September 24, 2021

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

Re: **Substituted Compliance Application for EU Swap Dealers from CEA Sections 4s(e)–(f) and Rules 23.101 and 23.105(d)–(e), (p)(2)**

Dear Mr. Kirkpatrick:

The Institute of International Bankers ("IIB"), International Swaps and Derivatives Association ("ISDA") and Securities Industry and Financial Markets Association ("SIFMA", and together with IIB and ISDA, the "Associations")[1] are submitting this application to request that the Commodity Futures Trading Commission ("Commission") make a determination with respect to the capital, financial reporting and related requirements of the European Union ("EU") specified herein (the "EU Capital & Reporting Framework") and that compliance with the EU Capital & Reporting Framework by a nonbank swap dealer ("SD") licensed as an investment firm or as a credit institution in the EU (an "EU SD") may satisfy the capital and financial reporting requirements applicable to a nonbank SD under Section 4s(e)–(f) of the Commodity Exchange (the "CEA") and Rules 23.101 and 23.105(d)–(e) thereunder (the "Commission Capital & Reporting Requirements").[2] As we describe in more detail below, the EU Capital & Reporting Framework is designed to ensure the safety and soundness of EU SDs in a manner comparable to the Commission Capital & Reporting Requirements.

I. Introduction

In making a substituted compliance determination pursuant to Rule 23.106 in regards to the Commission Capital & Reporting Requirements, the Commission will consider whether the capital and financial reporting requirements of the foreign regulatory system "are comparable to the Commission's corresponding capital adequacy and financial . . . reporting requirements."[3] The Commission has explained that its "approach to substituted compliance is a principles-based, holistic approach that focuses on whether the foreign regulations are designed

[1] Please see the Appendix for more information on the Associations.

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

[3] 17 C.F.R. § 23.106(a)(3).

with the objective of ensuring overall safety and soundness" in a manner that is comparable with the Commission's capital and financial reporting requirements, rather than a "line-by-line assessment or comparison" of the foreign jurisdiction's and the Commission's regulatory requirements.[4]

Rule 23.106 requires an applicant for substituted compliance to provide:

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

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

- "A description of the ability of the relevant foreign regulatory authority . . . to supervise and enforce compliance with the relevant foreign jurisdiction's capital adequacy and financial reporting requirements."[5]

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

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

II. Overview

Under the Commission Capital & Reporting Requirements, a standalone, nonbank SD may elect the "Bank-Based Approach" or the "Net Liquid Assets Approach" for establishing its minimum capital requirements and computing its regulatory capital under Section 4s(e) of the CEA and Rule 23.101 thereunder (the "Commission Capital Requirements").[6] The Commission sought to provide this flexibility to SDs in order to allow an SD to choose the capital approach

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

[5] 17 C.F.R. § 23.106(a)(2).

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

that best fits its business model and to mitigate competitive disparities that might otherwise arise were each SD required to follow the same capital approach.[7]

Bank-Based Approach. The "Bank-Based Approach" is based on the capital requirements established by the Federal Reserve Board ("FRB") for bank holding companies, which are codified in the FRB's Part 217 regulations.[8] Under the Bank-Based Approach, an SD must maintain:

- Common equity tier one capital ("Common Equity Tier 1") of at least $20 million;
- Common Equity Tier 1 equal to at least 6.5 percent of the SD's risk-weighted assets ("RWAs");
- Common Equity Tier 1, additional tier one capital ("Additional Tier 1"), and tier 2 capital ("Tier 2" and collectively, "total capital") equal to at least 8 percent of the SD's RWAs; or
- Total capital equal to 8 percent of the SD's uncleared swap margin.

An SD that follows the Bank-Based Approach will calculate its Common Equity Tier 1, Additional Tier 1, Tier 2 and RWAs in accordance with the FRB's Part 217 requirements. An SD's "uncleared swap margin" is the aggregate amount of initial margin ("IM") that the SD would be required to collect pursuant to the Commission's uncleared swap margin rules from each counterparty for each outstanding uncleared swap position (including exempt and excluded swaps) calculated on a counterparty-by-counterparty basis.

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

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

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

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

The EU Capital & Reporting Framework. The Capital Requirements Regulation (575/2013) ("CRR") and its related legislation, the Capital Requirements Directive IV (2013/36/EU) ("CRD IV"), include the prudential capital and financial reporting requirements applicable to both banks and "investment firms,"[9] such as EU SDs. CRR and CRD IV impose mandatory capital and liquidity requirements that address market, credit, counterparty and liquidity risks.

On May 20, 2019, the EU passed the Capital Requirements Regulation II (2019/876) ("CRR II") and the Capital Requirements Directive V (2019/878/EU) ("CRD V"), which further refine and implement Basel III standards by amending sections of CRR and CRD IV related to liquidity, large exposures, market and counterparty credit risk and reporting, amongst others.[10] Except as otherwise set forth herein, the amendments contained in CRR II will not materially affect the discussion in this application of the EU Capital & Reporting Framework.

[9] "Investment firm" is defined under CRR, Article 4(1)(2) (as amended by the Investment Firms Regulation (2019/2033)), as any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis, and which is authorised under the Markets in Financial Instruments Directive (2014/65/EU) ("MiFID") but excludes credit institutions.

[10] The majority of the amendments contained in the CRR II are applicable since June 2021, although certain measures (including total loss-absorbing capacity ("TLAC") requirements for global systemically important institutions ("G-SIIs"), the European equivalent for global systemically important banks ("GSIBs")) began to apply on June 27, 2019 when the legislation entered into force, and other measures began to apply on December 28, 2020 (including changes to the rules on prudential consolidation). EU member states were required to adopt and publish measures to implement CRD V by December 2020.

In addition, on December 25, 2019, the Investment Firms Regulation (2019/2033) ("IFR") and Investment Firms Directive (2019/2034/EU) ("IFD") went into effect. This set of legislation tailors the existing prudential rules under the EU Capital Framework to investment firms based on their size and complexity. The substantive requirements under the IFR are applicable since June 26, 2021, although large investment firms continue to be subject to the capital requirements under CRR and CRD IV (as amended by CRR II and CRD V). IFR, Recital 42. For the purposes of this application, we address only those EU SDs that will continue to be subject to the requirements imposed by CRR and CRD IV (as amended by CRR II and CRD V).

The EU Capital Framework. The capital and related requirements of the EU (the "EU Capital Framework") require an investment firm to hold equity and loss-absorbing liabilities, composed primarily of Common Equity Tier 1, Tier 1 and Tier 2 capital, equal to at least 8 percent of the sum of its RWAs.[11] In addition, an investment firm must maintain certain capital buffers above the minimum 8 percent capital level composed of Common Equity Tier 1 capital instrument.[12] Resolution authorities also require investment firms to satisfy a minimum requirement for own funds and eligible liabilities[13] ("MREL").[14] Separately, CRR imposes liquidity requirements designed to ensure that investment firms can meet both short- and long-term obligations. Moreover, as of June 2021, CRR imposes a leverage ratio that requires an EU SD to maintain Tier 1 capital equal to at least 3 percent of the SD's exposures, including exposures on uncleared swaps, without regard to any risk-weighting.

The EU Financial Reporting Framework. The financial reporting and related requirements of the EU (the "EU Financial Reporting Framework") require an EU SD to submit regular reports containing information on its financial condition and capital position.[15] The EU Financial Reporting Framework does not specify each individual statement an EU SD must provide, but leaves that determination to the relevant competent authorities. This serves to ensure that the content and timing of the statements are consistent with local conventions or requirements, such as local accounting standards. In all instances, however, an EU SD's financial statements must be audited and accompanied by an opinion of an independent auditor.[16]

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[11] CRR, Articles 26, 28, 50–52, 61–63 & 92 (as amended by CRR II).

[12] E.g., CRD IV, Articles 129, 130, 131 & 133 (as amended by CRR II and IFR, as the case may be).

[13] Eligible liabilities include, among others, instruments that are issued and fully paid up with remaining maturities of at least a year. CRR II, Article 1(31), introducing Articles 72a and 72b in the CRR. The respective rules have been tightened and refined under Article 1(17) of the Bank Recovery and Resolution Directive II (2019/879/EU) ("BRRD II"), amending Bank Recovery and Resolution Directive (2014/59/EU) ("BRRD"), which has inserted BRRD, Article 45b. In addition, the instruments cannot be owed to, secured or guaranteed by the EU SD itself, and the EU SD cannot have either directly or indirectly funded its purchase. Under BRRD II, the inclusion of derivatives is possible if certain requirements are met. The BRRD II, published by the EU on June 7, 2019 amended the BRRD, among other things, regarding the loss-absorbing and recapitalization capacity of credit institutions and investment firms, namely the institution-specific add-on for G-SIIs and the institution-specific requirement for non-G-SIIs, referred to as MREL, through targeted amendments. The respective changes had to be implemented into the national laws of the member states by December 28, 2020.

[14] CRR II imposes an additional supplemental standard of TLAC and requires the G-SIIs to maintain a risk-based ratio of capital and MREL of 18 percent and a non-risk-based ratio of capital and MREL of 6.75 percent against the firm's total calculated risk exposure (until December 31, 2021, 16 percent of total risk exposure and 6 percent of the leverage ratio exposure measure). CRR II, Article 92a(1). In addition, the competent authorities have the ability to impose MREL requirements on G-SIIs that exceed the statutory minimum requirements. EU SDs that are subsidiaries of U.S. GSIBs will be required to maintain MREL equal to 90 percent of the foregoing as applied to their U.S. parent at all times. Id. Article 92b(1).

[15] CRR, Article 430.

[16] Directive 2013/34/EU, Article 34 (June 26, 2013) ("Accounting Directive").

This audit requirement does not apply to small undertakings. A company qualifies as a small undertaking if it meets two of the following criteria: (1) balance sheet not more than €4m; (2) net turnover of not more than €8m; or (3) not more than 50 employees during the financial year. Accounting Directive, Article 3(2). No EU SD would fall within this exception.

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

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

Market and Credit Risk Charges. Especially for larger EU SDs with approval to calculate market and credit risk using internal models, both the Commission Capital Requirements and the EU Capital Framework permit firms to apply risk-based market charges that are consistent with the value-at-risk ("VaR") specifications set forth in Basel II standards.[17] In addition, the Commission Capital Requirements and the EU Capital Framework permit firms with model approval to apply model-based credit risk charges to their derivatives counterparties.[18] For firms without model approval, both the Commission Capital Requirements and the EU Capital Framework provide for standardized approaches for market and credit risk charges and deductions, depending on the asset or exposure. Both rule sets also impose operational risk capital requirements.

Minimum Required Capital. The minimum capital levels required by the EU Capital Framework are robust and comparable to the minimum levels required by the Commission Capital Requirements. In particular, taking into account applicable capital buffer requirements, EU SDs generally must hold own funds equal to at least 10.5 percent of their total

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[17] Compare 17 C.F.R. § 23.100 (providing for an SD that is approved to use internal models to calculate market and credit risk to calculate its RWAs using Subparts E and F of 12 C.F.R. Part 217), 12 C.F.R. § 217.205(b), 17 C.F.R. § 23.101(a)(1)(ii) (providing for an SD that elects the Net Liquid Assets Approach to calculate its net capital in accordance with Rule 18a-1), 17 C.F.R. § 23.102a(a), (i) and 17 C.F.R. § 240.18a-1(e)(1) with CRR, Articles 143(1) and 363.

[18] Compare 17 C.F.R. § 23.100 (providing for an SD to use internal models to calculate market and credit risk to calculate its RWAs using Subparts E and F of 12 C.F.R. Part 217), Subpart E of 12 C.F.R. part 217, 17 C.F.R. § 23.101(a)(1)(ii) (providing for an SD that elects the Net Liquid Assets Approach to calculate its net capital in accordance with Rule 18a-1) and 17 C.F.R. § 240.18a-1(e)(2) with CRR, Article 283(1). For OTC derivatives, credit valuation adjustment requirements also apply under the EU Capital Framework and the Bank-Based Approach, but not the Net Liquid Assets Approach. CRR II has removed the option previously opened under CRR to investment firms with model approval that enabled them to calculate counterparty credit risk using internal models when calculating large exposures. CRR II, Article 1(93) amending CRR, Article 390(4). Rather, CRR II has replaced the existing standardized approaches and models approaches with the standardized approach to counterparty credit risk ("SA-CCR") in line with the Basel framework. SA-CCR is intended to be a more risk sensitive measure of counterparty risk as opposed to the existing standardized approaches by reflecting netting, hedging and collateral benefits, but it generally is a more conservative measurement of credit risk than internal models-based approaches. Under the Bank-Based Approach, an SD that is not approved to use internal models to calculate credit risk may use SA-CCR or the current exposure methodology to calculate its RWAs. An SD approved to use internal models to calculate credit risk may use SA-CCR or the internal models method to calculate its RWAs.

risk exposure amounts (composed of market, credit, settlement, credit valuation adjustment, and operational risk requirements),[19] which is comparable to, and indeed substantially larger than, the regulatory capital requirement of 8 percent of an SD's RWAs under the Bank-Based Approach. Moreover, the EU Capital Requirements require that an SD calculate RWAs and capital in a manner that is similar to that required under the FRB's Part 217 regulations. Indeed, the FRB has effectively validated that the EU Capital Framework is comparable to its implementation of the Basel capital framework.[20]

Also, the minimum capital levels required by the EU Capital Framework may be compared in some respects to the 8 percent of the uncleared swap margin requirement under the Bank-Based Approach. As the Commission has noted, the uncleared swap margin requirement "provides a floor based on a measure of the risk of the positions, the volume of the positions, the number of counterparties and the complexity of the operations of the" SD.[21] The Commission further explained that the requirement covers "potential operational risk, legal risk, and liquidity risk."[22] As noted above, in calculating its RWAs for purposes of the EU Capital Framework's risk-based ratios, an EU SD must incorporate risk exposure amounts composed of market, credit, settlement, credit valuation adjustment, and operational risk. Because they cover the full range of a firm's exposures, not just those related to swaps, these exposures amounts will generally yield capital requirements that substantially exceed 8 percent of the SD's uncleared swap margin amount, even before application of the 2.5 percent Common Equity Tier 1 buffer.[23] Moreover, as of June 2021, the EU Capital Framework mandates a leverage ratio floor that, similar to the uncleared swap margin requirement, is based principally on volume and counterparties without regard to risk-weighting. Lastly, EU SDs are subject to comprehensive liquidity requirements, discussed below, that are designed to ensure that an SD has sufficient liquid assets to meet its ongoing obligations. As a result, although the EU Capital Framework does not have a direct analogue to the 8 percent uncleared swap margin requirement, it has various other measures that achieve the same regulatory objective of ensuring that an SD maintains an amount of capital that both is sufficient to cover the risks it may face and increases with the volume of the SD's positions, number of counterparties, and complexity of operations.

Considering that all EU SDs would be eligible to elect the Bank-Based Approach, we think that the foregoing comparison to that approach should suffice to establish the comparability of the EU Capital Framework to the Commission Capital Requirements. But in addition, for the reasons discussed above, the minimum capital levels required by the EU Capital Framework may be compared in some respects to the sum of the 2 percent uncleared swap

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[19] Lighter capital and liquidity requirements may apply to investment firms and groups of investment firms subject to IFR that are not authorized to carry out dealing on own account and underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis or that do not exceed certain thresholds. These lighter requirements do not apply to EU SDs.

[20] See, e.g., Federal Reserve System, Order Approving Establishment of a Branch for Nordea Bank Abp (Aug. 3, 2018) (stating that the risk-based capital standards under CRR and CRD IV "are consistent with those established by the Basel Capital Accord").

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

[22] Id.

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

margin amount requirement and market and credit risk charges applicable under the Net Liquid Assets Approach. We note in this regard that the SEC has recognized that the EU Capital Framework is comparable to the SEC's capital rules applicable to non-prudentially regulated SBSDs for purposes of substituted compliance.[24] The Commission has recognized that the Net Liquid Assets Approach is "consistent with the SEC's final capital requirements for SBSDs."[25]

Liquidity Requirements. The EU Capital Framework also imposes liquidity requirements on EU SDs. This approach differs from the Net Liquid Assets Approach, which, in lieu of a specific liquidity requirements, requires nonbank SDs to deduct from their net capital 100 percent of the carrying value for unsecured receivables (except that an SD with credit risk model approval may instead apply a credit risk weighted charge for receivables to certain derivatives counterparties) and other assets that cannot readily be converted into cash, as well as securities that have no ready market.[26] Conversely, the EU Capital Framework imposes separate liquidity buffers and "stable funding" requirements that ensure EU SDs can cover both long-term obligations and short-term payment obligations under stressed conditions for thirty days.[27]

In addition, liquidity risks are generally less significant to EU SDs than standalone U.S. SDs because EU SDs and other large investment firms are subject to a bank-style resolution regime under the BRRD that focuses on preserving the continuity of critical services and reducing the impact of an investment firm's failure on financial stability, rather than liquidation. Also, an EU SD will not be subject to liquidation as a commodity broker under the U.S. Bankruptcy Code.

Moreover, U.S. customer property should be at minimal risk if an EU SD were to experience financial distress, as an EU SD is required to segregate IM from its assets by either placing it with a third-party holder or custodian or via other legally binding arrangements, making the IM remote in the case of the firm's default or insolvency.[28]

Financial Reporting Requirements. The Commission's financial reporting requirements under Section 4s(f) of the CEA and Rule 23.105(d)–(e) thereunder (the "Commission Financial Reporting Requirements") and the EU Financial Reporting Framework provide the relevant regulatory authorities with audited information at regular intervals about the

[24] See Notice of Substituted Compliance Application Submitted by the French Autorité des Marchés Financiers and the Autorité de Contrôle Prudential et de Résolution in Connection With Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the French Republic; Proposed Order, 85 Fed. Reg. 85720 (Dec. 29, 2020).

[25] CFTC Capital Final Rule Release, 85 Fed. Reg. at 57467.

[26] 17 C.F.R. § 23.101(a)(ii)(A); 17 C.F.R. § 240.18a-1(a)(1)(iv).

[27] CRR, Article 413 (as amended by CRR II), establishes a general requirement that firms ensure that long-term obligations are adequately met with stable funding requirements. The Net Stable Funding Ratio ("NSFR"), introduced by Basel III, applies to EU SDs since June 2021.

[28] European Market Infrastructure Regulation Margin RTS (EU) (2016/2251) ("EMIR Margin RTS"), Articles 19(1)(d)–(e), (3) & (8). While not specifically required to be segregated from the investment firm's assets, counterparties may elect for variation margin ("VM") to also be segregated and placed with a third-party custodian. See EMIR Margin RTS, Article 3(b) (stating that the "exchange of collateral agreement" must address "segregation arrangements").

financial and capital positions of an SD in order to ensure the safety and soundness of the SD. Both the EU Financial Reporting Framework and the Commission Financial Reporting Requirements require a firm to disclose financial statements containing information on the firm's financial condition and compliance with capital requirements. In many instances, the EU Financial Reporting Framework also requires that an EU SD disclose additional information with respect to its financial condition and activities beyond that required under the Commission Financial Reporting Requirements. In each case, the reporting requirements under the regimes provide a comprehensive view of the financial condition of a firm, including the firm's compliance with applicable capital requirements and overall financial health. We note in this regard that the SEC has recognized that the EU Financial Reporting Framework is comparable to the SEC's financial reporting rules applicable to prudentially regulated and non-prudentially regulated SBSDs for purposes of substituted compliance.[29] The Commission has recognized that its "financial reporting . . . approach . . . was modelled after the existing reporting regimes followed by [futures commission merchants] and [broker dealers], and that was proposed by the SEC for SBSDs."[30]

III. Comparability Analysis

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

1. Comparability of Objectives

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

The EU Capital Framework seeks to achieve both of the objectives of the Bank-Based Approach and the Net Liquid Assets Approach. Consistent with the Bank-Based Approach, the EU Capital Framework looks to ensure that an EU SD has sufficient own funds in order to withstand losses. And consistent with the Net Liquid Assets Approach, the EU Capital

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[29] See Order Granting Conditional Substituted Compliance in Connection With Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants, Subject to Regulation in the Federal Republic of German, 85 Fed. Reg. 85686 (Dec. 29, 2020); Notice of Substituted Compliance Application Submitted by the French Autorité des Marchés Financiers and the Autorité de Contrôle Prudential et de Résolution in Connection With Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the French Republic; Proposed Order, 85 Fed. Reg. 85720 (Dec. 29, 2020).

[30] CFTC Capital Final Rule Release, 85 Fed. Reg. at 57512. The SEC has conditioned substituted compliance with respect to its financial reporting requirements on the provision of certain financial and operational information to the SEC or its designee in the manner and format required by SEC rule or order. To the extent the Commission similarly conditions substituted compliance for the Commission Financial Reporting Framework on the provision of certain information, we request that the Commission align such information with that required by the SEC.

Framework seeks to ensure that an EU SD has sufficient liquidity in order to meet its obligations in a distress scenario.

2. Comparability of Methodologies and Outcomes

i. Measurement of Assets and Total Risk Exposure

EU SDs are subject to bank-like capital requirements that, consistent with the Basel framework, require a firm to hold sufficient amounts of own funds, composed of Common Equity Tier 1, Tier 1 and Tier 2 capital instruments subject to certain capital deductions (referred to as Pillar I of the Basel framework).[31] The amount of own funds required to be held is determined by calculating the firm's total risk exposure, which requires the firm to risk weight its assets and exposures using specified standardized weights or approved internal model-based methodologies.[32] The categories of risk charges include:[33]

- credit and dilution risk, excluding risk-weighted exposure amounts from the trading book business of the firm;
- position risk and certain large exposures;
- foreign-exchange risk, settlement risk and commodities risk;
- credit valuation adjustment risk of OTC derivative instruments, other than credit derivatives recognized to reduce risk-weighted exposure amounts for credit risk;
- operational risk; and
- counterparty risk arising from the trading book business of the investment firm for certain derivative transactions, repurchase transactions, securities or commodities lending or borrowing transactions, margin lending or long settlement transactions.

This approach is comparable to the Bank-Based Approach, which similarly subjects a nonbank SD to bank-like capital requirements that require the SD to hold sufficient regulatory capital, composed of Common Equity Tier 1, Additional Tier 1 and Tier 2, based on the risk of its activities and positions.[34]

The Bank-Based Approach under the Commission Capital Requirements and the EU Capital Framework are both implementations of the Basel capital framework. The FRB has recognized the comparability of its capital requirements and the EU Capital Framework on a number of occasions. For example, in a recent approval allowing a bank subject to EU capital regulations to establish a U.S. branch, the FRB stated generally that the risk-based capital

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[31] CRR, Article 92(1)-(2).

[32] With regulator permission, investment firms may use internal models to calculate credit, dilution and counterparty risk, id. Article 143, certain counterparty credit risk exposure, id. Article 283, as amended by CRR II, operational risk, id. Article 312(2), market risk, id. Article 363, and credit valuation adjustment risk, id. Article 383. The permission to use, and continue using, internal models is subject to strict criteria and supervisory oversight by the regulators.

[33] Id. Article 92(3), as amended by CRR II.

[34] 17 C.F.R. § 23.101(a)(1)(i).

standards under CRR and CRD IV "are consistent with those established by the Basel Capital Accord."[35]

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

a. Derivative Instruments and Marketable Securities

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

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

1. Market Risk

In terms of market risk, the Bank-Based Approach similarly requires an SD to calculate additions to its RWAs for derivatives positions and marketable securities using either the Commission's standardized haircuts, multiplied by 12.5, or if approved to use models, market-risk models. The Net Liquid Assets Approach similarly requires a nonbank SD to take certain net capital deductions for its derivatives positions and marketable securities using either standardized haircuts or, if approved to use internal models, market risk models.

The Bank-Based Approach requires that a nonbank SD that is approved to use models to calculate market risk do so in accordance with Subpart F of the FRB's Part 217 regulations ("Subpart F"), while Appendix A to Rule 23.102 specifies the model requirements for an SD that elects the Net Liquid Assets Approach. Both Subpart F and Appendix A to Rule 23.102 are based on the internal model approach under Basel 2.5.[36] The Commission will

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[35] Federal Reserve System, Order Approving Establishment of a Branch for Nordea Bank Abp (Aug. 3, 2018).

[36] Compare 17 C.F.R. § 23.100 (providing for an SD that is approved to use internal models to calculate market and credit risk to calculate its RWAs using Subparts E and F of 12 C.F.R. Part 217), Subpart F of 12 C.F.R., § 23.101(a)(1)(ii) (providing for an SD that elects the Net Liquid Assets Approach to calculate its net capital in accordance with Rule 18a-1) and 17 C.F.R. § 23.102a, with Basel Committee on Banking Supervision, Revisions to the Basel II Market Risk Framework (2011), https://www.bis.org/publ/bcbs193.pdf (describing the revised internal model approach under Basel 2.5).

provisionally permit the use of models approved by a foreign regulator whose capital requirements are consistent with the Basel framework.[37]

Similarly, the EU Capital Framework's model-based methodology is based on the Basel 2.5 standard.[38] The EU Capital Framework, Subpart F and Appendix A to Rule 23.102 all incorporate relevant aspects of Basel II in terms of requiring firms with model approval to use a VaR model with a 99 percent, one-tailed confidence level with (i) price changes equivalent to a ten business-day movement in rates and prices, (ii) effective historical observation periods of at least one year and (iii) at least monthly data set updates.[39] All three also implement aspects of Basel 2.5, such as requirements to calculate a "stressed" VaR.[40]

2. *Credit Risk*

In terms of credit risk, the Bank-Based Approach provides for the credit risk of a nonbank SD's positions to be incorporated into the calculation of its RWAs. Under the Bank-Based Approach, a nonbank SD that is not approved to use internal models to calculate credit risk will compute its RWA in accordance with Subpart D of the FRB's Part 217 regulations, which sets forth a standardized methodology for calculating the risk weights applicable to a bank holding company's assets. A nonbank SD approved to use internal models will calculate its RWA in accordance with Subpart E of the FRB's Part 217 regulations, which sets forth a models-based methodology for calculating risk weights applicable to a bank holding company's assets. The Net Liquid Assets Approach, in turn, requires a nonbank SD to take a net capital deduction for unsecured current exposure and uncollected IM, but a firm with model approval may instead multiply that deduction by 8 percent and further by a credit risk weight.

Under the EU Capital Framework, an investment firm calculates its credit risk exposure by taking the accounting value of each of its on- and off-balance sheet exposures, making certain additional credit risk adjustments, and then applying specific risk weights based on the type of counterparty and the asset's credit quality.[41] For instance, high quality credit exposures, such as exposures to EU member states' central banks, carry a 0 percent risk weight, whereas exposures to EU banks, other investment firms or to other businesses may carry risk weights between 20–150 percent depending on the credit ratings available for the entity or (for

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[37] 17 C.F.R. § 23.102(f).

[38] Compare CRR, Article 362–377, with Revisions to the Basel II Market Risk Framework, supra note 13.

[39] Compare 17 C.F.R. § 23.100 (providing for an SD that is approved to use internal models to calculate market and credit risk to calculate its RWAs using Subparts E and F of 12 C.F.R. Part 217), 12 C.F.R. § 217.205(b), 17 C.F.R. § 23.101(a)(1)(ii) (providing for an SD that elects the Net Liquid Assets Approach to calculate its net capital in accordance with Rule 18a-1), 17 C.F.R. § 23.102a(a), (i) and 17 C.F.R. § 240.18a-1(e)(1) with CRR, Article 365(1).

[40] 17 C.F.R. § 23.100 (providing for an SD that is approved to use internal models to calculate market and credit risk to calculate its RWAs using Subparts E and F of 12 C.F.R. Part 217); 12 C.F.R. § 217.206, 17 C.F.R. § 23.101(a)(1)(ii) (providing for an SD that elects the Net Liquid Assets Approach to calculate its net capital in accordance with Rule 18a-1); 17 C.F.R. § 23.102a(j); CRR, Article 365(2). See also CFTC Capital Final Rule Release, 85 Fed. Reg. at n.332 (citing the BCBS' Revisions to the Basel II Market Risk Framework for an explanation of the implementation of the stressed VaR requirement).

[41] CRR Article 111 & 113(1).

exposures to banks and investment firms) for its central government.[42] If no credit rating is available, the investment firm must generally apply a 100 percent risk weight, meaning the total accounting value of the exposure is used.[43] If an investment firm is permitted to use models for determining credit risk, any positions in a basket for which the investment firm cannot determine the risk-weight using its models are assigned a risk weight of 1,250 percent (which is equivalent to a full capital deduction for the 8 percent minimum capital requirement).[44] This approach is closely aligned with the Basel framework and with the provisions of Subparts D and E of the FRB's Part 217 regulations.

Accordingly, for firms with model approval the approaches are largely similar, with the EU Capital Framework imposing potentially larger risk charges due to the additional capital buffers that it requires EU SDs to maintain.[45]

3. Additional Measures and Supervision

In addition, the internal and external supervisory process provided in Pillar II of the EU Capital Framework further helps ensure investment firms do not take on excessive uncollateralized credit risk.[46] Specifically, investment firms are required to maintain adequate internal capital to cover the nature and level of risks, including credit and counterparty risks, to which they may be exposed.[47] At least annually, regulators must review the investment firm's strategies and processes to manage these risks and evaluate the risks that the investment firm is or might be exposed to and the risks revealed by the investment firm's stress testing (taking into account the nature, scale and complexity of the investment firm's activities).[48] The internal and external assessments of risks often result in investment firms holding own funds in excess of the minimum capital requirements.[49]

We consider these requirements to be an effective backstop, especially for firms that do not have market or credit risk model approval. For these firms, the Net Liquid Assets Approach is arguably stricter than the EU Capital Framework, at least in regards to applying 100 percent capital charges to unsecured current exposure to OTC derivatives counterparties,

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[42] Id. Articles 114–122 (as amended by CRR II and IFR, as the case may be).

[43] Id. Articles 121(2) & 122(2).

[44] Id. Article 153(8).

[45] For example, $100 million of exposure to a counterparty with a 100 percent risk weight would result in an $8 million capital requirement under the Net Liquid Assets Approach versus at least a $10.5 million capital requirement under the EU Capital Framework, taking into account the capital conservation buffer. Additional capital would then be required for credit valuation risk.

[46] Pillar II obligations require additional own funds to be held above the minimum levels set by the Pillar I capital obligations. Broadly, the Pillar II regime requires an assessment of an investment firm's capital needs by reference to its risks to be conducted by the investment firm itself and, separately, its prudential regulator. Critically, this Pillar II assessment enables the regulator to exercise supervisory powers to increase an investment firm's capital requirements above the Pillar I minimum capital requirements and capital buffers.

[47] CRD IV, Articles 73 & 79.

[48] Id. Articles 97 & 99, as amended by CRD V.

[49] Id. Articles 104 & 104a.

without risk-weighting of these exposures. However, under the EU Capital Framework, an investment firm with such exposures that create risks that are not covered or not fully covered by the minimum own funds requirements under CRR would be expected to address those exposures as part of its Pillar II capital requirements.[50]

b. Other Types of Assets and Exposures

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

As noted above, considering that all EU SDs would be eligible to elect the Bank-Based Approach, we think that a comparison to that approach should suffice to establish the comparability of the EU Capital Framework to the Commission Capital Requirements. But, to the extent that a comparison to the Net Liquid Assets Approach is relevant, the EU Capital Framework addresses liquidity risk by imposing separate liquidity requirements on investment firms composed of three main obligations. First, an investment firm is required to hold an amount of sufficiently liquid assets to meet its expected payment obligations under gravely stressed conditions for thirty days.[51] Second, an investment firm is subject to a stable funding requirement whereby it must hold a diversity of stable funding instruments[52] sufficient to meet long-term obligations under both normal and stressed conditions.[53] Third, to ensure that an investment firm continues to meet its liquidity needs, it is required to maintain robust strategies, policies, processes, and systems for the identification of liquidity risk over an appropriate set of time horizons, including intra-day.[54] Accordingly, the liquidity requirements under the EU Capital Framework, like the Net Liquid Assets Approach, help ensure that investment firms can continue to fund their operations over various time horizons, including timely making payments to customers and counterparties. Further, as part of the Pillar II supervisory requirements under the EU Capital Framework, regulators annually review the exposure, measurement and management of liquidity risk by investment firms (including the composition and quality of liquidity buffers).[55]

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[50] EBA, *Final Report – Guidelines on the revised common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing* 5 (2018).

[51] CRR, Article 412(1). Liquid assets primarily include cash, exposures to central banks, government-backed assets and other highly liquid assets with high credit quality. Id. Article 416(1).

[52] Stable funding instruments include Tier 1 and Tier 2 capital instruments and other preferred shares and capital instruments in excess of the Tier 2 allowable amount with an effective maturity of one year or greater. CRR, Article 427(1).

[53] Id. Article 413(1) (as amended by CRR II). The Basel III NSFR requirements applies since June 28, 2021, as specified in CRR, Articles 428a to 428az introduced by CRR II, Article 1(116).

[54] CRD IV, Article 86 (as amended by IFD).

[55] Id. Article 98(1)(e).

1. EU SD Resolution Framework

The EU Capital Framework's liquidity requirements are designed to work in tandem with the resolution regime that would apply in the event an EU SD faced financial distress, as well as the resources available to an EU SD to address a distress scenario. Specifically, investment firms organized in the EU are subject to similar resolution regimes as banks. The EU resolution regime does not focus on liquidation and a rapid distribution of assets to customers. Rather, it emphasizes the continuity of critical services and reduction of the impact of an investment firm's failure on financial stability, including through the orderly winding down of activities or restructuring supported by the investment firm's own funds where this, among other requirements, cannot be ascertained through normal insolvency proceedings. In addition, unlike U.S. nonbank SDs, certain EU SDs will have access to short-term liquidity through relevant EU member state central banks. For instance, under the amendments to CRD IV and CRR that have been introduced by IFD and IFR, which apply since June 26, 2021, large investment firms with €30 billion in assets and above that engage in dealing on own account will be automatically reclassified as credit institutions, which would provide them access to Eurosystem standing facilities following authorization by the European Central Bank.[56]

With that said, if liquidation does occur, EU regulations also protect counterparties and promote continued market liquidity through margin requirements. Investment firms are required to exchange IM and VM composed of highly liquid assets, which are not exposed to excessive credit, market or foreign exchange risk, such that a non-defaulting counterparty can liquidate the collateral in a sufficiently short time to protect against losses on non-centrally cleared OTC derivative contracts.[57] IM must be segregated from the investment firm's assets by either placing it with a third-party holder or custodian or via other legally binding arrangements, making the IM remote in the case of the firm's default or insolvency.[58] In addition, while not specifically required to be segregated from the investment firm's assets, counterparties may elect for VM to also be segregated and placed with a third-party custodian.[59] These requirements help to further protect customers and counterparties in the event that an EU SD experiences financial distress and liquidation.

Therefore, although the EU Capital Framework reflects a somewhat different approach to addressing liquidity risk than the Net Liquid Assets Approach, both approaches are ultimately designed to ensure that a firm has sufficient liquid assets to satisfy customer obligations in the event of a distress scenario.

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[56] See IFD, Recital 7. National central banks may also allow investment firms to make use of intraday credit under TARGET2. See TARGET Guideline (EU/2012/27), Annex III, L 30/67, available at https://www.ecb.europa.eu/ecb/legal/pdf/l_03020130130en00010093.pdf.

[57] EMIR Margin RTS, Recital (31) & Article 7.

[58] Id. Articles 19(1)(d)-(e), (3) & (8).

[59] See Id. Article 3(b) (stating that the "exchange of collateral agreement" must address "segregation arrangements").

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

The Net Liquid Assets Approach permits a nonbank SD to include both equity capital and satisfactory subordinated debt as net capital by permitting the SD to exclude subordinated liabilities from the net worth calculation, with satisfactory subordinated debt allowed to comprise up to 70 percent of the sum of the SD's subordinated debt and equity.[60]

Under the Bank-Based Approach, an SD must maintain the following components of regulatory capital:[61]

- Common Equity Tier 1, which is generally limited to retained earnings and common equity; and
- Additional Tier 1 and Tier 2 capital, which include certain preferred stock and subordinated debt instruments.[62]

Similar to the Bank-Based Approach, the EU Capital Framework imposes different ratios for the various capital components of own funds. The components of own funds align with the components of regulatory capital required under the Bank-Based Approach, as they include:

- Common Equity Tier 1 capital instruments, which are comprised of retained earnings and common equity;[63]
- Additional Tier 1 capital instruments, which include other capital instruments and certain long-term convertible debt instruments;[64] and
- Tier 2 capital instruments, which provide an additional layer of supplementary capital that includes other reserves, hybrid capital instruments, and certain subordinated term debt.[65]

The EU Capital Framework also requires investment firms to make certain capital deductions from Common Equity Tier 1, Tier 1 and Tier 2 capital instruments that further help ensure that any assets held as capital have a positive realizable value in periods of stress. Due to the Common Equity Tier 1 ratio and capital buffers, an investment firm must hold, at a minimum,

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[60] 17 C.F.R. § 240.18a-1(c)(1), (g).

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

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

[63] CRR, Article 28 (as amended by CRR II).

[64] Id. Article 52 (as amended by CRR II).

[65] Id. Article 63 (as amended by CRR II).

66.67 percent of the firm's total capital requirements as Common Equity Tier 1 instruments (e.g., shareholder's equity, retained earnings, and other immediately available reserves).[66]

In addition, investment firms are also required to maintain MREL, which includes certain subordinated debt, in an amount set by the relevant resolution authority.[67] In effect, MREL serves as a less subordinated tier of contingent capital. The required amount of MREL varies by firm depending on its size, funding model, and risk profile, among other considerations, and is designed to absorb losses in the case that a bail-in tool were applied so that the Common Equity Tier 1 ratio of the investment firm could be restored to a level necessary to enable it to continue to comply with its capital requirements.[68] Under BRRD II, the relevant rules have been further refined and tightened, also with a view to restore other required levels of capital leverage ratios.[69]

Accordingly, each approach permits firms to count both equity and certain subordinated debt towards their capital requirements, with the EU Capital Framework and the Bank-Based Approach requiring investment firms to make additional capital deductions from their capital instruments and maintain a larger portion of their required capital as retained earnings and common equity, as compared to the Net Liquid Assets Approach.

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

1. Minimum Capital Requirements

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

- Common Equity Tier 1 of at least $20 million;
- Common Equity Tier 1 equal to at least 6.5 percent of the SD's RWAs;
- Total capital equal to at least 8 percent of the nonbank SD's RWAs; or
- Total capital equal to 8 percent of its uncleared swap margin.[70]

The Net Liquid Assets Approach requires a nonbank SD without model approval to maintain net capital, subject to the adjustments described above, at the higher of $20 million or 2 percent of its uncleared swap margin amount.[71] Under the Net Liquid Assets Approach, a

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[66] The Common Equity Tier 1 ratio and capital conservation buffer require an investment firm to hold, at a minimum, 66.67 percent of total capital amount in shareholder's equity, retained earnings and other reserves available for immediate use. At most, 14.3 percent of the total capital could be made up of Tier 1 capital instruments and 23.8 percent could be composed of Tier 2 instruments.

[67] BRRD, Articles 45 to 45g (Article 1(17) BRRD II amended Article 45 and introduced Articles 45a to 45g) .

[68] Id.

[69] BRRD II, Article 1(17), which added BRRD, Articles 45(c) & 45(d).

[70] 17 C.F.R. § 23.101(a)(1)(i).

[71] 17 C.F.R. § 23.101(a)(1)(ii).

nonbank SD with model approval is also required to maintain tentative net capital, which is the net capital *before* taking certain market and credit risk deductions, of at least $100 million.[72]

The EU Capital Framework takes a somewhat analogous approach to the Bank-Based Approaching, setting out minimum capital ratios for each component of own funds. Specifically, investment firms must maintain sufficient levels of Common Equity Tier 1 capital, Tier 1 (Common Equity Tier 1 and Tier 1) capital and Tier 2 capital, after making required capital deductions, to satisfy the following capital ratios, expressed as a percentage of the firm's total risk exposure amount:

- Common Equity Tier 1 capital ratio of 4.5 percent,[73]
- Tier 1 capital ratio of 6 percent,[74]
- Total capital ratio of 8 percent,[75]
- Additional buffers that must be met with Common Equity Tier 1 capital (in addition to the Common Equity Tier 1 capital used to meet the capital ratios above):[76]
    - Capital conservation buffer of 2.5 percent,[77]
    - Countercyclical buffer of which varies between member states and in some instances may exceed 2.5 percent,[78]
    - Systemically important institutions' buffers applicable to SDs of systemic importance, which depends on the relative size and significance of the investment firm and may exceed, in some instances, 3%, and
    - Systemic risk buffer, which varies between member states.[79]

Investment firms must also hold sufficient MREL, as determined by their relevant regulator.

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[72] Id.

[73] CRR, Article 92(1)(a).

[74] Id. Article 92(1)(b).

[75] Id. Article 92(1)(c).

[76] CRD IV, Articles 129(1), 130(1) & 133(4) (as amended by CRD V and IFD).

[77] Id. Article 129(1) (as amended by CRD V).

[78] Id. Article 130(1) (as amended by CRD V).

[79] Id. Article 133(1) (as amended by CRD V).

Accordingly, similarly to the Bank-Based Approach, the EU capital ratios are calibrated as a percentage of the investment firm's total risk exposure. However, the EU capital ratios are calibrated higher than the Bank-Based Approach's RWA ratios, as the former require, at a minimum, 10.5 percent of the investment firm's total risk exposure as compared to 8 percent of the SD's RWAs.

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

2. Leverage Ratio and Stress Testing

Since June 2021, EU SDs are required to comply with a leverage ratio of 3 percent.[80] The leverage ratio requirement is binding and sits alongside the minimum risk-based capital requirement.

Investment firms are also subject to annual stress testing requirements performed by their relevant regulators,[81] and those with model approval are subject to additional internal credit risk and counterparty credit risk stress testing requirements for testing capital adequacy.[82] Identified deficiencies in a firm's stress testing may lead to the firm holding additional own funds and act as a further check to ensure investment firms continue to hold sufficient own funds in response to evolving risks.

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

1. Comparability of Objectives

The EU Financial Reporting Framework and the Commission Financial Reporting Requirements are intended to enable the relevant regulatory authorities to assess the financial condition and safety and soundness of firms subject to their respective regulation. Specifically,

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[80] CRR II, Article 1(46), which amended CRR, Article 92(1).

[81] CRD IV, Article 100(1).

[82] CRR, Article 177(2), 290.

as discussed below, both regimes require firms to report their compliance with applicable capital requirements and their financial position. These disclosures serve to provide regulatory authorities with a comprehensive view of the financial health and activities of the firms. The EU Financial Reporting Framework also has the purpose of testing in advance and calibrating the application of new prudential requirements before they become binding.

2. Comparability of Methodologies and Outcomes

The Commission Financial Reporting Requirements require that a nonbank SD file with the Commission and with a registered futures association of which it is a member monthly, unaudited financial reports as of the close of business of each month and annual, audited financial reports as of the close of its fiscal year.[83] The monthly financial reports must be filed no later than 17 business days after the date for which the report is made, and the annual financial reports must be filed no later than 60 days after the close of the nonbank SD's fiscal year.[84] The annual financial report must be audited and accompanied by an opinion of an independent certified public accountant or independent licensed accountant in good standing.[85]

A nonbank SD must prepare its monthly and annual financial reports in the English language, denominated in U.S. dollars and in accordance with U.S. GAAP.[86] If the nonbank SD is not otherwise required to prepare financial statements in accordance with U.S. GAAP, it may prepare its monthly and annual financial reports in accordance with the International Financial Reporting Standards. The financial reports must include the following statements:

- Financial condition;
- Income/loss;
- Changes in liabilities subordinated to the claims of general creditors;
- Changes in ownership equity; and
- Compliance with and calculation of the nonbank SD's applicable regulatory capital requirements under Rule 23.101.[87]

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

- A statement of cash flows;

[83] 17 C.F.R. §§ 23.105(d), (e).

[84] 17 C.F.R. §§ 23.105(d)(1), (e)(1) .

[85] 17 C.F.R. § 23.105(e)(2).

[86] 17 C.F.R. §§ 23.105(d)(2), (e)(3) .

[87] 17 C.F.R. §§ 23.105(d)(2), (e)(4) .

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

The EU Financial Reporting Framework, like the Commission Financial Reporting Requirements, is designed to provide the regulators with a comprehensive view of the financial information and capital position of an EU SD. Article 430 of the CRR requires an EU SD to provide its relevant regulator with information on the EU SD's own funds and financial information "needed to provide a comprehensive view of the institution's risk profile and the systemic risks posed by the institution to the financial sector or the real economy."[88]

In view of differing local conventions, Article 430 does not itself dictate the specific statements that an EU SD is required to provide. Instead, it delegates to the relevant competent authorities to provide such specificity. This delegation allows the competent authorities to adopt requirements that are consistent with local practices, such as accounting or timing standards.

For instance, the EBA developed implementing technical standards ("ITS") under Article 430 of the CRR that specify the contents of the required financial reports ("FINREP") for EU SDs that are consolidated with parent entities that report using international financial reporting standards ("IFRS"). Pursuant to these requirements, an EU SD is required to provide the following to its relevant regulator, among other things:

- A balance sheet statement (or statement of financial position) that reflects the EU SD's financial condition (quarterly);[89]
- A statement of profit or loss (quarterly);[90]
- A breakdown of financial liabilities by product and by counterparty sector (quarterly);[91] and
- A statement of changes in equity (annually).[92]

In addition, an EU SD subject to the ITS is required to provide its regulator with FINREP financial information beyond that required by the Commission Financial Reporting

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[88] CRR, Article 430(5). The CRR also establishes reporting requirements for large exposures (Articles 394 and 430), liquid assets (Articles 415–416 and 430), stable funding (Articles 427–428), TLAC (Articles 92a and 430) and leverage (Article 430). As noted above, CRR II has amended sections of CRR and moved the content of Article 99 to a new part Seven A (Articles 430-430c) CRR. However, the amendments contained in CRR II do not materially affect the substance of these provisions of the EU Financial Reporting Framework discussed herein.

[89] CRR, Article 430; Annex III, 1.1, 1.2 and 1.3 of Commission Implementing Regulation (EU) 2021/451 with regard to supervisory reporting of institutions according to CRR ("CRR Reporting ITS").

[90] CRR, Article 430; Annex III, 2 CRR Reporting ITS.

[91] CRR, Article 430; Annex III, 8.1 CRR Reporting ITS.

[92] CRR, Article 430; Annex III, 46 CRR Reporting ITS.

Requirements. For example, such an EU SD must provide, quarterly, a breakdown of its loans and advances by product and type of counterparty,[93] as well as detailed information regarding its derivatives trading activities,[94] collateral and guarantees.[95]

The ITS also require an EU SD subject thereto to prepare and deliver common reporting ("COREP") on a quarterly basis. COREP requires, among other things, calculations in relation to the EU SD's own funds and own funds requirements,[96] capital ratios and capital levels,[97] and market risk.[98]

An EU SD that is not subject to the ITS may be required to provide different specific information. However, in all instances, Article 430 requires an EU SD to provide comprehensive information regarding its financial condition and capital position. Moreover, unless the EU SD is very small, Article 430 requires independent auditors to audit and provide an opinion on the EU SD's financial statements.[99]

As a result, an EU SD will be required to provide substantially the same information as that required by the Commission Financial Reporting Requirements in addition, in many instances, to other detailed information that is not required by the Commission Financial Reporting Requirements.

C. Consolidated Requirements

In limited circumstances, an EU SD that is a subsidiary of another institution subject to the CRR may apply to the relevant competent authorities to have the CRR's capital, liquidity, and/or MREL requirements imposed on the EU SD and its parent organization on a consolidated, rather than individualized, basis.[100] If the relevant authorities approve such a request, the related reporting requirements under the EU Financial Reporting Framework will similarly apply on a consolidated basis to the EU SD and its parent organization[101].

The relevant competent authorities will only approve a request to calculate and report capital, liquidity, and/or MREL on a consolidated basis if the EU SD and its parent organization satisfy a number of stringent requirements designed to ensure that the relevant resources will be available to the EU SD to substantially the same extent as would be the case were the capital, liquidity, and/or MREL obligations imposed on an individualized basis. For

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[93] CRR, Article 430; Annex III, 5.1 and 6.1 CRR Reporting ITS.

[94] CRR, Article 430; Annex III, 10 CRR Reporting ITS.

[95] CRR, Article 430; Annex III, 13 CRR Reporting ITS.

[96] CRR, Article 430; Annex I, 1 and 2 CRR Reporting ITS.

[97] CRR, Article 430; Annex I, 3 CRR Reporting ITS.

[98] CRR, Article 430; Annex I, 18–25 (as applicable) CRR Reporting ITS.

[99] See supra note 16.

[100] CRR Articles, 7, 8; Article 12h of the EU Single Resolution Mechanism Regulation (2019/877).

[101] CRR, Article 7(1), 8(6); CRR, Article 11(1) and (4).

example, in order to obtain approval to calculate capital on a consolidated basis, an EU SD must demonstrate, among other things, that capital is freely transferrable to the EU SD from the parent organization, the parent organization has control of the EU SD, and the parent organization has guaranteed all of the obligations of the EU SD.[102] In addition, even with such approval, the EU SD is still required to ensure they are not subject to excessive leverage.[103] As a result, calculating the relevant requirements on a consolidated basis should achieve substantially the same objectives as calculating the requirements on an individualized basis.

D. Enforcement and Supervision of the EU Capital & Reporting Framework

EU prudential regulators have ample supervision, audit, and investigation powers, which include the power to:

- require investment firms and their management to provide all necessary information in order to carry out their supervisory tasks, including providing information at recurring intervals and in specified formats for supervisory and related statistical purposes;[104]

- require submission of documents, examine, and take copies and extracts from, the books and records of investment firms, obtain written and oral explanations from management, staff, and other persons; [105] and

- conduct all necessary inspections at the business premises of investment firms and other group entities.[106]

The EU Capital Framework requires an investment firm to provide notice its prudential regulator, if it breaches its capital buffers within five business days, along with a capital conservation plan that sets out how the firm will restore its capital levels.[107] In the event of such a breach, the EU authorities possess wide-ranging tools to deal with an investment firm's financial deterioration:

- *Liquidity requirements are breached*. Regulators may impose administrative penalties or other administrative measures, including prudential charges, if an

[102] CRR, Article 8(1).

[103] CRD, Article 87.

[104] CRD IV, Article 65(3)(a)

[105] CRD IV, Article 65(3)(b)

[106] CRD IV, Article 65(3)(c)

[107] CRD IV, Article 142. The capital conservation plan includes estimates of income and expenditures and a plan to increase its own funds to meet its capital buffers. Id. Article 142(2). If the regulator does not approve the capital conservation plan, the regulator will impose requirements for the firm to increase its own funds to specified levels (or may impose more stringent restrictions on distributions). Id. Article 142(4).

investment firm's liquidity position falls below liquidity and stable funding requirements established at the national or EU level.[108]

- *MREL is breached.* Once the investment firm falls below its required MREL, the resolution authority may take early measures to intervene, such as requiring management to take certain actions, order members of management to be removed or replaced, or require changes to the investment firm's business strategy or legal or operational structure, among others.[109] If additional requirements are met, it is also possible that resolution authorities may assess the investment firm as "failing or likely to fail," triggering a resolution action (which could occur even *before* the investment firm actually breached its minimum capital requirements).[110] Under BRRD II, which was required to be implemented by member states by December 28, 2020 , a breach of the investment firm's MREL requirements may also trigger restrictions on the firm's ability to make certain distributions (e.g., paying certain dividends or employee bonuses).[111] An investment firm must immediately notify its competent resolution authority when in a situation where it meets the combined buffer requirement, but it fails to meet the combined buffer requirement when considered in addition to the applicable MREL requirements.[112] In addition, the investment firm must notify the competent resolution authority if it considers the firm to be failing or likely to fail.[113]

- *Capital buffers are breached.* A breach of an investment firm's capital buffers automatically triggers restrictions on the firm's ability to make certain distributions (e.g., paying certain dividends or employee bonuses).[114] Investment firms also must prepare a capital conservation plan and submit it to the relevant regulator within five business days after breaching the capital buffers.[115] The restrictions increase in severity with the degree of the breach. Regulators may also impose other requirements in case of non-compliance with regulatory requirements, such as:[116]

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[108] CRD IV, Articles 67(1)(j) and 105, as amended by CDR V.

[109] BRRD, Article 27(1).

[110] Id. Article 32(1)(a).

[111] BRRD II, Article 1(6), which inserted BRRD, Article 16a.

[112] Id.

[113] BRRD, Article 81(1).

[114] CRD IV, Article 141; CRD V, Article 141b.

[115] CRD IV, Article 142. The capital conservation plan includes estimates of income and expenditures and a plan to increase its own funds to meet its capital buffers. Id. Article 142(2). If the regulator does not approve the capital conservation plan, the regulator will impose requirements for the firm to increase its own funds to specified levels (or may impose more stringent restrictions on distributions). Id. Article 142(4).

[116] Id. Article 104(1) (as amended by CRD V).

- requiring the investment firm to have additional own funds in excess of any minimum requirements, if certain conditions are met;

- requiring the investment firm to submit a plan to restore compliance with applicable capital and liquidity requirements and set a deadline for implementation;

- requiring the investment firm to restrict or limit its business or operations, or requiring the divestment of activities that pose excessive risks to the soundness of the investment firm;

- requiring the investment firm to use net profits to strengthen its own funds;

- restricting or prohibiting distributions or interest payments by an investment firm to its shareholders or holders of Additional Tier 1 instruments;

- imposing additional or more frequent reporting requirements, including reporting on own funds, liquidity and leverage; and

- imposing specific liquidity requirements, including restrictions on maturity mismatches between assets and liabilities.

Note that while regulators generally have broad discretion as to what powers they may exercise, the EU Capital Framework specifically requires regulators to require investment firms to hold increased capital when:[117]

- risks or elements of risks are not covered by the capital requirements in the EU Capital Framework;

- the investment firm lacks robust governance arrangements, appropriate resolution and recovery plans, processes to manage large exposures or effective processes to maintain on an ongoing basis the amounts, types and distribution of internal capital needed to cover the nature and level of risks to which they might be exposed and it is unlikely that other supervisory measures would be sufficient to ensure that those requirements can be met within an appropriate timeframe;

- the institution repeatedly fails to establish or maintain an adequate level of additional own funds to cover the guidance communicated by the competent authorities; or

[117] Id. CRD IV, Article 104a(1), introduced by CRD V, Article 1(33).

  - other institution-specific situations deemed by the competent authority to raise material supervisory concerns.

- *Minimum capital requirements are breached*. Regulators can also sanction an investment firm (or its management) if the firm either falls below the capital or liquidity thresholds under the EU Capital Framework or the regulator has evidence that the firm will breach such capital and liquidity thresholds in the next 12 months.[118] They may also withdraw an investment firm's authorization.[119]

- *Reporting requirements are breached*. Regulators can also issue administrative penalties and other administrative measures if a firm (or its management) does not fully comply with its reporting requirements.[120] These penalties and measures include:

  - public statements identifying a firm or one or more of its managers as responsible for the breach;

  - cease-and-desist orders;

  - withdrawal of the firm's authorization;

  - temporary bans against a member of the firm's management body or other manager;

  - administrative pecuniary penalties against the firm of up to 10 percent of the total annual net turnover of the preceding year; or

  - administrative pecuniary penalties of up to twice the amount of the profits gained or losses avoided because of the breach.

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[118] Id. Article 102(1).

[119] MiFID, Article 8(c).

[120] CRD IV, Article 67(1)(e-i) and 67(2).

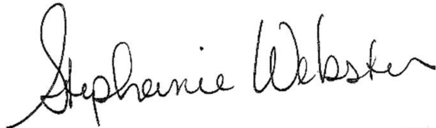
IV. Conclusion

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

* * *

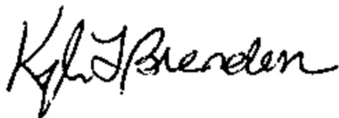
Please feel free to reach out to the undersigned should you have any questions.

Sincerely,



Stephanie Webster
General Counsel
Institute of International Bankers

Steven Kennedy
Global Head of Public Policy
ISDA



Kyle Brandon
Managing Director, Head of Derivatives Policy
SIFMA

Appendix

The **IIB** is the only national association devoted exclusively to representing and advancing the interests of the international banking community in the United States. Its membership is comprised of internationally headquartered banking and financial institutions from over 35 countries around the world doing business in the United States. The IIB's mission is to help resolve the many special legislative, regulatory, tax, and compliance issues confronting internationally headquartered institutions that engage in banking, securities and other financial activities in the United States. Through its advocacy efforts the IIB seeks results that are consistent with the U.S. policy of national treatment and appropriately limit the extraterritorial application of U.S. laws to the global operations of its member institutions.

Since 1985, **ISDA** has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 950 member institutions from 76 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation, and business policy, affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

May 15, 2023

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

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

Dear Mr. Smith:

Thank you for your letter dated March 9, 2023. Please find attached our answers to your questions related to the September 24, 2021 application submitted by the Institute of International Bankers, International Swaps and Derivatives Association and Securities Industry and Financial Markets Association requesting that the Commission determine that the capital and financial reporting laws and regulations of the European Union ("EU") applicable to CFTC-registered swap dealers organized and domiciled in the EU provide sufficient bases for an affirmative finding of comparability with respect to the Commission's swap dealer capital and financial reporting requirements adopted under the Commodity Exchange Act.

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

Very truly yours,

Kyle L Brandon
Managing Director, Head of Derivatives Policy
SIFMA

U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000

Market Participants Division

March 9, 2023

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

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

Dear Ms. Brandon:

The U.S. Commodity Futures Trading Commission's ("Commission" or "CFTC") Market Participants Division ("MPD") has received the application submitted by the Institute of International Bankers ("IIB"), International Swaps and Derivatives Association ("ISDA") and Securities Industry and Financial Markets Association ("SIFMA", and together with IIB and ISDA, the "Applicants") on September 24, 2021 requesting that the Commission determine that the capital and financial reporting laws and regulations of the European Union ("EU") applicable to CFTC-registered swap dealers organized and domiciled in the EU provide sufficient bases for an affirmative finding of comparability with respect to the Commission's swap dealer capital and financial reporting requirements adopted under the Commodity Exchange Act ("EU Application").

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

I. Scope of the EU Application

There are currently four swap dealers registered with the Commission that are domiciled in a member state of the EU ("EU Member State"): BofA Securities Europe SA ("BofASE"); Goldman Sachs Paris Inc. et Cie ("GSPIC"); Citigroup Global Markets Europe AG ("CGME"); and Morgan Stanley Europe SE ("MSESE").

Please confirm that these are the swap dealers with respect to which you request that the Commission issue a capital comparability determination order ("EU nonbank SD").

- Confirmed.

II. Regulatory Framework

Please confirm that all EU nonbank SDs are subject to the Capital Requirements Regulation (575/2013) ("CRR") and to the laws of an EU Member State that has implemented the provisions of the Capital Requirements Directive (2013/36/EU) ("CRD"). Please confirm that all CRD implementing provisions required as a result of the Capital Requirements Directive V (2019/878/EU) or the Investment Firms Directive (2019/2034/EU) ("IFD") updates have been adopted in France and Germany and are in force.

- Confirmed.

III. Registration and Capital Requirements Regime

We understand that there are two categories of investment firms that remain subject to the CRR/CRD regime following the adoption of the Investment Firms Regulation (2019/2033) ("IFR") and IFD: (1) the so-called "class 1 firms" that perform dealing on own account, underwriting of financial instruments or placing of financial instruments on a firm commitment basis and meet a EUR 30 bn threshold for their consolidated assets and (2) the so-called "class 1 minus" firms that perform dealing on own account, underwriting of financial instruments or placing of financial instruments on a firm commitment basis and (a) meet a EUR 15 bn threshold in terms of their consolidated assets or (b) meet a EUR 5 bn threshold and are designated by their competent authorities following specific criteria. While "class 1" firms must apply to be authorized as credit institutions, "class 1 minus" firms remain authorized as investment firms.

1. In which category (*i.e.*, "credit institution" or "investment firm") is each of the registered EU nonbank SDs currently authorized?

- Currently, GSPIC is an Investment Firm and as such is able to provide investment services while applying CRR/CRD rules.
- BofASE, CGME and MSESE are authorized as Credit Institutions.

2. For EU nonbank SDs that have applied for authorization as credit institutions, what is the status of the request for each EU nonbank SD? If the authorization is not finalized yet, what is the expected timeline for obtaining it?

- GSPIC submitted a draft application to become an *établissement de crédit et d'investissement* ("ECI") (i.e., a CRR Credit Institution) to the *Autorité de contrôle prudentiel et de résolution* ("ACPR") in October 2021 and a revised version in December 2022. The timeline for approval depends on the ACPR and the European Central Bank ("ECB"), which must both approve the application to become authorized as an ECI. Once the application is deemed complete by the ACPR and the ECB, the decision is due within a 6-months period.

- BofASE was authorized as a CRR Credit Institution on 8 December 2022
- MSESE was authorized as a CRR Credit Institution on 1 September 2022
- CGME was authorized as a CRR Credit Institution on 18 October 2022

IV. Qualifying Capital and Capital Buffer Requirements

1. Please explain the extent to which Article 63 of CRR subordinates certain tier 2 capital instruments to claims of other creditors.

- Article 63 of the CRR does not itself "subordinate" tier 2 capital instruments to the claims of other creditors. Rather, Article 63 provides the criteria for which capital instruments qualify as tier 2 instruments (which are in-line with the usual Basel tier 2 eligibility requirements). The conditions for qualification include the requirement that in the event of the entity's insolvency "the claim on the principal amount ….. ranks below any claim from eligible liabilities". Eligible liabilities are, in effect non-own funds liabilities including an issuer's MREL (or TLAC) resources. Therefore, Article 63 does not "subordinate instruments", but provides criteria which limit the inclusion into tier 2 capital, to instruments that are subordinated through their contractual terms.

2. With respect to the capital conservation buffer requirement of Article 129 of CRD, please confirm that:

   a. EU nonbank SDs are required to maintain common equity tier 1 capital equal to 2.5 percent of the EU nonbank SD's total risk exposure amount in addition to the minimum common equity tier 1 capital requirement of 4.5 percent; and

   - Confirmed.

   b. If an EU nonbank SD's common equity tier 1 capital falls below 7 percent of the EU nonbank SD's total risk exposure amount, the EU nonbank SD is required to file a notice to the competent authority and submit a capital conservation plan pursuant to provisions implementing Article 142 of CRD (assuming no other capital buffer requirements apply).

   - Confirmed.

V. MREL and TLAC Requirements

1. Is each of the four EU nonbank SDs subject to a minimum requirement for own funds and eligible liabilities ("MREL") pursuant to provisions implementing the Bank Recovery and Resolution Directive (2014/59/EU) ("BRRD")? If yes, on the basis of which specific regulatory provision (please specify for each EU nonbank SD)? Please cite to both BRRD and the relevant implementing provisions in France and Germany, and indicate, for each of the four EU nonbank SD, the category of entities subject to MREL in which the specific EU nonbank SD falls.

   - GSPIC and BofASE are not currently subject to MREL.
   - CGME and MSESE are subject to MREL pursuant to Article 45(1) of the BRRD (as implemented by section 49 of the German Recovery and Resolution Act (*Sanierungs- und Abwicklungsgesetz*, "SAG") as credit institutions.

2. Identify the relevant resolution authority for each of the four EU nonbank SDs.

- GSPIC: ACPR.
- BofASE, CGME and MSESE: Single Resolution Board ("SRB").

3. Please indicate whether each of the EU nonbank SDs has been designated as a resolution entity.

- None of the four firms are designated as a resolution entity.

4. Is each of the four EU nonbank SDs subject to a total loss absorbing capacity ("TLAC") requirement? If yes, on the basis of which specific regulatory provision (please specify for each EU nonbank SD)? For each EU nonbank SD, please indicate the applicable category of entities subject to a TLAC requirement in which the EU nonbank SD falls (*e.g.*, G-SII entity that is a resolution entity; material subsidiary of a non-EU G-SII that is not a resolution entity).

- None of the four firms are currently subject to the TLAC requirement.[1]

VI. Financial Reporting

1. Please confirm that each of the four EU nonbank SDs submits FINREP and COREP reports to its competent supervisory authority.

- Confirmed.[2]

2. Please confirm that the ECB FINREP Regulation (ECB/2015/13) applies to each of the EU nonbank SDs.

- Confirmed.

3. For each of the four EU nonbank SDs, please indicate the specific regulatory instrument that imposes a requirement on the EU nonbank SD to submit FINREP reports (*e.g.*, Commission Implementing Regulation (EU) 2021/451 ("CRR Reporting ITS"); ECB FINREP Regulation (ECB/2015/13)). Please also specify the relevant regulatory provision (*i.e.*, article) that applies to each of the EU nonbank SD.

Firm	Regulation	Article	Category
GSPIC	ECB Regulation (EU) 2015/534	Art. 13(4)	credit institution
BofASE	ECB Regulation (EU) 2015/534	Art. 6(1)	large institution
CGME	ECB Regulation (EU) 2015/534	Art. 6(3)	Significant CRR Credit Institution
MSESE	ECB Regulation (EU) 2015/534	Art. 7(1)	large institution

[1] As noted in the question, a firm would become subject to the TLAC requirement should it become a material subsidiary of a non-EU G-SII that is not a resolution entity, for example.

[2] Specific to Morgan Stanley based on a permission received from the ECB under CRR Article 9, minimum capital requirements are met by MSESE while incorporating its subsidiary, MS Bank AG ("MSBAG"). Consequently, COREP and FINREP reporting is provided on the same basis.

a. If any of the EU nonbank SDs submits FINREP reports pursuant to the CRR Reporting ITS, please specify on the basis of which specific regulatory provision the CRR Reporting ITS are applicable to the EU nonbank SD. For each relevant EU nonbank SD, explain why the EU nonbank SD is subject to the CRR Reporting ITS (*e.g.*, the EU nonbank SD prepares consolidated accounts in accordance with IFRS because it is consolidated with a parent entity that reports using IFRS; the EU nonbank SD determines its capital on a consolidated basis in accordance with IFRS and is required by its competent authority to apply the CRR Reporting ITS etc.)?

- GSPIC: Capital and financial reporting are under local GAAP on an individual basis.
- BofASE: Capital and financial reporting are on an individual basis in accordance with IFRS.
- MSESE: Required under Art. 7 (1) of Regulation (EU) 2015/534. MSESE is a significant credit institution with permission pursuant to Article 24(2) of Regulation (EU) No 575/2013 that allows it to provide regulatory reports under IFRS.
- CGME: Capital and financial reporting are under local GAAP on an individual basis.

b. Does the requirement to provide financial reporting on an individual basis pursuant to the ECB FINREP Regulation apply to any of the EU nonbank SDs? If yes, please cite to the relevant articles in the ECB FINREP Regulation that impose reporting requirements on an individual basis to each relevant EU nonbank SD.

- Yes. The relevant article is Article 1(c), and for GSPIC Article 1(1)(f), of Regulation (EU) 2015/534.[3,4]

4. In earlier communication with CFTC staff dated August 27, 2021, you represented that "each national competent authority has discretion to require institutions subject to the CRR to report additional supervisory information on the basis of the CRR and CRR Reporting ITS or of national law."

    a. Please provide citations to the relevant provisions that give competent authorities such discretion.

    - CRD Article 104 "Supervisory Powers"

[3] The ACPR requested that GSPIC submit the regulatory reporting applicable to ECIs prior to receiving the license. GSPIC submits on a standalone basis and does not submit consolidated reports. Therefore, COREP and FINREP reporting are submitted on a quarterly basis as per the regulation for ECIs.

[4] As a significant credit institution, MSESE prepares its regulatory reporting under IFRS pursuant to CRR Art.24(2) and Commission Implementing Regulation (EU) 2015/534 Article 7(1). Reporting is prepared incorporating MSBAG in accordance with MSESE's CRR Article 9 permission.

- France: As part of its supervisory powers, the ACPR may request such information under Articles L. 612-1 and L. 612-24 of the French *Code monétaire et financier* ("COMOFI"), which transposed under French law Article 104 CRD ("Supervisory Powers") in this regard.
- Germany: Firms are required to submit to the *Bundesanstalt für Finanzdienstleistungsaufsicht* ("BaFin") upon request information on all business matters and submit requested documents (section 44 KWG).

b. Do the competent authorities in France and Germany require such additional supervisory information? If yes, please provide the relevant provisions.

- France: The ACPR would typically require information under Article L. 612-1 COMOFI as an ad hoc request, during a special audit or during an on-site inspection. Several statistical financial reporting reports are required to be submitted to the ACPR and Banque de France on the basis of these articles (the main one being "RUBA").
- Germany: A request for information may be made in the context of special audits under section 44 KWG in principle at any time.

5. In the EU Application, you represented that: "An EU SD that is not subject to the ITS may be required to provide different specific information."

   a. In connection with this statement, is any of the EU nonbank SDs not subject to the CRR Reporting ITS? If yes, please indicate which EU nonbank SDs.

   - The four currently registered EU nonbank SDs are subject to the CRR Reporting ITS.

   b. If any EU nonbank SD is not subject to the CRR Reporting ITS and is therefore required to provide "different specific information," please provide details, as well as relevant citations, regarding the applicable financial reporting requirements.

   - N/A

6. Are all of the EU nonbank SDs subject to a requirement to prepare and publish annual audited financial statements and/or other annual reports? If yes, please cite to the relevant provisions, including local implementing provisions.

- France
  - GSPIC: Yes, annual audited financial statements are required to be published as per "*Règlement ANC – Autorité des normes comptables* 2014-07 of 26th November 2014, 3121-1". GSPIC financials are required to be approved by the competent body to approve these accounts (General Assembly) before May 31st and must published before June 30th (1 month after their approval by the general assembly).
  - BofASE: Yes, annual audited financial statements are required to be published as per French Commercial Code (Article L232-23). BofASE has to publish its financial statements within one month after it is approved by the shareholders' meeting and must be published by the end of May.

- Germany
  - Yes, pursuant to section 340a of the German Commercial Code (*Handelsgesetzbuch*, "HGB"), credit institutions, such as CGME and MSESE, are required to publish annual reports in accordance with the requirements.

    The KWG requires companies to submit their draft financial statements (pre audit and management sign off) within 3 months following the year-end to the BaFin and Bundesbank. Later, once the management report and audit are complete, the financial statements are re-submitted to the BaFin and Bundesbank and the auditor also sends the audit report to the regulators directly.

    The German Stock Corporation Act requires that the external audit be completed within 5 months of the year-end. External publication by each company in the federal gazette "Bundesanzeiger" would then happen shortly after the regulator filings have been completed.

VII. Notice Requirements and Supervision

1. For each of the EU nonbank SDs, please identify the primary supervisory authority for purposes of capital and financial reporting supervision.

- GSPIC is directly supervised by the ACPR.
- BofASE is subject to supervision by the joint supervisory team ("JST") consisting of the ECB and the ACPR.
- MSESE and CGME are subject to supervision by the JST consisting of the ECB, BaFin and the German Bundesbank.

2. We understand that some of the EU nonbank SDs are subject to the Single Supervisory Mechanism ("SSM") and fall within the direct supervisory authority of the European Central Bank ("ECB").

   a. Would any of the EU nonbank SDs be subject to the supervision of a national supervisory authority outside of the SSM? If yes, on what basis?
   - As an Investment Firm, GSPIC is currently supervised by the ACPR outside of the SSM[5]

[5] GSPIC is currently authorized as an Investment Firm and therefore directly supervised by the ACPR. Following the entry into force of the Investment Firm Regulation and Directive (IFR / IFD), GSPIC has been classified as a "Class 1 Investment Firm" (*établissement de crédit et d'investissement* – ECI). Accordingly, GSPIC applied to be reauthorized as an ECI. When the ECB will notify GSPIC of its decision to authorize it as an ECI, GSPIC could potentially fall under ECB's direct supervision under the conditions laid down in Article 6(4) SSM Regulation, notably if (i) assets > EUR 30bn or (ii) ECB decides "on its own initiative [to] consider an institution to be of significant relevance", subject to certain conditions. Please note that Article 4 SSM Regulation confers on the ECB tasks relating to the prudential supervision of <u>all</u> credit institutions in participating Member States, i.e., including "less significant" institutions (for example authorisations and qualifying holding proceedings)."

- BofASE, CGME[6] and MSESE: No.

b. Would any of the EU nonbank SDs qualify as a "less significant supervised entity" as defined in the SSM Regulation?"

- GSPIC: The SSM Regulation, which distinguishes between "significant" and "less significant" institutions, ("LSI") applies to credit institutions, financial holding companies, mixed financial holding companies, and certain branches of EU credit institutions. As an Investment Firm that is not yet authorized as an ECI, the SSM Regulation currently does not apply to GSPIC. We understand at this stage that GSPIC would be an LSI, subject to confirmation of the ACPR and ECB.
- BofASE, CGME and MSESE: No.

3. Please describe the functioning of the SSM in connection with the supervision of EU nonbank SDs' compliance with the applicable capital and financial reporting requirements.

a. Please describe in detail how the financial reporting requirements, notice requirements and the supervisory powers of relevant authorities discussed in the EU Application apply in the context of the SSM. Please specify which authority (ECB/national supervisory authority/national resolution authority/other) receives each relevant report and/or notice.

- GSPIC: the ACPR is currently the direct prudential supervisor and resolution authority, including in respect of capital and financial reporting requirements. This may change if the ECB were to consider GSPIC as a significant entity within the meaning of the SSM Regulation when it is authorized as an ECI. Please see responses to questions VII.2. above.

- BofASE, CGME and MSESE: The SSM Regulation confers to the ECB the responsibility for the prudential supervision of certain credit institutions (but not responsibility for non-prudential matters including conduct of business and anti-money laundering). Under the SSM Regulation and the SSM Framework Regulation, the ECB and national supervisory authorities are obliged to exchange information.

  Article 140 of the SSM Framework Regulation states that "*the ECB shall have the tasks and powers with regard to significant supervised entities as laid down in relevant Union law on supervisory reporting*" – this is relevant to as a significant supervised entity. It should be noted that this does not preclude the involvement of the relevant National Competent Authority ("NCA") (e.g. in France, ACPR and in Germany, BaFin); the ECB published their SSM Supervisory Manual[7] in March 2018

[6] CGME: We note that, according to the UK Financial Services Register, CGME has applied to cancel its UK branch's regulatory authorization. For so long as CGME's UK branch remains authorized in the UK, then its business activities conducted from that branch would be regulated by the UK Financial Conduct Authority ("FCA"). However, the FCA do not supervise or impose capital and related prudential regulatory requirements. CGME is registered with the U.S. Securities and Exchange Commission.

[7] *SSM Supervisory Manual – European banking supervision: functioning of the SSM and supervisory approach*, the European Central Bank, March 2018.

which states that "[w]ithin the SSM, the ECB, *assisted by the NCAs*, directly supervises all institutions that are classified as significant" (emphasis added).

Additionally, the ECB and the relevant NCA are required to share information, (for example, Para 47 of the Recitals to the SSM Regulation in particular notes that "[i]n order to carry out its tasks effectively, the ECB should be able to require all necessary information, and to conduct investigations and on-site inspections, where appropriate in cooperation with national competent authorities. The ECB and the national competent authorities should have access to the same information without credit institutions being subject to double reporting requirements").

Specifically, the ECB may require supervised entities to report any information necessary for it to carry out its tasks (including information to be provided at recurring intervals and in specified formats for supervisory and related statistical purposes) under Article 141 of the SSM Framework Regulation.

With respect to supervisory reporting generally, the ECB FINREP Regulation (ECB/2015/13) requires that reporting of supervisory financial information is made to the NCAs and the Decision (ECB) on the provision to the European Central Bank of supervisory data reported to the national competent authorities by the supervised entities (ECB/2014/29) lays down procedures concerning the submission to the ECB of data reported to the NCAs by the supervised entities on the basis of Commission Implementing Regulation (EU) 2016/2070 (implementing technical standards for templates, definitions and IT solution), the CRR Reporting ITS (Commission Implementing Regulation (EU) 2021/451) and Commission Implementing Regulation (EU) 2021/453 (laying down implementing technical standards for the application of the CCR with regard to the specific reporting requirements for market risk).

Under Article 16(2)(j) of the SSM Regulation, the ECB has the power to impose additional or more frequent reporting requirements, including reporting on capital and liquidity positions.

b. In connection with the investigative and enforcement powers discussed in the Application, explain in what circumstances the ECB has direct powers and in what circumstances the ECB can instruct the national supervisory authorities to initiate proceedings.

- GSPIC: The scope of the ECB's supervisory tasks is limited to the prudential supervision of credit institutions (Art. 1(2) SSM Regulation). As such, the SSM Regulation and the investigative and enforcement powers set out therein are currently not applicable to GSPIC. Please also see responses to questions VII.2. above.
- BofASE, CGME and MSESE: The ECB is vested with under the SSM Regulation – such as general information request rights (c.f., Art. 10 Council Regulation (EU) No 1024/2013 - SSM Regulation), general investigations and onsite inspections (Art. 11 and 12 SSM Regulation) as well as specific measures (Art. 16 SSM Regulation) and enforcement measures, sanctions (Art. 18 SSM Regulation).

c. For each statement/relevant requirement, please provide references to the relevant laws and regulations imposing the respective reporting or notice requirement to the ECB or giving the relevant powers to the ECB.

- GSPIC: Not applicable.
- BofASE, CGME and MSESE: Article 18 of the SSM Regulation (in connection with Part X of the SSM Framework Regulation) gives the ECB powers to impose pecuniary sanctions and periodic penalty payments where, inter alia, credit institutions, intentionally or negligently, breach a requirement under relevant directly applicable acts of Union law in relation to which administrative pecuniary penalties are made available to competent authorities. Article 113(2) of the SSM Framework Regulation that where the ECB is addressing such a decision to a supervised entity, it shall instead issue instructions to the NCA in close cooperation and that NCA shall in turn address a decision to the supervised entity. However, in the case of a significant supervised entity (such as CGME), Article 113(3) of the SSM Framework Regulation states that, where Article 18 of the SSM Regulation or Part X of the SSM Framework Regulation provide for the relevant NCA to address a decision to such an entity, the NCA in close cooperation shall initiate proceedings with a view to taking action to ensure that appropriate administrative penalties are imposed only on the ECB's instructions and shall inform the ECB once a decision has been adopted.

  In relation to the investigative powers set out under the first paragraph above, Article 9 of the SSM Regulation states in relation to supervisory and investigatory powers that: (1) for the purpose of carrying out its prescribed tasks under the SSM Regulation, the ECB shall be considered, as appropriate, the competent authority or the designated authority in the participating Member States as established by relevant Union law; (2) the ECB shall have all the powers and obligations, which competent and designated authorities shall have under the relevant Union law, unless otherwise provided for by the SSM Regulation and, crucially, (3) the ECB may require, by way of instructions, national authorities to make use of their powers, under and in accordance with the conditions set out in national law, where the SSM Regulation does not confer such powers on the ECB.

  This should be considered in the context of the fact that the ECB directly supervise significant supervised entities (such as CGME). As stated above, the ECB published their SSM Supervisory Manual in March 2018 which states that "[w]ithin the SSM, the ECB, assisted by the NCAs, directly supervises all institutions that are classified as significant".

  By way of background, paragraph 36 of the Recitals to the SSM Regulation states that:

  > "In order to ensure that supervisory rules and decisions are applied by credit institutions, financial holding companies and mixed financial holding companies, effective, proportionate and dissuasive penalties should be imposed in case of a breach. In accordance with Article 132(3) TFEU and Council Regulation (EC) No 2532/98 of 23 November 1998 concerning the powers of the European Central Bank to impose sanctions (1), the ECB is entitled to impose fines or periodic

penalty payments on undertakings for failure to comply with obligations under its regulations and decisions. Moreover, in order to enable the ECB to effectively carry out its tasks relating to the enforcement of supervisory rules set out in directly applicable Union law, the ECB should be empowered to impose pecuniary penalties on credit institutions, financial holding companies and mixed financial holding companies for breaches of such rules. National authorities should remain able to apply penalties in case of failure to comply with obligations stemming from national law transposing Union Directives. Where the ECB considers it appropriate for the fulfilment of its tasks that a penalty is applied for such breaches, it should be able to refer the matter to national competent authorities for those purposes."

4. Do you expect the ECB to apply capital buffer requirements that are higher than the buffer requirements imposed by the national supervisory authorities?

- To date, the ECB has not applied capital buffers higher than those imposed by the NCAs, which would take the form of Pillar 2 Guidance if applied in the future.

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

Sincerely,

Thomas Smith
Deputy Director
Market Participants Division