 146, 150 through 158 Bis, 159, 160, 161, 161 Bis through 161 Bis 5, 162, 162 Bis, 162 Bis 1, 163, 163 Bis, 169, 169 Bis, 175, 176, 179, 180, 201, 202, 203, 204 Bis 1, 204 Bis 2, 204 Bis 3, 204 Bis 7 through Bis 21, 214, 216, 217, Exhibits 5 and 9 of the Disposiciones de Caracter General Aplicables a las Casa De

Bolsa ("General Provisions Applicable to Broker-Dealers"); Section C.B1 of Circular 115/2002, issued by the Mexican Central Bank; and Provision 3.1.3 of Rule 4/2012, issued by the Mexican Central Bank (collectively, the "Mexican Capital Rules" and "Mexican Financial Reporting Rules," as applicable);

(5) The Mexican nonbank SD maintains at all times fundamental capital, as defined in Article 162 and Article 162 Bis of the General Provisions Applicable to Broker-Dealers, equal to or in excess of the equivalent of $20 million in United States dollars ("U.S. dollars"). The Mexican nonbank SD shall use a commercially reasonable and observed peso/U.S. dollar exchange rate to convert the value of the peso-denominated common equity tier 1 capital to U.S. dollars;

(6) The Mexican nonbank SD has filed with the Commission a notice stating its intention to comply with the applicable Mexican Capital Rules and Mexican Financial Reporting Rules in lieu of the CFTC Capital Rules and CFTC Financial Reporting Rules. The notice of intent must include the Mexican nonbank SD's representations that the firm is organized and domiciled in Mexico; is a licensed casa de bolsa with the Mexican Commission; and is subject to, and complies with, the Mexican Capital Rules and Mexican Financial Reporting Rules. The Mexican nonbank SD may not rely on this Capital Comparability Determination Order until it receives confirmation from Commission staff that it may comply with the applicable Mexican Capital Rules and Mexican Financial Reporting Rules

in lieu of the CFTC Capital Rules and CFTC Financial Reporting Rules. Each notice filed pursuant to this condition must be prepared in the English language and submitted to the Commission via email to the following address: MPDFinancialRequirements@cftc.gov;

(7) The Mexican nonbank SD shall provide notice to the Commission and National Futures Association ("NFA") if at any time it initiates the process of seeking the approval of the Mexican Commission to use internal models to compute market risk and/or credit risk. The Mexican nonbank SD shall not use internal models to compute its regulatory capital under the terms of this Capital Comparability Determination Order without the authorization of the Commission or NFA;

(8) The Mexican nonbank SD prepares and keeps current ledgers and other similar records in accordance with accounting principles required by the Mexican Commission;

(9) The Mexican nonbank SD files with the Commission and with NFA a copy of its quarterly financial report filed with the Mexican Commission pursuant to Article 203 of the General Provisions Applicable to Broker-Dealers and a copy of the monthly financial information, including the monthly balance sheet and income statement, filed with the Mexican Commission pursuant to Article 202 and Exhibit 9 of the General Provisions Applicable to Broker-Dealers. The Mexican nonbank SD must also include with the monthly information provided to the Commission a statement of regulatory capital as of each month end. The quarterly

financial report and monthly financial information must be translated into the English language and balances must be converted to U.S. dollars. The quarterly financial report and monthly financial information must be filed with the Commission and NFA within 15 business days of the earlier of the date the quarterly financial report and monthly financial information are filed with the Mexican Commission or the date that the financial reports and financial information are required to be filed with the Mexican Commission;

(10) The Mexican nonbank SD files with the Commission and with NFA a copy of its audited annual financial report that is required to be filed with the Mexican Commission in accordance with Article 203 of the General Provisions Applicable to Broker-Dealers. The audited annual report must be translated into the English language. The audited annual report must be filed with the Commission and NFA within 15 business days of the earlier of the date the audited annual report is filed with the Mexican Commission or the date that the audited annual report is required to be filed with the Mexican Commission;

(11) The Mexican nonbank SD files Schedule 1 of Appendix B to Subpart E of Part 23 of the Commission's regulations (17 CFR Part 23 Subpart E – Appendix B) with the Commission and NFA on a monthly basis. Schedule 1 must be prepared in the English language with balances reported in U.S. dollars and must be filed with the Commission and NFA together with the financial information set forth in condition (9) ;

(12) The Mexican nonbank SD must submit with the monthly financial information, the quarterly financial report, and the audited annual report required under conditions (9) – (11) of this Capital Comparability Determination Order a statement by an authorized representative or representatives of the Mexican nonbank SD that to the best knowledge and belief of the representative or representatives the information contained in the reports, including the translation of the reports into the English language and the conversion of balances into the reports to U.S. dollars (as applicable), is true and correct. The statement must be prepared in the English language;

(13) The Mexican nonbank SD files a margin report containing the information specified in Regulation 23.105(m) (17 CFR 23.105(m)) with the Commission and with NFA.[256] The margin report must be filed together with the monthly financial information required by Article 202 and Exhibit 9 of the General Provisions Applicable to Broker-Dealers (Condition 9). The margin report must be in the English language and balances reported in U.S. dollars;

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

[256] 17 CFR 23.105(m).

(15) The Mexican nonbank SD files a notice with the Commission and NFA within 24 hours of when it knows that its regulatory capital is below 120 percent of the minimum capital requirement under the Mexican Capital Rules. The notice must be prepared in the English language;

(16) The Mexican nonbank SD files a notice with the Commission and NFA if it experiences a 30 percent or more decrease in its excess regulatory capital as compared to that last reported in the financial information filed with the Mexican Commission pursuant to Article 202 and Exhibit 9 of the General Provisions Applicable to Broker-Dealers. The notice must be prepared in the English language and filed within two business days of the firm experiencing the 30 percent or more decrease in excess regulatory capital;

(17) The Mexican nonbank SD files a notice with the Commission and NFA within 24 hours of when it knows or should have known that it has failed to make or keep current the books and records required by the Mexican Commission. The notice must be prepared in the English language;

(18) The Mexican nonbank SD files a notice with the Commission and NFA within 24 hours of the occurrence of any of the following: (i) a single counterparty, or group of counterparties under common ownership or control, fails to post required initial margin or pay required variation margin to the Mexican nonbank SD on uncleared swap and security-based swap positions that, in the aggregate, exceeds 25 percent of the Mexican nonbank SD's minimum capital requirement; (ii) counterparties fail to

post required initial margin or pay required variation margin to the Mexican nonbank SD for uncleared swap and security-based swap positions that, in the aggregate, exceeds 50 percent of the Mexican nonbank SD's minimum capital requirement; (iii) a Mexican 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 Mexican nonbank SD's minimum capital requirement; and (iv) the Mexican 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 Mexican nonbank SD's minimum capital requirement. The notice must be prepared in the English language;

(19) The Mexican 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 Mexican Commission. The notice required by this condition will satisfy the requirement for a nonbank SD to obtain the approval of NFA for a change in fiscal year end under Regulation 23.105(g) (17 CFR 23.105(g)). The notice of change in fiscal year end must be prepared in the English language and filed with the Commission and NFA at least 15 business days prior to the effective date of the Mexican nonbank SD's change in fiscal year end;

(20) The Applicants notify the Commission of any material changes to the information submitted in their application, including, but not limited to, material changes to the Mexican Capital Rules or Mexican Financial Reporting Rules imposed on Mexican nonbank SDs, the Mexican Commission's supervisory authority or supervisory regime over Mexican nonbank SDs, and proposed or final material changes to the Mexican Capital Rules or Mexican Financial Reporting Rules as they apply to Mexican nonbank SDs. The notice must be prepared in the English language; and

(21) Unless otherwise noted in the conditions above, the reports, notices, and other statements required to be filed by Mexican nonbank SD 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 [Date], by the Commission.

Christopher Kirkpatrick,

Secretary of the Commission.