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David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Center  
1155 21st Street, NW  
Washington, DC 20581

**COMMENT**

Office of the  
Secretariat

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Re: Capital Requirements of Swap Dealers and Major Swap Participants, RIN 3038-AD54 76  
Fed. Reg. 27802 (May 12, 2011) (the "Capital Proposal").

Secretary Stawick:

Nomura Securities International, Inc. ("Nomura") appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission") on the Capital Proposal for swap dealers ("SDs") and major swap participants ("MSPs"). In connection with the Capital Proposal, the Commission requests comment on "whether it is appropriate to permit SDs and MSPs to use internal models for computing market risk and counterparty credit risk charges for capital purposes if such models have been approved by a foreign regulatory authority and are subject to periodic assessment by such foreign regulatory authority."<sup>1</sup> The Commission further requests input regarding what criteria it should consider in assessing whether to approve or to accept a model approved by a foreign regulator.

In this letter, we respond to the Commission's requests for comment set forth above. We also respectfully suggest certain technical modifications to the Capital Proposal intended to address the treatment of SDs and MSPs that are dually registered with the Securities and Exchange Commission (the "SEC").

Specifically, we recommend that a non-bank SD/MSP should be permitted to apply to the Commission for approval or acceptance to use an internal model when calculating market and/or credit risk capital requirements if the relevant internal model (1) is utilized by the SD/MSP's non-U.S. home country parent company (or financial holding company), (2) has been approved by a qualifying foreign regulatory authority for computing market risk and/or credit risk charges for consolidated capital purposes, and (3) is subject to periodic assessment by such qualifying foreign

<sup>1</sup> 76 Fed. Reg. at 27818.

regulatory authority. A foreign regulatory authority would qualify if it is a home country prudential supervisor from a jurisdiction that is a member of the Group of 20 (“G-20”) countries or a member of the Basel Committee. Such approval or acceptance would be subject to conditions assuring the effective supervision of the SD/MSP’s use of its internal models by the foreign regulatory authority, as described below.

In addition, pending the SEC’s implementation of capital requirements for security-based swap dealers (“SBSDs”) and major security-based swap participants (“MSBSPs”), we recommend that an SD or MSP that is registered with the SEC as an over-the-counter derivatives dealer (“OTCDD”) should be permitted to utilize internal risk models (including those models developed, upgraded or amended in any manner in accordance with any development of applicable rules or requirements) that are reviewed, and subject to assessment, by the SEC in its capacity as the regulator of OTCDDs.

In each case, the market and/or credit risk capital requirements generated by these models would be used by the registrant in lieu of the “grid” or “standardized” requirements set forth in the Capital Proposal. This would be consistent with and reflect the manner in which global, sophisticated swap dealers manage their risk.

If adopted, these measures would aid the Commission in implementing an effective capital regime that makes efficient use of the Commission’s limited resources by leveraging existing regulatory structures. They would also ensure comparable treatment in the context of internal risk models across institutions subject to the oversight of Basel-compliant prudential regulators.

## Discussion

In the Capital Proposal, the Commission proposes that a non-bank SD or MSP would be permitted to apply to the Commission for approval or acceptance to use internal models to compute market and/or credit risk capital requirements if the SD or MSP is either (i) a subsidiary of a U.S. bank holding company whose internal models have been reviewed, and are subject to regular assessment by, the Federal Reserve Board or (ii) an SBSB or MSBSP registered with the SEC whose internal models have been reviewed, and are subject to regular assessment by, the SEC. We support these proposals. However, the Capital Proposal does not extend such treatment to subsidiaries of non-U.S. financial holding companies or to non-U.S. bank holding companies that are subject to comparable capital requirements and prudential supervision, nor does it address models reviewed and regularly assessed by the SEC in a capacity other than as regulator of SBSBs and MSBSPs.

Nomura’s parent company, Nomura Holdings, Inc. (“Nomura Holdings”), operates subsidiaries engaged in swap dealing in several jurisdictions. In such cases, an SD subsidiary would propose to employ internal risk-based models that are approved and subject to periodic assessment by a G-20 prudential supervisor or member of the Basel Committee.

In addition, an SD subsidiary subject to SEC oversight would propose to use internal models approved and supervised by the SEC. We discuss each of these examples in turn below.

### **I. Foreign-Approved Internal Models**

As noted above, under proposed § 23.103 of the Capital Proposal, an SD or MSP that is a subsidiary of a U.S. bank holding company could seek Commission approval to use internal models that have been reviewed and are subject to regular assessment by the Federal Reserve Board to compute market and/or credit risk capital requirements. This proposal would apply to both U.S. and foreign subsidiaries of U.S. bank holding companies.

By contrast, the Capital Proposal does not stipulate a framework to permit SDs and MSPs to seek Commission approval of internal risk-based models that are reviewed and subject to periodic assessment by foreign regulatory authorities. Rather, as noted above, the Commission requests comment regarding “whether it is appropriate to permit SDs and MSPs to use internal models for computing market risk and counterparty credit risk charges for capital purposes if such models have been approved by a foreign regulatory authority and are subject to periodic assessment by such foreign regulatory authority.”<sup>2</sup>

We believe that SDs and MSPs should be permitted to use such internal models, subject to certain criteria satisfactory to the Commission. We suggest the following criteria designed to address (i) the qualifications of the foreign regulatory authority and (ii) approval and periodic assessment by such authority of the SD/MSP’s use of internal models. This approach would ensure parity with the treatment of U.S. bank holding company subsidiaries, and would provide benefits similar to those identified with respect to U.S. bank holding company subsidiaries by leveraging existing and comparable capital regimes.

With regard to competency of the foreign regulatory authority, we respectfully recommend that the Commission condition use of foreign-approved models on the relevant regulatory authority qualifying as a prudential supervisor from a jurisdiction that is a member of the G-20 or a member of the Basel Committee. By so doing, the Commission would assure that qualifying foreign regulatory authorities are limited to those who actively take part in setting global standards for capital supervision and regulation. We believe this approach is in line with best practices by international regulators such as the “Core Principles for Effective Banking Supervision” recommended by the Basel Committee on Banking Supervision which recommends, amongst other principles: (i) cooperation and collaboration between relevant domestic authorities and foreign supervisors, (ii) effective consolidated supervision given business operations conducted by the banking group worldwide and (iii) cooperative home-host relationships. In Nomura’s case, its SD subsidiaries would seek to rely on models approved and subject to periodic

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<sup>2</sup> 76 Fed. Reg. at 27818.

assessment by Japan's Financial Services Agency (the "JFSA"), Nomura's home country consolidated supervisor.<sup>3</sup>

We further recommend that the Commission considers adopting the following conditions designed to establish objective, uniform standards for the approval and regular assessment of internal models by qualifying foreign regulatory authorities: (i) prior submission of any new model or any material change to an existing model to the authority for its review and approval; (ii) notification to the authority of any non-material change to an existing model; (iii) remediation of any material weaknesses in a model identified by the authority and (iv) periodic assessment of the models by the authority. These model control conditions are consistent with Nomura's experience with the supervision of internal models by the JFSA.

Accordingly, we respectfully recommend that the Commission modify proposed Commission Regulations § 23.103(e) to include an additional prong for an SD or MSP whose internal market and/or credit risk models have been approved, and are subject to periodic assessment by, a qualifying foreign regulatory authority (as described above) and who satisfies the review and assessment conditions specified above. In addition, the Commission may wish to consider adding to § 23.106(d)(3)(iv) a requirement that, if an SD or MSP relies on a foreign-approved internal model, the annual report required by the rule must include a statement that, to the best of its knowledge and reasonable belief, the SD/MSP complied with the conditions regarding review and periodic assessment of that model by a qualified foreign regulatory authority. With these modifications, an SD or MSP whose internal models satisfied these conditions could apply the market and/or credit risk capital requirements generated by those models in lieu of the standardized requirements set forth in Commission Regulations § 23.104.

## **II. SEC-Approved Internal Models**

As noted above, the Capital Proposal would permit a SD or MSP to apply for Commission approval to use internal market and credit risk models if it is registered with the SEC as a SBSB or MSBSP and such models have been reviewed and are subject to regular assessment by the SEC. Subject to the modifications suggested below, we support this proposal, as we believe it constitutes an effective method of leveraging the resources of the SEC.

In particular, as the Commission is aware, the SEC has not yet proposed its capital requirements for SBSBs and MSBSPs. Accordingly, it is quite possible that the SEC requirements that would form the basis for permitted use of internal models may not be in effect by the time comparable Commission requirements are in effect.

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<sup>3</sup> Under Japan's Financial Instruments and Exchange Act (as amended, the "FIEA"), the Prime Minister of Japan has the authority to supervise and regulate Japan's securities industry and securities companies, and delegates such authority to the Commissioner of the JFSA. Nomura Holdings and its consolidated subsidiaries are subject to the FIEA as well as extensive consolidated supervision and regulation by the JFSA, including Basel-compliant comprehensive, consolidated minimum capital requirements that cover the activities of Nomura Holdings' SD subsidiaries.

At the same time, other SEC regulatory regimes for the review and assessment of internal market and/or credit risk models currently exist. One of those regimes is for so-called "alternative net capital" full-purpose broker-dealers under Appendices E and G to SEC Rule 15c3-1.<sup>4</sup> Another regime is for OTCDDs under Appendix F to SEC Rule 15c3-1. The OTCDD regime was established by the SEC in 1998 to tailor capital, margin, and other broker-dealer regulatory requirements to a class of registered dealers, called OTCDDs, that are active in over-the-counter derivatives markets. The OTCDD regime includes a framework for SEC review and approval of internal risk models. While the regime seems likely to be supplanted by the SBSB/MSBSP regime, once it is finalized, in the interim there are several entities operating as OTCDDs that may register as SDs or MSPs with the Commission and wish to seek Commission approval for the use of internal risk models currently reviewed and assessed by the SEC in its capacity as the regulator for OTCDDs.

Accordingly, we respectfully recommend that the Commission modify proposed Commission Regulations § 23.103(e)(2) to include a reference to registration with the SEC as an OTCDD, particularly where such OTCDD intends to register as either SBSBs or MSBSPs. With this modification, an SD or MSP registered as an OTCDD could apply the market and/or credit risk capital requirements generated by its SEC-approved models in lieu of the standardized requirements set forth in Commission Regulations § 23.104.

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We believe the foregoing proposals will foster national treatment, competitive parity across comparably situated institutions and appropriate allocation of supervisory resources.

We thank the Commission for the opportunity to submit this comment letter. We would be happy to discuss with you any of the concerns described above or any other matters that would be helpful in adopting the final rules. Additionally, we would be pleased to provide further information or assistance at the request of the Commission or its staff. Please do not hesitate to contact me at (212) 667-8954 if you would like to discuss these comments further.

Respectfully submitted,



Gary H. Mandelblatt

<sup>4</sup> The Capital Proposal would permit broker-dealers that are dually registered as futures commission merchants and eligible for alternative net capital treatment from the SEC to continue to apply the same capital treatment if they register as SDs or MSPs. See proposed Commission Regulations § 1.17(c)(6)(i). We note that, as a technical matter, a conforming change to proposed Commission Regulations § 23.103 (cross referenced in § 1.17(c)(6)(i)) would be necessary to effectuate the Commission's intent in cases where the registrant is not also registered with the SEC as an SBSB or MSBSP.