May 15, 2017

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

Re: Capital Requirements for Swap Dealers and Major Swap Participants; RIN 3038-AD54

Dear Mr. Kirkpatrick:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] welcomes the opportunity to provide the Commodity Futures Trading Commission (the "**CFTC**" or the "**Commission**") with comments on the Commission's reproposed capital and liquidity requirements, and related financial reporting and recordkeeping requirements (the "**Proposal**"),[2] that would be applicable to swap dealers ("**SDs**") and major swap participants ("**MSPs**"). The Proposal would also revise the capital requirements now in place for Commission-registered futures commission merchants ("**FCMs**") that are involved in swap transactions even if not registered as SDs. SIFMA greatly appreciates the Commission's efforts to craft capital requirements for those SDs that are not subject to the capital requirements of the Prudential Regulators[3] (such firms, "**CFTC Capital SDs**").

Alternative Approaches to Capital Compliance. SIFMA wishes to make particular recognition of the efforts that the Commission has undertaken in providing two principal sets of options by which a CFTC Capital SD may calculate its capital requirements: (i) one based on the "liquid assets capital approach" (the "**LAC Approach**") that is a modification of the rules that currently apply to FCMs and securities broker-dealers, and (ii) the other based on the "risk-weighted assets approach" (the "**RWA Approach**") to which U.S. and non-U.S. banks and their

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

[2] 81 Fed. Reg. 91,252 (Dec. 16, 2016); s*ee also* 76 Fed. Reg. 27,802 (May 12, 2011). The new rules would be adopted pursuant to Sections 4s(e) and (f) of the Commodity Exchange Act, as added by Section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**").

[3] The "**Prudential Regulators**" are the Board of Governors of the Federal Reserve System ("**FRB**"), the Federal Deposit Insurance Corporation ("**FDIC**"), the Federal Housing Finance Agency ("**FHFA**"), the Farm Credit Administration ("**FCA**") and the Office of the Comptroller of the Currency ("**OCC**").

affiliates are generally subject under the Basel capital guidelines.[4] SIFMA also appreciates that the Commission has indicated that it will make available to a non-U.S.-organized and -domiciled CFTC Capital SD (a "**Foreign SD**")[5] the ability to meet its capital requirements through "substituted compliance"; *i.e.*, through compliance with the capital requirements of its home or host country regulator. Providing these alternative approaches to meeting capital requirements (the LAC Approach, the RWA Approach and substituted compliance) will offer each CFTC Capital SD the ability to implement the approach that is best tailored to its business and is most likely to be consistent with the way that it currently calculates capital whether in the SD itself, in an affiliate or at the holding company level.

Further in this regard, we appreciate the willingness of the Commission to work in tandem with, and by reference to, or in conformity with, rules adopted or proposed by, the Securities and Exchange Commission (the "**SEC**") and the Prudential Regulators, and to establish comparable capital and financial reporting requirements for CFTC Capital SDs that will also be regulated by the SEC as security-based swap dealers ("**SBSDs**").

While SIFMA appreciates the overall approach that the Commission has taken in the Proposal, we believe that unless substantial amendments are made, the Proposal has the potential to drive a good number of firms out of the swaps business (*e.g.*, any firm not able to or not approved to use models), thereby reducing market liquidity and unduly increasing the costs of SDs doing business, which will directly result in increased costs to end-users. Many of the problems with the Proposal result from the fact that the Commission did not in many specific instances adhere to its general approach of putting forth rules that were consistent with current regulation. A significant pattern in the Proposal was the tendency for the Commission to take existing requirements—whether of the SEC, the Prudential Regulators or Commission's own rules—and then add additional requirements on top of them, often requirements that will create material difficulty for firms. Many of our recommendations are geared towards conforming the Proposal to existing requirements and more generally towards establishing an efficient regime with appropriately weighted costs and benefits. If implemented, we believe that our recommendations will increase the liquidity and uniformity of the global swap markets.

MAJOR POINTS AND SUPPORT FOR THE FIA AND ISDA LETTERS

In light of the length of this letter, which is commensurate with the breadth, significance and complexity of the Proposal, we think it useful to highlight a few major issues:

- The Commission's Proposal incorporates material aspects of the SEC's related rulemaking, which is itself likely subject to material and ongoing amendments. As a result, SIFMA is not being given a fair opportunity to comment on a complete and known set of proposed amendments.

---

[4] We also note that the Commission had provided a third method of computing capital, the "tangible net worth approach" (the "**TNW Approach**"), that is available to firms that are engaged only to a limited extent in financial activities. As SIFMA member firms are primarily engaged in financial activities, the TNW Approach is not available to SIFMA's membership.

[5] As used herein, the term "**Foreign SD**" includes non-U.S. swap dealers that are subsidiaries of U.S. parent or holding companies.

- The Commission has not given sufficient consideration to the costs of its Proposal, particularly as to (i) the costs to individual firms where the Proposal's requirements deviate from existing rules and (ii) the costs to the markets of driving firms, particularly firms using the standardized capital charges, from the swaps business.

- There must be a highly efficient process of the Commission or its delegate approving models, including, most importantly, automatic acceptance by the Commission or its delegate of models previously approved by other regulators.

- The Commission should not impose capital requirements based on aggregate margin levels on firms using the RWA Approach (these additional charges are inconsistent with the approach taken by the Prudential Regulators), nor should such requirements be imposed on proprietary positions (which are already subject to substantial charges) under either the RWA Approach or the LAC Approach. More generally, the Commission should revisit the existence of charges based on aggregate margin and, even if it determines to continue such charges, lower their amount.

- The capital requirements imposed on firms subject to the RWA Approach are substantially more burdensome and costly than is imposed by the Prudential Regulators. The Commission should set the minimum capital level for RWA firms at an amount that is considered to be "adequately capitalized" by the Prudential Regulators, and the early warning level for RWA firms at an amount that is considered to be "well capitalized" by the Prudential Regulators. We also note that Commission defines "capital" more narrowly than do the Prudential Regulators. For example, the Commission seeks to exclude subordinated debt.

- "Early warning levels" as to capital serve, as a practical matter, to increase the minimum level of capital required of a firm. The Commission should re-evaluate its capital requirements taking account of the fact that the early warning requirements establish a practical minimum requirement that is 20% higher than the amount asserted in the Proposal to be the minimum capital requirement.

- For LAC firms that are not approved to use credit models, capital charges related to credit exposure should be reduced for transactions with commercial end users and in respect of "legacy swaps" where counterparties were not required to post margin.

- The two alternative measures of liquidity that the Commission has proposed should be more closely conformed, particularly in regard to the assets that are deemed to be liquid. Further, regardless of the capital approach chosen, firms should be given the opportunity to elect which of the two alternative measures of liquidity they must meet. Finally, the Commission should allow for the possibility of a firm meeting its liquidity requirements through a third "Prudential Approach" (as further discussed herein) that would be closely modeled on the existing requirements of the Prudential Regulators.

- Recordkeeping and reporting obligations should be very closely conformed to long existing rules. Many of the new obligations that the Commission proposes would be very expensive to meet and would not provide the Commission with materially useful information. Some of the new reporting obligations, including as to the formats requested and the timing of reporting, are wholly impractical.

- For substituted compliance to be meaningful, there must be open acceptance of the regulatory oversight of non-U.S. regulators that is consistent with the broad acceptance afforded such oversight by the Prudential Regulators.

- A very substantial time period must be allotted between the adoption of any version of the Proposal and its effective date. In light of the time that will be required for firms to obtain model approvals and to build the necessary technology, SIFMA recommends that capital charges not become effective until the later of (i) the time that all initial margin requirements have become effective, (ii) three years from the date that the capital requirements are adopted and (iii) three months from the date that the Commission has determined that all provisionally approved CFTC Capital SDs have been given a reasonable opportunity for model approval.

We also note that the Futures Industry Association ("**FIA**") has submitted a comment letter, dated May 15, 2017, regarding the Commission's Proposal (the "**FIA Letter**"). While the FIA letter primarily concerns the effect of the Proposal on Commission-registered FCMs that are not registered as SDs and our letter primarily concerns the effect of the Proposal on SDs registered with the Commission, there is significant consistency between the concerns expressed in the FIA Letter and the comments made in this letter. For example, the FIA also has expressed concern with the manner in which the Proposal would set capital requirements and the ability (or inability) of firms that do not have approved models to continue participating in the swaps markets. We hope that the Commission will take seriously our joint concerns regarding the effect that the Proposal in the current form may have on the financial markets.

Likewise, the International Swaps and Derivatives Association, Inc. ("**ISDA**") letter, dated May 15, 2017, shares our concerns, particularly as to the need (i) for a streamlined "substituted compliance" process in order for non-U.S. Firms to participate in U.S. Markets and (ii) for the Commission to accept models approved by other regulators so that the model approval process may proceed efficiently and in a reasonable time period. We ask that the Commission give strong consideration to the industry's recurring concerns.

TABLE OF CONTENTS

I. ADMINISTRATIVE PROCEDURES ACT CONSIDERATIONS 7

II. COST-BENEFIT CONSIDERATIONS 8

III. PRINCIPAL RECOMMENDATIONS AND COMMON THEMES 9

IV. SPECIFIC RECOMMENDATIONS 14

A. The Proposed Standardized Grid Charges for Non-Model Firms Must Be Substantially Revised if They Are to Be Used. 14
B. An Efficient Model Approval Process Will Advance the Interests of the Commission, SDs and U.S. Swaps Markets. 16
C. The Commission Should Clarify that SDs Are Entitled to Use Internal Models for Both Credit Risk and/or Market Risk Calculations. 17
D. Theoretical Initial Margin Level Is a Measure of Customer Specific Risk and Is Not a Good Surrogate for an SD's Overall Risk. 17
E. The Risk Weighted Assets Ratio and the RWA Approach. 19
F. As to Non-Model Firms Using the LAC Approach, Relief Should Be Provided in Respect of Transactions with Commercial Users and for Legacy Swaps. 21
G. Early Warning Level. 22
H. Liquidity Requirements. 22
1. General Considerations 22
2. Comments on the LAC Approach 24
3. Comments on the RWA Approach 25
4. Alternative Liquidity Risk Management Standard: Prudential Approach 26
I. Recordkeeping, Reporting and Notification Requirements. 27
1. General Considerations 27
2. CFTC Capital SDs and Prudentially Regulated SDs 27
3. CFTC Capital SDs 30
4. Prudentially Regulated SDs 31
5. Substituted Compliance SDs 33
J. Substituted Compliance. 34
K. The Implementation Timing Must Be Consistent with the Full Implementation of Margin Requirements and Needs to Fully Harmonize the Commission and SEC Requirements. 34

V. REGULATORY, MARKET AND OPERATIONAL CONTEXT. 36

A. Adopted Dodd-Frank Regulations Have Materially Decreased Risk. 36
B. Adopted Dodd-Frank Regulations Have Had Some Negative Market Impacts. 37
C. Operational Complexity of Computing Capital Requirements Argues for the Adoption of Consistent Capital Regulatory Frameworks. 39

APPENDIX A: SUGGESTED REVISIONS TO THE MODEL APPROVAL PROCESS..........41

APPENDIX B: COMMISSION QUESTIONNAIRE RESPONSES..44

APPENDIX C: REPORTING APPENDICES CLARIFICATION REQUESTS 69

Appendix D-1: SIFMA Comment Letter to the SEC on Capital, Margin, and Segregation Requirements for SBSDs and MSBSPs..71

Appendix D-2: SIFMA Comment Letter to the SEC on Recordkeeping and Reporting Requirements for SBSDs and MSBSPs..151

Appendix D-3: SIFMA Apr. 30, 2015 Unofficial Discussion notes on Recordkeeping and Reporting Requirements for SBSDs and MSBSPs..214

I. Administrative Procedures Act Considerations

While SIFMA appreciates the fact that the Proposal incorporates, to a good extent, the SEC's proposed capital requirements (the "**Proposed SEC Capital Requirements**")[6] and proposed recordkeeping and reporting requirements applicable to SBSDs (the "**Proposed SEC Reporting Requirements**";[7] and, with the Proposed SEC Capital Requirements, the "**Proposed SEC Requirements**"), SIFMA notes that it has already commented extensively on those SEC proposals, and has urged the SEC to amend them in material respects.[8] The Proposed SEC Capital Requirements were issued in 2012 and the Proposed SEC Reporting Requirements were issued in 2014. While we are uncertain as to what specific amendments the SEC ultimately will make, we are certain that the SEC will not adopt all of the Proposed SEC Requirements in the form that they were originally proposed. As a result, we have no way to know which portions of this Commission's Proposal are subject to change through cross-references to the Proposed SEC Requirements.

In light of the interdependence between the capital, liquidity and financial reporting requirements of the Commission and those of the SEC, SIFMA believes that it would be sensible and appropriate for all of these requirements, of both regulators, to be jointly or simultaneously reproposed, so that each of the CFTC and the SEC is fully informed as to the positions of the other and so that market participants may provide meaningful comments on a joint and comprehensive rules package. As it is, the Commission is proposing its rules based on SEC rules that are essentially a moving foundation and SIFMA is commenting on rules that are likewise a moving target. While the industry recognizes that such coordination between the SEC and the Commission would entail some delay, the regulators should find that any detriment is greatly outweighed by the benefits of the regulators taking a coordinated and consistent approach.

If the Commission determines not to, or is not able to, fully coordinate with the SEC, it should at a minimum hold off on adoption of its capital, liquidity and reporting rules until the SEC's rules are finalized; otherwise, the two rules sets, which should largely conform, will be inconsistent.[9]

---

6 *See* Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 Fed. Reg. 70,214 (Nov. 23, 2012).

7 *See* Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers, 79 Fed. Reg. 25,194 (May 2, 2014).

8 *See* SIFMA comment letter to the SEC on capital, margin, and segregation requirements for SBSDs and MSBSPs (Feb. 22, 2013) ("**SIFMA Comment Letter on SEC Capital and Margin Proposal**"); *see also* SIFMA comment letter to the SEC on recordkeeping and reporting requirements for SBSDs and MSBSPs (Sep. 5, 2014) ("**SIFMA Comment Letter on Reporting Proposal**") and SIFMA Apr. 30, 2015 unofficial discussion notes on recordkeeping and reporting requirements for SBSDs and MSBSPs (Apr. 30, 2015) ("**SIFMA Unofficial Discussion Notes on Reporting Proposal**").

9 SIFMA understands that the Commission might also go first, and hopes that the SEC would conform its rules to those adopted by the Commission, but as a practical matter, the Commission has modeled its proposals after those of the SEC, and thus it would be appropriate for the Commission to wait on the SEC's rule adoptions.

Additionally, SIFMA wishes to express a very particular concern as to the manner in which credit risk capital charges may be calculated by firms not using credit models. Currently, such firms would be required to take charges to the extent to which they have unsecured current exposure or unmet margin requirements. However, we understand that the SEC is considering a revision that would subject SBSDs (and, by cross-reference in the Proposal, SDs) to additional capital requirements in order to account for potential future credit risk exposure on uncleared swaps. We believe that a change of this magnitude represents a major amendment to the Proposal, as this concept was not in the Proposed SEC Capital Requirements or in this Proposal. SIFMA believes that any changes of this nature, if in fact they are being considered, should be reproposed by the Commission so that they may be put through the appropriate notice and comment process. We stress this potential additional charge in particular because, even without that amendment, application of the Proposal in its current form to SDs subject to the Standardized Grid Charges ("**Non-model Firms**") would be potentially devastating to those firms.

In any event, given that the Commission's Proposal incorporates the Proposed SEC Requirements, SIFMA incorporates by reference in this letter our prior comments to the SEC. A copy of our SIFMA Comment Letter on SEC Capital and Margin Proposal is attached as Appendix D-1, and a copy of our SIFMA Comment Letter on Reporting Proposal and our SIFMA Unofficial Discussion Notes on Reporting Proposal are respectively attached as Appendices D-2 and D-3 to this letter. It is SIFMA's understanding that the Commission is required by the Administrative Procedures Act to provide full consideration to SIFMA's prior comments on the Proposed SEC Requirements that are incorporated in the Proposal.[10]

II. Cost-Benefit Considerations

SIFMA recognizes that there has been disagreement as to the extent to which the Commission is required to take into consideration the costs and benefits of its rulemakings, and that the Commission has asserted that it is not required to conduct the same level of review as are the SEC and other agencies. Even if one was to accept this viewpoint, we believe that the Commission's analysis of the Proposal is not sufficient. In this regard, SIFMA wishes to emphasize what we regard as two material deficiencies.

The Commission bases its Proposal on "well-established existing capital regimes."[11] However, it then goes to say that the Proposal makes only "minor adjustments" to those regimes to "account for the inherent risk of swap dealing and to mitigate regulatory arbitrage."[12] On the apparent basis of the position that its changes to existing rules are "minor," the Commission did not conduct any meaningful review of the cost of these adjustments. However, SIFMA does not believe that the adjustments that the Commission has made are minor. For example, the Commission has grafted on to the RWA Approach capital requirements, additional "risk margin amount" capital requirements and early warning requirements; likewise (perhaps

---

[10] All of the comments in the referenced prior letters on the SEC's rule proposals should be considered incorporated herein.

[11] 81 Fed. Reg. 91,252, 97,286.

[12] *Id.*

unintentionally), the Proposal would materially alter existing reporting requirements and accelerate reporting schedules. Accordingly, SIFMA believes that the Commission is obligated to conduct a more thorough cost-benefit analysis. In this regard, we would ask that the Commission not only consider costs, but also that the Commission question the benefits that it would receive as to many of the requirements, particularly those related to recordkeeping and reporting.

Even more significantly, the Commission seems to have underestimated, to a material extent, the costs that it would impose on firms not approved to use models. The Commission has acknowledged that Non-model Firms would become subject to some "additional cost, [and that] some swaps activities may become too costly and, therefore, some SDs may limit their activities or exit the swaps market."[13] However, the reality is far more stark than this. Firms that do not have models approved, at least market risk models, likely will not be able to remain in business. These firms' exit from the swaps markets may have materially deleterious effects on prices to the public, on price discovery and on competition. SIFMA believes that the Commission should be mindful of, and take into account, these very substantial costs.

III. Principal Recommendations and Common Themes

Before setting out specific recommendations, there are a number of common overriding issues that we think are useful to highlight, as these issues are fundamental to many of the more specific recommendations in this letter.

The standardized charges, incorporated in the Proposal by cross-reference to the Proposed SEC Capital Requirements,[14] would force Non-model Firms out of the swaps markets.

The "Standardized Grid Charges" are too punitive for an SD subject to them to continue to participate in the swap dealing market. The difference between the grid charges and the model charges is not a matter of mere "degree," as in 5%, or 20%, or even 200% or 300%. It is a difference in kind; as the standardized charges are based on notional values (*e.g.*, the Commission would require a minimum 1% capital charge on the hedged notional amount of interest rate swaps) and not on any measure of risk. If implemented as proposed, SIFMA believes that these high grid charges will force Non-model Firms to significantly curtail their business or, very likely, exit the market entirely, leading to increased market concentration and decreased market competition, raising end-user costs.

The anti-competitive effect of the Standardized Grid Charges would be most felt by the remaining medium-sized firms that have been able to sustain Dodd-Frank's costs, particularly those medium-sized firms based in the United States.[15] We note that the FIA Letter expresses the same concern—but more so—as to FCMs that are not of a size, and do not have the

---

13 *Id.* at 91,291.

14 *See* proposed SEC Rule 18a-1(c) (the "**Standardized Grid Charges**").

15 The majority of large firms either operate out of banks or have received model approval from the SEC as a result of operating an alternative net capital firm. We expect that non-U.S. firms will be able to rely on substituted compliance.

resources, to be registered as an SD, but that nonetheless currently provide hedging services, through the use of swaps, to smaller commercial end-users.

From the above concerns, three conclusions follow. First, if the Commission in fact wishes to provide for the possibility of medium-sized Non-model Firms participating in the market, it must substantially revise the Standardized Grid Charges so that they are more reflective of risk. Second, the Commission must allow all firms an opportunity to obtain model approval, the medium-sized firms equally with the larger firms. Third, to give the model approval process some chance of being implemented within any reasonable time period, the Commission must provide for automatic recognition of models that have been previously approved by other regulators.

We also note that while the use of the grids does not require firm-by-firm regulatory approval, the proposed Standardized Grid Charges are by no means easy to implement. Generally, the grid matrix does not "line up" with the way in which firms either do financial reporting or monitor their financial risk. Further, the grid calculation requirements are too complicated to be met with a "low tech" approach, such as a spread sheet in light of regulatory examination and audit examination standards. Firms would have to build or buy new technology, even if they were to employ the grids for an interim period. The costs of developing and implementing one technology approach before switching to another would be quite substantial for any firm forced to do so.

The Commission must be mindful of the practicalities of reviewing and approving models, which is a time-consuming and resource-consuming process, both for firms and for regulators. In light of the finite resources available to the Commission and its delegate, the National Futures Association ("**NFA**"), for model approval, and the time that it takes to approve models, we believe that (i) the Commission must be willing to automatically accept reliance on market risk and/or credit risk models approved by other regulators (including the SEC, the Prudential Regulators and/or those Basel-regulators whose models are effectively accepted by the Prudential Regulators with regard to non-U.S. banks and their U.S. subsidiaries (a "**Qualifying Foreign Regulator**"), and (ii) for those models that must be approved directly by the Commission (or the NFA as its delegate), the Commission must give itself sufficient time to gain familiarity with the models, and give the relevant firms sufficient time to implement the accepted models. Further, given that many Foreign SDs will operate under a regime of full substituted compliance, the Commission must also promptly describe the procedures by which "substituted compliance" will be granted.

We do not believe that we can over-emphasize how essential it is that the Commission accept market risk and credit risk models that have been approved by another regulator, rather than itself or the NFA separately approving each and every model to be used by an SD. Allowing firms to use a model approved by another regulator, will (i) ease the implementation burden and costs placed on SDs, (ii) provide certainty to SDs currently using models approved by another regulator, (iii) streamline the Commission's model approval process and use of its own limited resources or that of the NFA, and (iv) align with the core principles outlined by the

President in the January 30, 2017 Presidential Executive Order on Reducing Regulation and Controlling Regulatory Costs (the "**Executive Order**").[16]

Once final rules are adopted, the Commission's implementation must account for the substantial time that it will take for firms to build the necessary systems. The Commission must recognize that its capital, recordkeeping and reporting requirements, once adopted, will require a very significant amount of time to implement. Once the CFTC capital and related requirements are adopted, and once models are approved, each firm will still need to put various technology-intensive procedures, systems and processes in place, regardless of whether it uses models or the Standardized Grid Charges. Additionally, it is essential that the initial margin requirements be fully effective before capital requirements can be imposed—otherwise, SDs will be subject to very significant capital charges for the "failure" to collect margin that is not yet required to be collected.[17]

Accordingly, SIFMA recommends that capital charges not become effective until the later of (i) the time that all initial margin requirements have become effective, (ii) three years from the date that the capital requirements are adopted and (iii) three months from the date that the Commission or its delegate has determined that all provisionally approved CFTC Capital SDs have been given a reasonable opportunity for model approval.

SIFMA acknowledges that three years between the time of rule adoption and effectiveness seems a long period. In practice, SIFMA members are concerned that it will prove too short, perhaps materially too short. The experience of individual SIFMA members is that the model approval process for an individual firm that has presented its model to a regulator has taken up to three years—even when the relevant regulator was dealing with a very limited number of firms seeking model review. After the capital requirements are adopted, there will be numerous firms seeking, all at once, both credit risk and market risk model approval. Given the number of firms and the complexity of the models, it is not at all certain, in fact it seems unlikely, that three years will be sufficient time for the Commission, or its delegate, to review and approve models and also give firms an opportunity to implement those models. As we have very clearly stated, SIFMA believes that the Commission will effectively force firms out of the market if they are not given time to obtain model approval and implement the approved models.

The Commission's regulations should more closely correspond with existing regulatory requirements. SIFMA acknowledges that the Commission has made tremendous strides in this direction by providing SDs a choice between two different methods of capital calculation. Nevertheless, there are numerous instances where the Commission has imposed additional, different and more onerous requirements than are either imposed or proposed by other regulators. These incremental requirements are often quite costly or burdensome, assuming that

---

16 Exec. Order No. 13,771, *Reducing Regulation and Controlling Regulatory Costs*, 82 Fed. Reg. 9,339 (2017).

17 SIFMA also believes that imposing capital requirements before initial margin requirements have become fully effective would raise issues under the Administrative Procedures Act. That is, an important consideration in the adoption of the initial margin requirements was the timing of their effectiveness. If the capital requirements were to become effective before the finalized date of the margin requirements, as a practical matter firms would have to try to accelerate their collection of initial margin, notwithstanding the supposed "effective date" of the initial margin rules, or else suffer very significant capital charges.

they could be implemented at all (which in the case of certain requirements, particular as to financial reporting, is not assured), and it is questionable whether they would provide any meaningful regulatory benefit.

By way of example, SIFMA is appreciative of the Commission's recognition of the fact that many SDs are consolidated subsidiaries of bank holding companies ("**BHC**") subject to the capital standards of the Prudential Regulators, and of the fact that the Commission's RWA Approach is intended to be based upon the capital requirements of the Prudential Regulators. Nonetheless, the Commission has imposed additional requirements for the use of the RWA Approach that are materially inconsistent with the requirements of the Prudential Regulators. For example, the Commission would require that RWA Approach firms maintain capital based on a variant of the SEC's "risk margin amount," even though the Prudential Regulators impose no such requirement. Similarly, the Commission would require SDs using the RWA method to base their capital requirements on what is referred to as "Common Equity Tier 1 ("**CET1**"), which excludes all non-equity sources of capital, such as subordinated debt, even though the Prudential Regulators give value to such financing.

As for Prudentially Regulated SDs, the financial reporting requirements are materially, and impractically, inconsistent with existing requirements. Banks provide their financial reports ("**Call Reports**") to the Prudential Regulators 30 calendar days after each quarter end; bank holding companies provide financial information to the Prudential Regulators 40 to 45 calendar days after quarter end, on Form FR Y-9C. However, the Proposal would require such prudentially regulated SDs to provide different reports 17 business days after quarter end. This is simply unrealistic, both in terms of the expectation that banks and bank holding company affiliates could meet this expedited timetable, and as to the additional information that the Proposal would require. We strongly urge the Commission not to require more or different financial reporting than do the Prudential Regulators. Likewise, for firms subject to non-U.S. regulations who have qualified for substituted compliance, the Commission's reporting periods should conform to those imposed by non-U.S. regulators.

As to both Prudentially Regulated and CFTC Capital SDs, the financial reporting requirements are inconsistent with existing requirements in ways that may not have been fully considered. For example, Schedule 1 to proposed Rule 23.105, Appendices A and B seemingly commingles financial reporting data (which is based on market values) and trade information (which is based on disaggregated amounts). Accordingly, we suggest that the Commission repropose its reporting requirements, and include with any such reproposal a very detailed schedule and set of instructions that will make clear exactly what would be required.

SIFMA urges the Commission to impose capital requirements that are proportionate to, and based upon, a reasoned quantification of risk. By way of example, SIFMA urges the Commission to reconsider basing its capital requirements on the "risk margin amount." While SIFMA acknowledges that the Commission currently employs this formulation as part of its capital requirements applicable to FCMs, (i) it has no current basis as applied to RWA firms, and (ii) more significantly, it has a limited relationship to actual risk. That is, use of the "risk margin amount" as a measure of required capital is based on the presumption that an SD's total risk from all of its customers is the sum of the risk that the SD has from each of its

customers. This is not in fact the case. For the most part, **customer risks offset, they do not aggregate** (we discuss this more fully in our specific recommendations below).

If the Commission is not willing, as to LAC Approach firms to replace this measure of capital with another more appropriate measure that would be more closely tied to risk, and to eliminate the requirement as to RWA Approach firms, then we request that the 8% multiplier be replaced by a lower multiplier such as 2% for such time as will be sufficient to allow the Commission to gather empirical data in order to determine an appropriate charge.

In addition, the Commission should recognize the operational efficiencies and risk mitigation benefits associated with cleared swaps and cleared security-based swaps by, at a minimum, not imposing credit charges on centrally cleared positions that are fully margined. Commodity Exchange Act Section 4s(e)(3)(A) specifically refers to the "greater risk to the swap dealer or major swap participant and the financial system arising from the use of swaps that are not cleared" when describing the required capital requirements. Nonetheless, the RWA Approach incorporates 12 CFR 217.35, which requires swap dealers to take a material credit risk charge even on cleared positions.

More generally, SIFMA requests that the Commission recognize that burdensome requirements, that go beyond what is truly required to keep markets safe, will inevitably reduce and concentrate market participation, further concentrating risk and increasing costs. SIFMA notes that the Commission, in adopting its clearing requirements, stated its belief that *increasing* "the number of firms clearing swaps . . . will make markets more competitive, increase liquidity, reduce concentration and reduce systemic risk."[18] This proposal would likely have the opposite effect. The concern that the Commission's rules will drive firms out of the swaps market is not unique to SIFMA; this is likewise a concern expressed, perhaps even more urgently, in the FIA Letter as to the effect of the Proposal on smaller firms. By way of example, according to the Commission's own public data, there were 134 FCMs at the end of 2008, and there are only 63 today.[19] While there are many factors that have contributed to this precipitous decline, unprecedented regulatory costs have been a significant factor.

[18] *See* Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334, 69,355 (Nov. 8, 2011).

[19] Selected FCM Financial Data As Of March 26, 2017, *available at* http://www.cftc.gov/idc/groups/public/@financialdataforfcms/documents/file/fcmdata0217.pdf.

IV. Specific Recommendations

A. The Proposed Standardized Grid Charges for Non-Model Firms Must Be Substantially Revised if They Are to Be Used.

Analysis by SIFMA members has shown that the Standardized Grid Charges on a matched book of transactions results in punitive capital charges. As illustrated by the charts below, firms that are charged for capital based on the notional value of their transactions likely will not be able to stay in business.

Table 1: Cleared Interest Rate Swap Portfolio (in millions)					**Capital Approach as Proposed**			**Alternative Capital Approaches**				
					Standardized Grid Charges Including the 1% Minimum (a)			**Charges Based on Clearing House Maintenance Margin Requirement (MMR)** (b)**		**Standardized Grid Charges Excluding the 1% Minimum (c)**		
Maturity Category	**Government Haircut***	**Notional Value Long**	**Notional Value Short**	**Notional Value Net**	**1% Minimum of Matched Notional Long/Short Value**	**Charge on Unhedged Notional of Long/Short Position**	**Total**	**Total MMR**	**150% of MMR**	**Hedged**	**Unhedged**	**Total**
Category 1	0% - 1%	$377,500	$(372,500)	$5,000	$3,725	$50	$3,775			$-	$28	$28
Category 2	1.5% - 2%	95,000	(97,500)	(2,500)	950	83	1,033			-	83	83
Category 3	3% - 4%	150,000	(152,500)	(2,500)	1,500	73	1,573			-	73	73
Category 4	4.5% - 6%	10,000	(10,000)	-	100	-	100			-	-	-
Total		**$632,500**	**$632,500**	**$-**	**$6,275**	**$206**	**$6,481**	**$45**	**$68**	**$-**	**$184**	**$184**

*Each maturity category within the U.S. government haircut schedule has two or more subcategories. A blended haircut percentage was applied to categories 2 through 4.
**MMR is provided by the clearing corporation.

Table 1 compares (a) the proposed Standardized Grid Charges to (b) CFTC Rule 1.17(c)(5)(x)'s clearing house maintenance margin requirements with and without an additional 50% requirement for non-clearing member firms[20] and (c) the Standardized Grid Charges excluding the 1% minimum notional charge. As the table illustrates, the Standardized Grid Charges would be more than 144 times higher than the clearing house margin requirements ($6,481 v. $45) and more than 95 times higher than the clearing house margin requirements for a non-clearing member firm ($6,481 v. $68). Given that the clearing house margin requirements serve essentially the same purpose as the capital requirements (one is intended to assure the safety of the clearing house, the other the soundness of the swap dealer), this disproportion should give the Commission considerable pause. Similarly, the Standardized Grid Charges that include the 1% minimum capital requirement would result in market risk charges that are nearly 35 times higher than the charges without the 1% minimum ($6,481 v. $184).

[20] 17 C.F.R. § 1.17(c)(5)(x).

Table 2: Diversified Product Portfolio (in millions)	**Standardized Grid Charge (Including the 1% Minimum for the entire IRP)**	**Standardized Grid Charge (Including the 1% Minimum for Uncleared IRP Only)**	**Standardized Grid Charge (Using Government Grid for the entire IRP)**	**Standardized Grid Charge (Using Government Grid for Uncleared IRP Only)**	**Market Risk Total Portfolio VaR (Basel 2.5)**
Interest Rate Products (“IRP”)	$35,691	$19,132	$2,055	$462	
Equity Products	5,968	5,968	5,968	5,968	
FX Products	462	462	462	462	
Total Capital Charge	**$42,121**	**$25,562**	**$8,485**	**$6,892**	**$391**
Times Greater v. Basel 2.5 (last column)	108	65	22	18	

Table 2 illustrates the non-competitive gap between the market risk capital requirements imposed by the standardized grids on a diversified portfolio of interest rate, equity and FX products and the Basel 2.5 market risk charge. The Standardized Grid Charge would result in market risk charges that can be more than 100 times higher than those calculated using, for example, a risk-based methodology. Even the Government Grid charges (under SEC Rule 15c3-1) would impose capital requirements 22 times higher than a risk-based methodology. We recommend that the Commission implement a set of charges that accounts for the risks associated with a given transaction instead of the magnitude of the position.

These discrepancies create a question as to whether the Commission’s charges are properly tailored to the risks posed by the relevant portfolios. SIFMA does not believe that any firm could continue in the swaps business if its standardized capital charges were many multiples higher than that imposed on other firms. Accordingly, SIFMA urges the Commission to revisit the Standardized Grid Charges with the goal of providing some method by which it is possible for Non-model Firms to participate in the market. For example, we recommend the following:

(a) *For cleared swaps and cleared security-based swaps (regardless of asset class),* the capital charge should be based on the relevant clearing organization’s maintenance margin requirement, similar to the Commission’s current treatment of futures under SEA Rule 15c3-1b (Appendix B) (a)(3)(xiv) instead of the standardized grids applicable to uncleared swaps and security-based swaps;

(b) *For uncleared swaps*, the capital charge should be calculated using an industry standard methodology for initial margin amount as calculated by an industry adopted model (*e.g.*, Standard Initial Margin Model created by the International Swaps and Derivatives Association, Inc.). As an alternative approach for uncleared interest rate swaps, the capital charge should be calculated using the U.S. government securities grid, without the proposed 1% minimum haircut;

(c) *For cleared swaps or security-based swaps*, there should not be a credit risk charge imposed (assuming that they are appropriately margined by the customer), as is currently the case under the RWA Approach;[21]

[21] *See*, *e.g.*, 12 C.F.R. § 217.35 (which is incorporated by reference into the Commission’s capital requirements). We also agree with the remarks recently made by Commissioner Bowen, in which she pointed out that various requirements imposed by the Prudential Regulators actually had the effect of discouraging firms from entering into cleared swaps, which is inconsistent with the Congressional policy established in Dodd-Frank. *See* What Future for Global Regulation of Financial Markets (Apr. 5, 2017).

(d) *For credit default swaps* ("**CDS**"), the disparity between the proposed grid requirements and capital charges derived from internal models is sufficiently wide to merit further review by the Commission of empirical data regarding the historical market volatility and losses given default associated with CDS positions. SIFMA also notes that CDS positions are commonly entered into as hedging tools for particular durations of debt exposure, but the grid charges are based on maturity (rather than duration). This approach does not properly account for the product's use as a means for hedging, and presents a significant disadvantage for firms that hedge on a duration basis but must attempt to calculate capital charges using the grid based on maturities;

(e) *For transactions in highly liquid currencies not subject to initial margin requirements (e.g., spot foreign exchange contracts)*, the capital charges should be based on the current haircuts for similar maturity instruments—commercial paper, bankers acceptances and certificates of deposit or U.S. government securities—under SEC Rule 15c3-1; and

(f) *For foreign exchange transactions and swaps, security-based swaps and securities forward transactions,* the capital rules should recognize offsets.

B. An Efficient Model Approval Process Will Advance the Interests of the Commission, SDs and U.S. Swaps Markets.

The Commission should provide for automatic recognition and approval of models that have been previously approved by the Prudential Regulators, the SEC or Qualifying Foreign Regulators. Such model acceptance is essential not only for non-U.S. firms that may benefit from "substituted compliance" but also for firms located in the United States, including U.S. subsidiaries of non-U.S. firms, that are operating with models that have been approved by one of these regulators. Such acceptance would increase market liquidity, preserve global trading markets, and further international regulatory comity, three outcomes that Chairman Giancarlo has stated are vitally important to the Commission.[22] Automatic model approval would encourage non-U.S. SDs to participate in and provide liquidity to the U.S. markets. (Even with automatic acceptance of models, the Commission would retain its right of oversight, and potential rejection of a model, under proposed Commission Regulation 23.102(f).)

The Proposal anticipates that the Commission will delegate the model approval process to the NFA, which is currently responsible for reviewing and approving internal margin models for uncleared swaps. However, as conceded in the Proposal, the review and approval of capital models produces significantly different challenges than margin models because of the lack of industry standard and the different variations of capital related market and credit risks models.[23] The complexity of a capital model, as well as the sheer number of models that must be approved, will place a significant strain on the NFA staff. An automatic approval regime would ease this burden while simultaneously enhancing market competition, both of which are contemplated by and in furtherance of the core principals outlined in the Executive Order.

---

[22] *See* Statement of Acting Chairman Christopher Giancarlo, *Changing Swaps Trading Liquidity, Market Fragmentation and Regulatory Comity in Post-Reform Global Swaps Markets* (May 10, 2017).

[23] 81 Fed. Reg. 91,252, 91,269 (Dec. 16, 2016).

The need for automatic model approval is emphasized by the impracticality of any SD competing while bearing the costs imposed by the Standardized Grid Charges for certain products, most obviously for cleared interest rate products, which are the most common and basic type of swap transaction. The competitive disadvantage associated with the use of the standardized charges renders the manner in which, and the timing by which, the Commission approves models essential to the ongoing operations of the markets. Without a workable timeframe for all firms to seek and obtain model approval, the Commission may drive many medium-sized U.S. firms that do not have such approval out of business, decreasing competition in the financial markets and increasing costs to users.[24]

C. The Commission Should Clarify that SDs Are Entitled to Use Internal Models for Both Credit Risk and/or Market Risk Calculations.

The Commission should clarify that SDs are entitled to use separate and distinct market risk and/or credit risk frameworks. There will almost certainly be cases in which an SD has approvals to use internal models to calculate either credit risk or market risk, but not both. This outcome would appear to be permitted by proposed Rule 23.102 under which an SD may submit an application pursuant to Appendix A that meets the necessary standards for either credit risk or market risk. However, in proposed Rule 23.102(b) for example, the Proposal references market risk exposure and credit risk exposure together, creating what we believe is an unintended suggestion that the two model frameworks are required to be tied together. This clarification would help to address potential operational burdens and competitive inequalities, as it would allow SDs that do not have approved internal models to focus their resources on the development and regulatory approval of either credit or market risk capital models, depending on which is most significant for that firm.

D. Theoretical Initial Margin Level Is a Measure of Customer Specific Risk and Is Not a Good Surrogate for an SD's Overall Risk.

The Proposal would require that an SD maintain capital calculated with respect to the aggregate minimum amount of initial margin that would be due from each individual customer of the SD, without regard for any exclusion or exemption from posting margin (the "**Theoretical Initial Margin Level**" or "**TIML**").[25]

While a lesser variant of this requirement (the "**risk margin amount**") has been in place since 2004, the requirement is predicated on the assumption that the total risk of an SD's customer activities may be roughly estimated as the sum of its risks with each customer. In reality, individual customer risks do not aggregate; they predominantly offset and reduce each other. As a result, while the TIML amount as to any one customer might be a reasonable

---

[24] The Commission is essentially permitting select firms to operate under a TNW Approach because it does not wish to drive those firms out of the market. It would be a surprising result to permit one group of firms to operate largely outside of capital requirements, yet drive another group of firms, perhaps more significant to general market liquidity, out of business because there was insufficient time to approve their models.

[25] For firms subject to the RWA Approach, the TIML calculation is required by proposed Rule 23.101(a)(1)(i)(C); for firms subject to the LAC Approach, the TIML calculation is required by proposed Rule 23.101(a)(1)(ii)(A) by cross reference to the SEC's proposed Rule 18a-1(a).

measure of an SD's risk to that one customer, it is not a reasonable means to measure an SD's overall risk with respect to all of its customers. This can be illustrated with a single, very simple example.

Suppose an SD enters into a swap with Customer A, where the SD is "long X" and the margin requirement on the trade is 10 dollars, which should reflect the risk that the SD takes in doing business with Customer A. Now suppose the SD enters into a mirror, but otherwise identical, swap with Customer B, in which the SD is "short X," and the margin requirement on that trade is also 10 dollars. Entering into the mirror trade (i) eliminates the SD's market risk entirely and (ii) diversifies the SD's credit risk (which diversification becomes greater as more customers are added). In spite of the fact that the mirror trade has dramatically reduced the SD's actual market and credit risk, the imposition of a capital requirement based on the aggregate of all customers' initial margin requirements treats the SD as if its risk had doubled, rendering the capital requirement a form of volume tax.[26]

While SIFMA recognizes the fact that the general concept of basing capital requirements on margin levels has the benefit of history (although not the benefit of empirical support), the Proposal in fact significantly expands the capital requirements that it would impose under this methodology. Most significantly, the Commission would require an SD to include cleared proprietary swaps positions in its TIML calculation. This currently is not the case for FCMs, on which the 8% multiplier is based, and would place a significant financial burden on an SD trading for its own account. The risk of proprietary trades is already accounted for in a firm's net capital computation because an FCM must deduct from its net capital the entire amount of its proprietary margin requirement, and sometimes a further cushion.[27] Requiring that the initial margin on these proprietary trades be accounted for yet again when calculating the TIML would effectively force an SD to take a double capital charge. This double charge would increase cost for all firms and would most severely impact smaller and medium-sized SDs (and as the FIA has commented, smaller FCMs, a group that the Commission has flagged as essential to market diversity and competition).

Application to LAC Firms. If the Commission is not prepared to replace the TIML charges with another measure,[28] SIFMA suggests that the Commission (i) at least eliminate the

---

[26] This problem is exacerbated by the split of jurisdiction between the Commission and the SEC. Suppose, for example, a single customer has a swap on the S&P Index (regulated by the Commission) and numerous swaps on the components of that index (regulated by the SEC); the risk in those swaps largely offset each other, and the credit risks entirely offset, leaving only a minimum of residual market risk. However, because the Commission and the SEC set margin requirements independently as to the transactions that each regulates, even as to individual customers, the margin requirements, and thus the capital charges, from doing business with the single customer entering into both Commission- and SEC- regulated transactions would be doubled, instead of reducing to near zero.

[27] 17 C.F.R. § 1.17(c)(5)(x)(A)-(B); a clearing member must take a charge of 100% of the maintenance margin required by the applicable clearing organization, while a non-clearing member must take a charge of 150% of the maintenance margin required by the applicable clearing organization.

[28] Ideally, the Commission should adopt an alternative measure of capital that is tied to the overall risk of the SD, rather than merely being a sum of individual risk. In this regard, SIFMA had previously proposed to adopt (i) for SDs that use internal models, a ratio based on a percentage of the entity's market and credit risk charges to capital, and (ii) for SDs that take standardized charges, a ratio based on a credit quality adjusted version of the proposed 8% margin factor.

TIML charge as to proprietary positions, (ii) reduce the TIML charge as to positions held by the SD's affiliates, as trades with these entities present less operational risk than non-affiliates, and (iii) generally reduce the TIML charge multiplier, as we do not believe that there is empirical evidence related to swaps and security-based swaps to support the use of an 8% multiplier. Pending the conduction of a study to determine the impact of the TIML charge, SIFMA proposes that the multiplier be reduced to 2%.

Application to RWA Firms. The Commission's primary reason for offering different methodologies for the calculation of capital was to allow each of the LAC firms and the RWA firms to measure their capital in a manner that is consistent with existing requirements. For the RWA firms subject to proposed Rule 23.101(a)(1)(i)(C), there simply is no existing analog to TIML; the Prudential Regulators rely upon risk weighted assets as the basis of their capital measures. SIFMA does not believe that there is any reason for the Commission to include an additional capital requirement measure that is not consistent with the measure of capital currently used by the Prudential Regulators, particularly given that TIML is a measure that has limited connection to actual risk.

Alternatively, if the Commission wishes to preserve a TIML indicator for RWA firms, SIFMA recommends lowering the multiplier from 8% to 2% on an interim basis in order to evaluate what effects, if any, the measurement will have on RWA firms. After the interim period, the Commission will be in a better position to consider a more appropriate TIML multiplier for RWA firms, whether it is a discard of the measurement, or replacement of it with another multiplier or methodology.

E. The Risk Weighted Assets Ratio and the RWA Approach.

As noted in our introductory remarks, SIFMA very much appreciates the fact that the Commission has provided two means for a CFTC Capital SD to calculate its capital requirements. However, for firms using the RWA Approach, the Commission has established a requirement materially higher and more restrictive than have the Prudential Regulators.

Under the existing Prudential Regulatory standards, an entity is considered to be "adequately capitalized" if its CET1 ratio is at least 4.5%[29] and to be "well capitalized" if its CET1 ratio is at least 6.5%.[30] In contrast, the Commission would impose a minimum capital standard under the RWA Approach of a CET1 ratio of 8%. Further, because of the "early warning requirement," the Commission is actually proposing a minimum capital level that is 20% higher than the purported minimum. Tacking this 20% cushion on to the Commission's nominal 8% CET1 ratio means that an SD would be required to maintain CET1 equal to 9.6% of risk-weighted assets, nearly 50% more than the 6.5% CET1 ratio required by the Prudential Regulators for a firm to be considered "well capitalized." We see no basis for the Commission to require a greater CET1 ratio than do the Prudential Regulators, especially given that the SDs using the RWA Approach will likely all themselves be subsidiaries of capital-regulated banking organizations.

---

[29] 12 C.F.R. § 6.4(c)(2)(iii); 12 C.F.R. § 208.43(b)(2)(iii).

[30] 12 C.F.R. § 6.4(c)(1)(iii); 12 C.F.R. § 208.43(b)(1)(iii).

In the Proposal, the Commission stated its intent that the proposed RWA approach be "generally consistent with the approach that the FRB imposes on bank holding companies," and noted that "it is important . . . that an SD . . . maintain a level of common equity tier 1 capital that is comparable to the level it would have to maintain if it were subject to the capital rules of the FRB."[31] SIFMA does not believe that the Commission's stated intent has been achieved by the Proposal. To align the Commission's stated intent of maintaining comparability between its capital requirements and the Prudential Regulators' capital requirements, SIFMA believes that material changes are warranted.

First, the Commission's capital requirement for RWA Approach firms should be a 4.5% CET1 ratio, with the "early warning requirement" set at a 6.5% CET1 ratio.[32] Although bank capital rules do not have an early warning mechanism, the "well capitalized" standard is structurally similar and establishes a formal regulatory capital buffer above the minimum (adequately capitalized) standards. These changes would ground the Commission's RWA Approach in the existing prudential regulatory standards and would harmonize the Commission's early warning standard with existing bank practices.[33] Furthermore, this requirement would raise the early warning level from 120% to more than 140% of the minimum CET1 ratio.

Second, the procedural requirements for model approvals under the RWA Approach should be fully conformed to the applicable Prudential Regulatory standards. The Commission and the NFA should not require anything more or different, as to process, than is required by the Prudential Regulators. In the case of market risk models, these approval procedures are set out in 12 C.F.R. § 217 Subpart F and, in the case of credit risk models, these approval procedures are set out in 12 C.F.R. § 217 Subpart E, Sections 131-155.[34] The drafting of the Proposal creates ambiguity as to whether SDs using the RWA Approach would have to satisfy separate procedural requirements imposed by both the Prudential Regulators and the Commission.

---

[31] 81 Fed. Reg. at 91,257.

[32] *See* FRB Regulation Q, 12 C.F.R. § 217.20 defining the term Common Equity Tier 1 Capital.

[33] We note that the Proposal not only would impose capital requirements that are substantially higher than the requirements imposed by the Prudential Regulators, it would also define "capital" in a materially more restrictive manner. The proposed CET1-only standard derecognizes an SD's ability to include additional tier 1 capital or tier 2 capital elements in its regulatory capital, notwithstanding that the value of these capital elements has been expressly acknowledged by the Prudential Regulators. Notably, when adopting the Basel III standards in the United States, the Prudential Regulators explained that the criteria for additional tier 1 capital and tier 2 capital elements were specifically designed to meet regulatory capital objectives. With respect to additional tier 1 capital instruments, the Prudential Regulators attested that the qualifying criteria "were designed to ensure that additional tier 1 capital instruments would be available to absorb losses on a going-concern basis." Similarly, with respect to tier 2 instruments, which include certain forms of subordinated debt, the U.S. banking agencies further reported that the tier 2 criteria had been revised and tightened so that the current criteria do not recognize, for capital purposes, funding arrangements that had proved unreliable in the financial crisis, such as subordinated debt with acceleration rights. These concepts are also consistent with the capital criteria under the Proposed SEC Capital Requirements and within this Proposal. Firms using the LAC Approach are permitted to reserve 25% of their capital in the form of equity and 75% in the form of subordinated debt.

[34] Sections 131-155 are the relevant standards within Regulation Q, Subpart E for calculating credit risk RWAs. Sections 100-124 within Regulation Q, Subpart E cover the purpose and qualification standards generally applicable within Regulation E; Sections 161-162 cover operational risk RWA calculations; and Sections 171-173 cover disclosure requirements, which are separately addressed through CFTC proposed Rule 105.

Although the Commission's procedural requirements are very similar to those of the Prudential Regulators, the wording is not identical. Further, it is unclear what it would mean for the NFA to "approve" models that have been previously approved by a Prudential Regulator should the Commission mandate the use by the NFA of a different procedural or model creation process than is mandated by the Prudential Regulator.

Finally, the proposed rule text requires an SD to calculate RWA "as if the swap dealer itself were a bank-holding company subject to 12 C.F.R. Part 217." SIFMA requests confirmation from the Commission that an SD that does not, as a standalone legal entity, meet the criteria outlined in 12 C.F.R. Part 217, Subpart E, Section 100 is not required to calculate RWA under that Subpart, without regard to the status of its parent company. Such smaller SDs should be able to calculate credit risk RWA under 12 C.F.R. § 217, Subpart D only, or choose to use models under 12 C.F.R. Part 217, Subpart E.

F. As to Non-Model Firms Using the LAC Approach, Relief Should Be Provided in Respect of Transactions with Commercial Users and for Legacy Swaps.

As to LAC Approach firms that do not use credit models, the Proposal largely undoes the exemption from posting margin that Congress granted to commercial users using standardized capital charges. Congress exempted swaps with commercial counterparties from the margin requirements because (i) commercial users are generally using swaps to reduce the risk to which they are subject in their business and (ii) they are unlikely sources of systemic risk. If capital charges are imposed on any "margin deficiencies" on transactions with commercial end users, even though the commercial end user will not have to post margin, then commercial users will effectively have to fund an amount equal to the SD's capital charge on the transaction. This can be simply illustrated as follows.

Suppose a commercial end user enters into a swap on interest rates to hedge its interest rate risk on the debt used to build a factory. If no commercial party exemption were available, the swap would have a margin requirement of $1,000. If the commercial party had to post margin, it would likely have to borrow $1,000 and pay interest on that amount—assume at a rate of 4% per annum. However, Congress excused the commercial party from posting margin. Under the proposed LAC Approach, the Commission would require the SD to take a capital charge on the $1,000 that the SD did not collect. If the SD does not have model approval, it would take a capital charge equal to the $1,000—which would be a straight deduction to the SD's equity, as computed for capital purposes. This would mean that the SD would have to raise "net capital" of $1,000, perhaps at a rate of 4% per annum.

As the paragraph above illustrates, without relief for commercial end users, the LAC Approach effectively undoes the Congressional exemption for commercial users. As the Commission acknowledged in the Proposal, there is a much lesser degree of systemic risk associated with doing business with commercial parties. Because commercial parties are using swaps to reduce their own business risks, allowing commercial parties to do so on economically feasible terms serves to reduce market-wide systemic risk. Accordingly, it is SIFMA's view that both credit charges and capital requirements associated with commercial parties should be treated differently than such charges and requirements with respect to financial counterparties.

Therefore, SIFMA recommends that LAC Approach capital charges be decreased from 100% to 25% of the value of the uncollected margin when facing commercial parties.[35]

For analogous reasons, SIFMA believes the charge on uncollected initial margin for "legacy swaps" is inappropriate. It seems patently unfair to penalize firms so heavily for the failure to collect margin before it was actually required to be collected. The Proposal would effectively require SDs to bear very substantial expenses that were wholly unanticipated at the time these transactions were entered into. Further, these new requirements will increase instability in the market as they will strongly incentivize SDs holding legacy positions to exit them at the first opportunity.

G. Early Warning Level.

The proposed capital requirements are set quite high as compared to quantifiable measures of risk. Further, as a practical matter, the effective capital minimums are not the minimums specifically set forth in the rule, but rather those minimums increased by the "early warning requirement level," which is 20% higher.[36] While setting the early warning requirement so high may seem to reduce risk at the entity level, it actually increases systemic risk because it traps capital in a legal entity that may not need it, and precludes it from use by an affiliated legal entity or business that may need it. The added safety to one entity is more than offset by the loss of liquidity to the financial group.

In light of the above, SIFMA suggests that the early warning level be reduced from 20% above the minimum to 10% above the minimum as to LAC Approach firms and that, for RWA Approach firms, the early warning requirement be set at the level at which a prudentially regulated firm would be considered to be "well-capitalized"; *i.e.*, 6.5% CET1.

H. Liquidity Requirements.

1. General Considerations

SIFMA acknowledges that the Commission has generally attempted to align its liquidity requirements with applicable requirements of the Prudential Regulators and the Proposed SEC Requirements. Before going into our specific comments as to each of the LAC and RWA Approaches to liquidity, we have general concerns that apply to both approaches:

A. Ability to Elect Compliance Measure. SIFMA believes that each SD, regardless of whether it is an RWA Approach firm or an LAC Approach firm, should be able to elect either of

---

[35] We note that an RWA Approach firm or a prudentially regulated firm would only be subject to an 8% capital requirement as to the uncollateralized receivables resulting from a swap with a commercial party or on a legacy swap.

[36] We observe that the 20% early warning requirement was imposed more than 25 years ago. *See* Net Capital Rule amendments, 56 Fed. Reg. 9,124 (Mar. 5, 1991). There is nothing to suggest that "20%" was the right number at the time or is now. Further, given the additional regulatory requirements that have been imposed since such time and that are now being imposed, including liquidity requirements, SIFMA believes that a 10% early warning requirement would be a sufficient buffer to provide for adequate notice to the regulators of any firm in financial difficulty.

the two proposed methods to compute and meet its liquidity requirement. Both measures of liquidity are intended to obtain the same objective. Additionally, there is no inherent tie between the method by which a firm calculates its liquidity requirement and the method by which it calculates its minimum capital requirement. Therefore, there is no reason that a firm should be bound to select one measure of liquidity rather than the other.

B. Comparability of Liquidity Requirements. SIFMA further recommends that the RWA Approach and LAC Approach liquidity requirements be made similar to the extent practicable, given that both requirements have the same purpose. Currently, there are seemingly arbitrary differences between the requirements under each approach. Most significantly, the LAC Approach's definition of liquidity reserves is materially narrower than the RWA Approach's definition of High Quality Liquid Assets ("**HQLAs**"). The Commission should expand the definition of liquidity reserves under the LAC Approach to match the HQLA definitional requirements so as to recognize the full range of assets that are actually available to a firm to support its liquidity needs, and so as to reduce any arbitrary disparity that a firm might otherwise experience by being under one liquidity method as compared to the other.

C. Flows between affiliates should be excluded in determining liquidity requirements. The cash and asset flows between affiliates, each of which is subject to a liquidity requirement, should be excluded from the calculations of how much liquidity each affiliate requires. Such treatment would be consistent with the approach to affiliate transactions taken by the CFTC in the margin regulations. Under CFTC Rule 23.519, SDs are not, subject to conditions specified in the rule, required to collect or post initial margin in transactions with affiliates.[37] As Chairman Giancarlo noted in his statement on the margin rule adoption, the imposition of margin requirements on inter-affiliate transactions would have had two negative impacts: (i) increasing costs to end users for hedging and (ii) concentrating risk in the U.S. marketplace, thereby increasing the risk of systemic hazard in the United States.[38] These same concerns are relevant to cash flows between affiliated entities. The liquidity requirements of SDs would be materially overstated if flows between regulated affiliates were included in the computation. Requiring each entity to hold reserves for its flows to affiliated entities would unnecessarily restrict the movement of cash, and would decrease market liquidity as a whole.

D. Consolidated Contingency Funding Plans and Communications.[39] As a practical matter, any financial group that experiences a liquidity challenge is likely to have problems at the group level and not merely at the entity level. Accordingly, it would be most practical if financial groups were able to manage liquidity at the holding company level, which would allow groups to move liquidity between affiliated entities as needed, rather than having it trapped in individual entities that may not need the liquidity at the relevant time.[40] Nonetheless, SIFMA

---

[37] 17 C.F.R. § 23.519

[38] *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636, 708 (Jan. 6, 2016).

[39] Proposed CFTC Rule 23.104(a)(4) requires the establishment of an entity-level contingent funding plan and public communications program.

[40] SIFMA believes that an SD should be able to participate in the consolidated funding plan of its holding company rather than be obligated to create a contingency funding plan at the entity level, which is likely to be both less efficient and less practical, given that entities within a common financial group are likely to draw from common

recognizes that each regulator is likely to have a preference for mandating the storage of liquidity within the entity or entities that it regulates. Even accepting that practical regulatory reality, SIFMA believes contingency funding plans and policies regarding communications with the public and other market participants should be established at the consolidated level. Given that the financial markets will certainly regard liquidity events at a single entity as having significance for the entire group, it follows that the parent company should be able to develop a coherent plan and public communications strategy for the group as a whole, under the oversight of its primary regulator, rather than forcing each entity in the group to deliver a separate message.

2. Comments on the LAC Approach

One of the difficulties of commenting on the Commission's liquidity proposal is that it is based on an SEC liquidity proposal on which we have previously commented, and which has yet to be finalized. Accordingly, from a procedural standpoint, it is not entirely clear what we are commenting on. That said, we have the following comments specifically with regard to the LAC Approach, in addition to those general issues raised above:

(a) The LAC Approach, as drafted, provides that SDs are to maintain liquidity reserves "at all times." We request that the Commission affirm and clarify that firms using the LAC Approach to liquidity are subject a constant, once-a-day calculation standard for their liquidity stress calculations similarly to firms using the RWA Approach.[41] Requiring firms to maintain liquidity throughout the business day would wreak havoc with both market making and the settlement process (in fact, it would seem to undermine the entire purpose of liquidity if a firm cannot use it). It would mean that a firm could not send out $1,000 to pay for securities until it had received in $1,000 from another firm purchasing securities. One can easily imagine a situation in which firms are essentially frozen in making payments with no firm being willing to send out payments until it receives payments from other firms.[42] The only way for firms to prevent such a problem would be by completely "locking up" their liquidity and not using it for "business as usual" intraday funding during the course of the day. Any such end result would be enormously expensive and would effectively constitute a massive drain on liquidity as it would render all liquid assets effectively wholly illiquid. Additional costs from such a requirement would be passed on to end users. By

---

sources of liquidity. Recognizing that a parent company and its subsidiaries will, and should, collectively manage their liquidity status during a stress event would allow members of a financial group to work together to benefit themselves, their customers and the financial markets.

[41] *See, e.g.,* Payments Market Practice Group, *Global Market Practice Guidelines for Intraday Liquidity Reporting Messaging from the Liquidity Implementation Task Force* (Sep. 2015); Bankers Association for Finance and Trade, *Implementation Challenges, Outstanding Issues and Recommendations Regarding the Basel Committee Monitoring Tools for Intraday Liquidity Management*, (Jun. 2015).

[42] This risk is sometimes known as "Herstatt risk," where a disconnection in the timing of settlement payments results in a breakdown in the system.

contrast, under the terms of the Proposal, SDs using the RWA Approach calculate liquidity once a day as specified by 12 C.F.R. § 249.10(a).[43]

(b) The LAC Approach liquidity regime should provide that if an SD is below its mandatory liquidity requirement for three consecutive business days, the SD must promptly provide the Commission with a plan for achieving compliance with its minimum liquidity requirement.[44]

(c) Under the LAC Approach, liquidity reserves should be expanded to include, not only an SD's cash deposits that are readily available to meet the general obligations of the SD, but all HQLAs as defined in 12 C.F.R. § 249.20. That provision, for example, recognizes the liquidity value (albeit subject to very substantial "haircuts") of certain corporate debt and equity securities. Given that these assets are treated as having value for liquidity purposes for firms using the RWA Approach, there seems no reason to disregard them for firms using the LAC Approach. By conforming the definitions of liquidity reserves and HQLAs, the Commission would increase the comparability of the two approaches (which have identical goals) and thus reduce any competitive disparity that may otherwise exist by way of the RWA Approach's currently broader definition of liquid assets.

3. Comments on the RWA Approach

As to RWA Approach firms, the Proposal would set liquidity requirements that are disproportionate to those imposed by the Prudential Regulators. Under the FRB's Regulation WW, there are two tiers of liquidity requirements that may be imposed on bank holding companies—one for firms with greater than $250 billion in assets or subject to the Prudential Regulators' advanced approaches method to capital that meet the applicability requirements under 12 C.F.R. § 249.1(b) (known as the "**liquidity coverage ratio**" or "**LCR**"), and another requirement (known as the "**modified LCR**") for bank holding companies with between $50 billion and $250 billion in assets and not otherwise subject to the advanced approaches methodology.

In the determination of the Prudential Regulators, the modified LCR is appropriate for firms with less than $250 billion in assets. It would seem inappropriate from a competitive standpoint for bank SDs that are subject to the Prudential Regulators to be subject to one set of standards, but for CFTC Capital SDs to be made subject to a more burdensome standard. We therefore recommend that the RWA Approach liquidity regime permit firms to satisfy their liquidity requirements by reference to the modified LCR approach permitted under the FRB Regulation WW. An SD that meets the criteria for the modified LCR approach should be able to calculate its liquidity requirements under this method, regardless of the size of its parent company.

---

[43] This provision states that "An [FRB]-regulated institution must calculate its liquidity coverage ratio as of the same time on each business day (elected calculation time)."

[44] This is the approach taken by the Prudential Regulators. *See e.g.* 12 C.F.R. § 249.40(b)(2) (*i.e.*, Federal Reserve Board).

4. Alternative Liquidity Risk Management Standard: Prudential Approach

SIFMA also recommends that the Commission recognize a third liquidity risk management framework ("**Prudential Approach**") that firms using either the RWA Approach or LAC Approach may adopt. The Prudential Approach would be grounded in the liquidity risk framework of the FRB's Regulations YY and would be ideally suited for nonbank SDs that are consolidated subsidiaries of U.S. BHCs or U.S. intermediate holding companies ("**IHCs**").

Regulation YY requires large U.S. BHCs and U.S. IHCs to establish comprehensive liquidity risk management programs, through standards addressing:

a) Board of directors' oversight responsibilities for liquidity risk management;

b) Liquidity risk management strategies, policies and procedures;

c) Liquidity stress testing, including combined market and idiosyncratic stresses projected for overnight, 30-day, 90-day and one-year planning horizons;

d) Maintenance of a liquidity buffer to meet projected 30-day net stress cash outflow needs;

e) Liquidity risk limits, including with respect to concentrations in sources of funding;

f) Liquidity risk independent review functions;

g) Cash flow projections;

h) Contingency funding plan requirements;

i) Liquidity event management processes; and

j) Collateral and intraday liquidity monitoring.[45]

An SD that elects the Prudential Approach would be required to comply with the liquidity risk regulations in 12 CFR Rule 252.34 and part 35 (Regulation YY), as if the SD itself were a bank holding company subject to 12 CFR Part 252; provided, however, that for purposes of determining the SD's liquidity buffer requirement in 12 C.F.R. Rule 252.35(b), the SD would take into account liquidity resources and support provided by a controlling BHC or IHC. Governance reports, data and internal analyses supporting an SD's compliance with the Prudential Approach would be made available to the Commission.

Recognizing the Prudential Approach as an alternative to both the LAC and RWA Approaches would enable the Commission to implement a liquidity regime parallel with the Commission's proposed capital framework, which incorporates standards from the Federal Reserve's Regulation Q. If an SD is a subsidiary of a BHC or IHC that is subject to compliance

[45] 12 C.F.R. §§ 252.34-35.

with Regulation YY, the SD's liquidity risk management program would be fully integrated with that of the larger group. The Prudential Approach will provide firms with the ability to impose an overarching governance framework and to require strategic analysis of each SD's particular circumstances, ultimately resulting in a more comprehensive and accurate assessment of an SD's liquidity needs.

I. Recordkeeping, Reporting and Notification Requirements.

1. General Considerations

We urge the Commission to conform its recordkeeping and reporting requirements to those required under existing regulations, whether of the Prudential Regulators, Qualifying Foreign Regulators, the SEC or the Commission itself. On this point, SIFMA again recognizes the Commission's efforts to align with existing Prudential Regulator and Basel III requirements. Likewise, SIFMA appreciates the willingness of the Commission to coordinate with the SEC in developing a single system of recordkeeping and reporting for those firms that are dually registered with the Commission and the SEC.

That said, while the Proposal is based on existing requirements, the Proposal is, in numerous material respects, far more onerous than, and inconsistent with, existing regulatory requirements. The timing, content and public disclosure requirement of the reports should match those already required, unless there is some very considerable benefit for requiring otherwise. If the Commission does determine that an additional reporting requirement provides some benefit, we urge the Commission to consider the most efficient manner of acquiring that new information so that the additional requirement is not unduly burdensome for the reporting firm.

Although we have made comments and asked for detailed clarification on the Commission's financial reporting requirements in Appendix C of this comment letter and included our comments on the SEC's Proposed SEC Reporting Requirements in Appendices D-2 and D-3, we would further suggest that the Commission repropose the financial reporting requirements in a separate rulemaking. While it may seem that financial reporting is a mere footnote to the imposition of capital requirements, in fact such reporting has its own material complexities that should be fully acknowledged. A separate rulemaking on financial reporting would allow the Commission the opportunity to prepare line-by-line instructions as to each required item of data, and also would afford the industry a more meaningful opportunity to understand what information the Commission is seeking and to comment on how it may be best provided. In the absence of detailed instructions, it is exceedingly difficult to understand fully the details of what is being requested by the Commission, which makes it impossible for the industry to provide essential detailed feedback to the Commission.

2. CFTC Capital SDs and Prudentially Regulated SDs

A. Governance and Attestation

The information required to be attested by representatives of a CFTC Capital SD and a Prudentially Regulated SD is neither consistent nor entirely clear. As a preliminary matter, we would like to note that (i) new technology may need to be built in order to meet these requirements and (ii) the departments within a firm that are responsible for producing existing

reports on capital and liquidity, for example, are not likely to be the same. Therefore, it is important that the Commission give significant consideration to the timing of the reporting requirements, the specific person, if any, who would be designated to provide any particular report, and as to whether an attestation should be required in respect of such reports. It goes without saying that firms will do their best in responding to any reporting requirement imposed by the Commission. However, in many cases, the actual specifics of the reporting requirements are not entirely clear.

More specifically, and by way of example, proposed Rule 23.105(f) requires an oath or affirmation for each filing, while only requiring that the attesting party represent that the information in the filed financial report be true and correct. This leads to uncertainty regarding what exactly is being attested in the non-financial reports (*i.e.*, notice filings for CFTC Capital SDs, models reporting requirements, liquidity, Appendix A & B Reports, Margin Reports, etc.). Even more confusing is proposed Rule 23.105(p)(5)'s affirmation requirement. This section requires a prudentially regulated SD's filings to be attested, but only specifies the attesting party for financial reports, creating uncertainty as to who is responsible for attesting to the other required filings. This discrepancy also creates uncertainty as to why all prudentially regulated SD filings must be accompanied by a true and correct affirmation, while the CFTC Capital SD non-financial filings require no such attestation. SIFMA requests that the Commission clarify the affirmation requirements and explain the rationale for the inconsistencies.

The individual attesting to any reports with the Commission should be either the person filing the identical report with the SEC or Prudential Regulators, or, in the case of non-U.S. SDs, any other responsible principal of the firm. There are long existing Commission, Prudential Regulator and SEC requirements as to who must sign various financial reports and any affirmation that should be given in connection with these attestations. The Commission's financial requirements for registered SDs should not expand or alter these requirements, which are consistent with the manner in which firms currently operate. Requiring an individual who may not be familiar with the specifics of the reporting process or with the requirements of the Commission, to attest that any particular report is true and correct will be difficult, particularly where the Proposal fails to specify what exactly is being attested. This issue is of particular importance for parent holding companies seeking substituted compliance, as it would seem anomalous to require an SD's filings to be attested by the CEO of a foreign entity who may have limited or no involvement in swaps activities.

B. Notices

The required regulatory notice of recordkeeping issues should be limited to issues that are material. Proposed Rules 23.105(c)(3) and 23.105(p)(iv) require an SD to submit a notice to the Commission within 24 hours in the event of prescribed margin collection issues. However, firms must keep thousands of records, and small issues inevitably arise from time to time. SIFMA suggests that the Commission add a materiality standard to this notice requirement. This would parallel the standard to the comparable early warning requirement in Rule 17a-11 under the Securities Exchange Act.

The notice provisions' margin failure "common ownership and control" reference should be made more specific. Proposed Rules 23.105(c)(8) and 23.105(p)(iii) require notice when a

"group of counterparties under common ownership and control" fail to post margin. SIFMA requests that the definition of common control be clarified in the final rule. SIFMA believes that common ownership and control should be limited to situations where two or more customers have common beneficial ownership such that the credit failure of one of the customers is likely a sign of credit failure of the other entity.

The notice provisions related to an SD's failure to collect or post margin should include a carve out for cured failures. Proposed Rules 23.105(c)(8) and 23.150(p)(3)(iii) require an SD to submit a notice to the Commission within 24 hours upon a few types of specified events regarding the failure to collect or post margin as applicable. However, in light of a firm's ability and likelihood to cure any such failure within 24 hours, SIFMA requests that the Commission revise the proposed rule to eliminate the need to report a failure cured within 24 hours of its initial occurrence. It would seem excessive to needlessly require an SD to file an attested deficiency notice for an incident that is no longer an issue. SIFMA recommends that the proposed rule include a carve out that exempts failures cured by close of business on the next day from the otherwise applicable notice requirement.

C. Weekly Position and Margin Reporting

Proposed Rule 23.105(q)'s weekly position and margin reporting requirements should be evaluated within the scope of existing CFTC requirements. While we recognize the rationale and significance behind the proposed weekly position and margin reporting requirements, SIFMA believes that the data required by proposed Rule 23.105(q) is in material respect duplicative of Part 45 of the CFTC rules and will raise privacy concerns for firms and counterparties. The degree of duplication will depend on the format for the position information which has yet to be specified by the Commission. However, to the extent that reporting under the proposal is duplicative with existing requirements, we recommend that the Commission reconsider and potentially remove its proposed additions.

The margin information required by proposed Rule 23.105(q)(2) raises another issue. The only collateral information required to be provided under Part 45 is the "indication of collateralization," which is more "high level" than the proposed requirement. Any additional data would be of very limited value in relation to the cost of collection, particularly when one considers the overall aims of capital regulation. The primary purpose of capital requirements is the safety and soundness of the regulated entity. Through other information collected and proposed to be collected on an aggregate basis as to a firm's overall business, the Commission will receive a detailed snapshot of an SD's capital. However, the requirements of proposed Rule 23.105(q)(2) are extremely granular and ask for a collateral report as to every counterparty an SD faces. This information is not required under capital or margin requirements established by any other U.S. regulator.

In addition, the granularity of the data collection may raise privacy concerns for SDs. If the CFTC insists on collecting this information separate from the Part 45 reports that are already being submitted, we are concerned that the CFTC would want the weekly position and margin data to identify relevant counterparties either by name or Legal Entity Identifier. SDs act in a large number of jurisdictions and such jurisdictions have varying privacy laws—some of which require an explicit consent to transmit customer data. Obtaining such consents will be both

costly and time consuming, assuming even that counterparties would consent. If the CFTC adopts the position and margin reporting requirements, SDs would benefit if such requirements are adopted under Part 45 of the CFTC regulations. Under standard industry documentation used by SDs to comply with the Part 45 requirements (among other things),[46] SDs obtain a data privacy waiver relating to all reporting required by those rules.[47] Adopting this requirement as a Part 45 amendment could reduce the number of clients from whom additional consents would need to be sought.

Another way to minimize the data privacy concern would be to amend the requirement so as not to require a regular report. The Commission could instead require a notice to be provided when the margin actually collected from a relevant counterparty was deficient. The stated purpose of the weekly position and margin reports is to conduct risk surveillance of SDs—not to identify information specific to individual counterparties. This stated purpose could be satisfied by a notice of outstanding material margin delinquencies over a certain number of days that does not identify specific counterparties.

3. CFTC Capital SDs

SIFMA appreciates the Commission's efforts to align the timing of its reporting requirements with those of the SEC as well as with the Commission's existing requirements. We also acknowledge that certain of the Commission's proposed new reporting requirements are derived from the Proposed SEC Reporting Requirements. However, those Proposed SEC Reporting Requirements were themselves quite problematic, a topic on which SIFMA and various member firms have had discussions with the SEC and the CFTC staffs.

A. Appendix A to the reporting requirement is imprecise. The most problematic of the new requirements is the information requested by "lines" 12-14 of Appendix A to proposed Rule 23.105(d). As a starting matter, it is not clear whether the Commission is seeking information as to the "market value" of transactions or as to the "notional value." We are concerned that the Commission may be asking for notional value information; if that is the case, the information requested by the Commission will not tie back to a firm's balance sheet, which is based upon market values. Appendix C contains a more detailed analysis of the Appendix A and B requirements.

B. The Commission's requirements would require substantial reprogramming of financial report systems without any material benefit to the Commission. The manner in which the Commission requests that information be broken down is actually quite difficult, and would require most, if not all, firms to do a significant amount of reprogramming of their systems. By way of example, the Commission would require firms to differentiate between the values (whether the market value or the notional value) of security-based swaps (broken down into four different categories), mixed swaps and swaps (broken down into seven different categories), with each of the aforementioned eleven categories further subdivided between cleared and uncleared positions, and long and short positions.

---

[46] *See* ISDA August 2012 DF Protocol.

[47] The Protocol makes reference to "DF Supplement Rules," which include the Part 45 requirements but would not include any capital requirements adopted by CFTC.

While it may seem that firms should be readily able to break down swaps into these groups because they must categorize all swaps for certain trading or other regulatory purposes, it does not follow that firms' financial reporting systems and other subsystems are currently able to categorize transactions in this way. These regulatory distinctions (for example, between swaps and mixed swaps) are wholly arbitrary from an economic standpoint and do not have any significance for purposes of financial reporting. There is nothing "special" about mixed swaps for financial reporting purposes that distinguishes them from security-based swaps or swaps, and no reason that they would be tracked separately in a firm's financial reports—and in fact they have not been. Accordingly, if the Commission were to require financial reports that, for example, break out the performance of mixed swaps, as compared to the performance of swaps or security-based swaps, firms would be required to revamp their financial reporting systems at a material expense. In light of the expense of doing so, SIFMA would ask the Commission to reconsider any such requirement, as it is not clear that a break out of this information would have any value whatsoever.

C. The proposed financial reporting requirements are inconsistent with existing requirements. SIFMA requests that the Commission reconsider the information that would be required monthly by proposed Rules 23.105(d) and 23.105(l). Currently, firms regulated by the SEC and the Commission provide annual statements of cash flow. Further, the SEC's Derivatives and Off-Balance Sheet Report is provided quarterly. The Commission's Proposal, perhaps mistakenly, would seemingly require firms to provide cash flows and other off-balance sheet reporting on a monthly basis. This would be a very significant additional recordkeeping and reporting task beyond what is currently required, particularly because many firms prepare these reports in tandem with parent and sister companies that are otherwise required to report quarterly. The Proposal's reporting requirement should be conformed to existing requirements.

In this regard, SIFMA requests that the Commission clarify the substance requested by the clause requiring "such further material information as may be necessary to make the required statements not misleading" located in proposed Rules 23.105(d)(2) and 23.105(e)(4)(vi). As written, it is unclear whether the clause is referring to footnotes to the financial statements or an entirely new report. Additionally, we ask that the Commission clarify that firms may comply with all year-end requirements using fiscal year end as well as calendar year end. With regards to the audited financial statements required by proposed Rule 23.105(e), SIFMA requests that the Commission confirm that no additional report on internal controls will be required and that it clarify which financial reports are subject to an audit requirement.

D. The Commission should specifically provide that its standards as to financial reporting supersede third party auditing standards, whether existing or subsequently adopted. SIFMA is concerned about the inconsistencies that can exist between the Commission's regulatory intent and statutory requirements, and auditing industry standards adopted by state agencies, foreign bureaucracies and auditing trade association industry groups. Auditing industry standards may not account for the Commission's particular requirements. Accordingly, SIFMA believes that the rules of the Commission should govern rather than those intended for general auditing application.

4. Prudentially Regulated SDs

A. The Commission should accept the financial reports of the SD's primary financial regulator. As a starting matter, SIFMA suggests that the Commission reconsider whether it should impose any additional financial reporting requirements on SDs that are subject to the capital requirements of the Prudential Regulators. There does not seem to be any reason for the Commission to require additional financial information than is required by the regulator tasked with the primary responsibility of financial oversight over such entity. The Proposal allows CFTC Capital SDs to submit the SEC's Form SBS with the Commission in lieu of the financial report that would otherwise be required. By the same token, substituted compliance should also be available for Prudentially Regulated SDs who are otherwise required to submit financial reports (*i.e.*, these firms should be allowed to satisfy this reporting obligation by submitting the financial reports mandated by their primary financial regulator).

B. The timing, content and signature of the CFTC's financial reporting requirements should align with that of existing financial reports required by other regulators. Proposed Rule 23.105(p)(2) would require the submission of financial statements within 17 business days following the end of the calendar quarter. Many SDs are bank or bank holding company affiliates which are subject to regulatory reporting to the Prudential Regulators. Banks and bank holding companies have long reported financial information to their respective regulators 30 calendar days after the end of the calendar quarter (40-45 calendar days after the quarter-end in the case of bank holding companies), and thus have structured their internal financial reporting structures consistent with these longstanding timetables. These financial reports to the Prudential Regulators are prepared on a consolidated basis and thus incorporate financial information supplied by bank and bank holding company subsidiaries—including any subsidiaries that are SDs subject to the Commission's Proposal. This 30- to 45-day period is used by banks and bank holding companies to verify and reconcile the financial information, address any issues created by consolidation, and resolve any discrepancies. Requiring an SD to report financial information on an earlier timetable such as 17 business days (roughly 22-24 calendar days) would obligate the SD to supply financial information to the Commission before the overall organization has "closed the books" for the period. Imposing such an abbreviated reporting deadline would be highly disruptive to these existing internal financial reporting processes, for no apparent added benefit other than the Commission receiving the information a week earlier than the Prudential Regulators that are responsible for regulating the SD's financial soundness.

The contents of the financial reports that would be required by proposed Rule 23.105(p)(2) should be consistent with those required by the Prudential Regulators or imposed by Basel III. Banks have long provided financial information to the Prudential Regulators based on the Call Report, a uniform financial report adopted by the OCC, FDIC and FRB. Likewise, bank holding companies have reported financial information to the FRB using Form FR Y-9C.[48] These reports include particular information necessary to determine the financial standing of a banking organization. The Proposal's Appendix B to proposed Rule 23.105 includes reporting requirements that are more granular than what is required by Basel III. We believe that determinations regarding what reporting data are required should be left to the Prudential

[48] Foreign banking organizations ("**FBOs**") that have elected "financial holding company" status – which encompasses most of the FBOs that own SDs subject to the Proposal – similarly file quarterly financial information with the FRB on Form FR Y-7Q.

Regulators, and that Appendix B to proposed Rule 23.105 should correlate with the Call Report and Form FR Y-9C.

We also urge the Commission to clarify that the financial reports that would be required under proposed Rule 23.105(p)(2) may be provided on a consolidated basis. The Call Report is consolidated (*i.e.*, the Call Report reflects financial information of the consolidated subsidiaries of the reporting bank), and therefore we expect and assume that the Commission would expect prudentially regulated SDs to provide their financial reports on a consolidated basis. Requiring a standalone balance sheet from a prudentially regulated SD would be an entirely new and burdensome process.

C. Public disclosure requirements should be made consistent with existing requirements. The public disclosure requirements set forth in proposed Rule 23.105(p)(7) should be limited to the information otherwise made public by existing regulatory requirements. The Proposal does not specify what information must be publicly disclosed. The relevant public portions of existing regulatory reports contain select portions of the information made available to the Prudential Regulators. We urge the Commission to limit any public disclosure to the information already made public by the Prudential Regulators.

D. The books and records failure notification requirement should be clarified. Proposed Rule 23.105(p)(3)'s notice provision states that an SD must provide notice to the Commission "at any time [that it] fails to make or to keep current the books and records required by these regulations." This requirement mirrors the Commission's proposed notice requirement for SDs that are not prudentially regulated. However, it is unclear whether the Commission is requesting notice in the event of a reporting failure or for some other event. SIFMA requests that the Commission clarify that the reporting requirement only relates to a violation of an enumerated Commission requirement.

5. Substituted Compliance SDs

In light of the need for the Commission to truly accept "substituted compliance" if the expectation is to allow or encourage non-U.S. swap dealers to participate in and provide liquidity to the U.S. markets, SIFMA urges the Commission to be consistent in at least the following ways as to reporting by substitute compliance firms:

(a) The reports required by the Commission should not be more burdensome than those required by the Qualifying Regulators;

(b) The timing of the reports required by the Commission should follow on the timing to which the firm is already subject by its Qualifying Regulators;

(c) Any conversion of local currencies into U.S. dollars should be limited to an unaudited "convenience" translation; *i.e.*, one that is done at a single exchange rate determined as of a particular day, not a complete recalculation of a firm's financial statements; and

(d) Any reports submitted to a U.S. regulator may be affirmed by an appropriate principal of the swap dealer (not necessarily the CEO or CFO), which will likely be a U.S.-based principal of the firm.

J. Substituted Compliance.

It is essential that Foreign SDs, including SD subsidiaries of U.S. bank holding companies, be permitted to operate under a regime of full substituted compliance. Likewise, it is important that U.S. SDs that are part of a foreign-based financial group and foreign SD subsidiaries of U.S. bank holding companies are able to operate using models approved by the home or host country Qualifying Foreign Regulator. SIFMA believes that less than full acceptance of foreign regulation will result in substantially increased costs to non-U.S. SDs and to U.S. SDs with a non-U.S. parent with a model approved by a Qualifying Foreign Regulator. These costs will be passed on to U.S. customers (assuming that the Foreign and U.S. SDs are not driven from the market). Appendix A to this letter sets forth our suggested revisions to proposed Rule 23.102 and includes an approval process for models recognized by other regulators.

For the Commission to truly accept "substituted compliance," it must not only accept the capital requirements that home country regulators impose on Foreign SDs and provide automatic approval to models approved by Qualifying Foreign Regulators (for use by non-U.S. SDs and certain U.S. SDs with a non-U.S. parent), it must also accept other local accounting regimes, and it must accept reports of a type that the Foreign SD would deliver to its home country regulator.

The reluctance to date of the Commission to accept home country regulation of non-U.S. SDs has generally redounded to the detriment of the U.S. swaps markets.[49] We also note that the Commission's actions with respect to home country regulation have been in contrast to those of the Prudential Regulators who have fully accepted the capital oversight of Basel regulators. Unwillingness to accept the judgments of non-U.S. regulations or to non-U.S. entities would further fragment the swaps market, leading to smaller, disconnected liquidity pools and less efficient, more volatile pricing. Given the significance that Chairman Giancarlo has placed on increasing liquidity and supporting globalization and regulatory comity,[50] establishing an efficient procedure of substituted compliance should be among the Commission's top priorities.

K. The Implementation Timing Must Be Consistent with the Full Implementation of Margin Requirements and Needs to Fully Harmonize the Commission and SEC Requirements.

As a starting matter, because SIFMA believes it expensive and operationally difficult for SDs to operate under two sets of regulatory requirements, SIFMA believes that the Commission

---

[49] *See* Keynote Address of now-CFTC Acting Chairman J. Christopher Giancarlo before SEFCON VII (Jan. 18, 2017) (stating that "[w]hile we have made some progress in cross-border harmonization since then, the CFTC's cross-border approach too often has been over-expansive, unduly complex and operationally impractical. And, its substituted compliance regime remains a somewhat arbitrary, rule-by-rule analysis of CFTC and foreign rules under which a transaction may be subject to a patchwork of U.S. and foreign regulation").

[50] *See* Statement of Acting Chairman Christopher Giancarlo, *Changing Swaps Trading Liquidity, Market Fragmentation and Regulatory Comity in Post-Reform Global Swaps Markets* (May 10, 2017).

and the SEC should fully harmonize their capital requirements and adopt such requirements in tandem.

Second, because premature implementation of these requirements will force SDs to exit registration and because firms will require a significant amount of time to put procedures in place to comply with the capital requirements, the capital requirements should not become effective until the latest of (i) the date after which all initial margin requirements have become fully effective, (ii) three years from the date that the capital requirements are adopted, or (iii) three months from the date that the Commission or its delegate has certified that all provisionally approved CFTC Capital SDs have been given a reasonable opportunity for model approval.

If the capital requirements are implemented prior to the effective date of all initial margin requirements, SDs will be subject to massive capital requirements for "failing" to collect margin that they have no ability (or legal requirement) to require from counterparties. Imposing capital requirements in front of margin requirements effectively undoes the schedule for collecting initial margin that the Commission has promulgated and on which firms had relied. Therefore, the capital requirements should not come into effect until all SDs are required to collect initial margin.

Further, with regards to our suggestion that the Commission implement the requirements three years after they are adopted, SIFMA believes that the operational complexities associated with revamping systems will require firms to spend a considerable amount of time preparing to comply. The Standardized Grid Charges are too complex to manually calculate. Firms may be required to switch platforms and vendors in order to implement them and the industry will need time to upgrade its financial technology. Moreover, while the data required to calculate capital requirements using the Standardized Grid Charges are available within a firm, those data are typically available in risk systems, not the finance systems typically involved in capital calculations. Firms required to use the Standardized Grid Charges would be forced to build or purchase a system to calculate the grid-based capital charges. Currently, there are no systems that calculate charges in this manner and it will likely take a significant amount of time to build, test and deploy such a system, with one member estimating a cost of $2.5-2.7 million.

Member firms have also communicated that it has taken up to three years to have their internal models approved. By allowing the industry and itself a three-year gap between the adoption and the implementation of the capital rules, the Commission will allow firms to adequately assess their best courses of action (*i.e.*, whether it be to use the standardized grid charges (permanently or temporarily) or to build and submit capital models), while simultaneously allowing itself and the NFA the it needs to approve capital models. Ultimately, firms will not know what is required until the final rule is adopted, the extensiveness of procedural modifications and length of time needed to make such modifications will largely depend on what is asked by the Commission. It is very possible that a financial entity may be required to reorganize its swap dealing entities, transfer its positions and make other operational adjustments. A three-year phase-in period would allow firms to properly gauge how to comply efficiently rather than hastily, and will lower the costs for SDs and ultimately end-users.

With regards to our request that the Commission implement the capital requirements three months after the date that all CFTC Capital SDs have been given a reasonable opportunity

to have its models approved. SIFMA believes that the serious implications associated with using the Standardized Grid Charges will force SDs to use capital models in order to remain competitive. If the Commission wishes to not disrupt the markets, it will indeed allow all SDs the opportunity to have their models approved prior to the capital rules going into effect.

V. Regulatory, Market and Operational Context.

In considering the recommendations that we have put forth above, and that are further elaborated in the Appendices to this letter, SIFMA believes that the Commission should be mindful of the regulatory and market developments that have occurred since Dodd-Frank was first adopted. While Dodd-Frank has reduced certain risks (as briefly set out in part V.A.), it may have also had some negative market impacts (as briefly set out in part V.B.). SIFMA, the Financial Stability Board and other commercial and academic institutions have also performed detailed analyses regarding the impacts of recent regulation, many of which reveal that impacts have been both positive and negative.[51] Given that the Presidential Executive Order on Core Principles for Regulating the United States Financial System specifically calls for regulators to "make regulation efficient, effective, and appropriately tailored,"[52] we ask that the Commission be mindful of the cost and competitive impact of these rules, and their effect on both SDs and on their clients. Capital charges imposed on transactions are borne in large part by customers, who either are willing to share in these costs or who are not able to hedge their commercial exposures.

A. Adopted Dodd-Frank Regulations Have Materially Decreased Risk.

Since the adoption by Congress of Dodd-Frank, the financial regulators in general, and the Commission in particular, have implemented significant market-protection requirements that materially reduce the amount of risk that SDs or FCMs may assume thereby reducing the amount of exposure that SDs or FCMs may pose to their counterparties or to the financial markets. Among the most significant of the new regulations that have been put into place subsequent to the adoption of Dodd-Frank are the following:

(a) Additional Commission requirements with respect to custody of customer assets by FCMs, which requirements bar an FCM from using the collateral posted by one customer to benefit another customer and enhancing the ability to transfer collateral if necessary;[53]

---

[51] *See, e.g.*, Pennsylvania + Wall, *Facts and Studies: Understanding the Impact of Regulation on Economic Growth* (Oct. 3, 2016); http://www.sifma.org/blog/facts-and-studies-understanding-impact-of-regulation-on-economic-growth/ Financial Stability Board; PROPOSED FRAMEWORK FOR POST-IMPLEMENTATION EVALUATION OF THE EFFECTS OF THE G20 FINANCIAL REGULATORY REFORMS: CONSULTATION DOCUMENT ON MAIN ELEMENTS (Apr. 11, 2017), http://www.fsb.org/wp-content/uploads/Framework-for-the-post-implementation-evaluation-of-the-G20-financial-regulatory-reforms.pdf; and Laurin C. Ariail, The Impact of Dodd-Frank on End-Users hedging Commercial Risk in Over-the Counter Derivatives Markets, 15 N.C. BANKING INST. 175 (2011).

[52] Exec. Order No. 13772, *Principles for Regulating the United States Financial System* 82 Fed. Reg. 9,965 (2017).

[53] *See* Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 Fed. Reg. 6,336 (Feb. 7, 2012).

(b) A mandate that clearing houses collect initial margin from clearing member FCMs and SDs on a gross rather than net basis;

(c) Enhanced reporting and disclosure requirements;

(d) Mandatory central clearing of the most broadly-traded swaps;

(e) The adoption, and pending implementation, of the mandatory collection and posting of margin with respect to swaps;

(f) The requirement that Commission registrants adopt and comply with internal risk management procedures; and

(g) New restrictions on the types of investments that FCMs or clearing houses can make with customer funds under CFTC Rule 1.25.[54]

In addition to the above new Commission requirements, the NFA in 2012 imposed extensive new financial duties upon FCMs to protect customer funds in both domestic and foreign accounts, including enhanced reporting, supervision, and custody requirements. Following this rollout, the Commission in 2013 imposed even more obligations on FCMs to maintain adequate capital and enhance protections of funds in their customer accounts.[55]

These new rules, taken together, incorporate and build upon the rules previously adopted by the Commission and NFA and help ensure that customers do not bear the credit risk of either their FCM or customers.

B. Adopted Dodd-Frank Regulations Have Had Some Negative Market Impacts.

While the adoption of Dodd-Frank regulations has decreased risk in the financial system, it should also be acknowledged that the cost and operational difficulties of all these regulations have caused (or at least been correlated with) a number of negative market developments. These negative developments include the following:

(a) A significant reduction in the number of Commission-registered FCMs (the number has fallen by more than half over the last several years), leading to diminished competition for client business and diminished industry capacity to take on business;[56]

---

[54] *See* Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions, 76 Fed. Reg. 78,776 (Dec. 19, 2011).

[55] *See* Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 Fed. Reg. 68,506 (Nov. 14, 2013).

[56] *See* Statement of CFTC Acting Chairman Giancarlo before the Market Risk Advisory Committee (June 1, 2015) ("[T]here are far fewer FCMs than there used to be. The number of FCMs has dramatically fallen in the past 40 years: from over 400 in the late 1970s, to 154 before the 2008 financial crisis and down to just 72 today."). According to the most recent Selected Financial Data published by the Commission, the number of FCMs has since further declined from 72 to 63. CFTC, Selected FCM Financial Data As Of March 26, 2017, *available at* http://www.cftc.gov/idc/groups/public/@financialdataforfcms/documents/file/fcmdata0217.pdf.

(b) Fewer swap dealing entities electing to go above the *de minimis* level of swaps dealing activity and register with the Commission than expected, leading to the same negative results as mentioned in (a) above;[57] and

(c) Apparent reductions in market liquidity in certain products and an apparent increase in the number of market breaks in certain products.[58]

Increased regulatory costs imposed on market intermediaries result in either those costs being passed on to commercial market participants or with the withdrawal from customers facing activities of the market intermediaries who are unable to cover their costs. This concern has been communicated to the Commission by commercial end users, including the National Corn Growers Association ("**NCGA**") and the Natural Gas Supply Association ("**NGSA**") in a 2012 comment, as well as the Air Transport Association ("**ATA**") in a 2011 comment.[59] The NCGA, NGSA and the ATA all described how the then-proposed capital requirements calculation would raise the cost of commercial market participants' swap transactions as a result of (i) higher swap prices passed on from SDs and (ii) a reduction in the number of market intermediaries willing to enter into hedging transactions.[60] All of the negative consequences that were anticipated by these commercial users appear to be coming to pass.

SIFMA also observes that SDs, and perhaps FCMs even more, have been hit by increased costs resulting from the actions of regulators other than the Commission itself. For example, both Acting Chair Giancarlo and former Chair Massad have commented that the "Supplementary Leverage Ratio",[61] as imposed with respect to cleared swaps, imposes significant and unnecessary costs on FCMs and SDs, reducing participation in the cleared markets and raising costs to investors.

---

[57] The Commission in the Proposal likewise recognized this issue, commenting that it was making the TNW Approach available in light of the fact that a "standardized capital requirement may also impose significant disincentives for certain SDs to remain in the market . . . which would concentrate dealing in a smaller number of firms." 81 Fed. Reg. at 91,256.

[58] *See* Statement from now-Acting Chairman Christopher Giancarlo: Reconsidering the CFTC's Swaps Trading Rules for Greater Effectiveness in the Global Economy (Nov. 12, 2014) (stating that "[T]he CFTC's swaps trading framework is the cause of abrupt fragmentation of global swaps markets between U.S. persons and non-U.S. persons. This has led to smaller, disconnected liquidity pools and less efficient and more volatile pricing and shallower liquidity, posing a significant risk of failure in times of economic stress or crisis. This market fragmentation is increasing the systemic risk that the Dodd-Frank regulatory reform was predicated on reducing."); *See also* Statement of Acting Chairman Christopher Giancarlo, *Changing Swaps Trading Liquidity, Market Fragmentation and Regulatory Comity in Post-Reform Global Swaps Markets* (May 10, 2017) (stating that "since the financial crisis of 2008 and the Dodd-Frank Act of 2010, markets have signaled warnings that liquidity has been significantly curtailed.).

[59] NCGA and NGSA comment letter on capital Requirements of SDs and MSPs (Jan. 12, 2012).

[60] *Id.*

[61] *See, e.g.,* 12 C.F.R. Part 252. (Enhanced Prudential Standards).

C. Operational Complexity of Computing Capital Requirements Argues for the Adoption of Consistent Capital Regulatory Frameworks.

There are few regulatory requirements that are as operationally complex as the computation of capital. SDs are required to take account of every pre-existing position, each newly entered or terminated position, a myriad of market events and changes in market prices with regard to both liquid and illiquid assets. SDs are also required to account for developments with respect to their counterparties, including deliveries (or failures to deliver) of margin or changes in their creditworthiness. All of these developments must then be run through various calculations, whether standardized or models-based.

Given the difficulties of this process, it is highly desirable that firms be able to operate pursuant to a single set of regulatory requirements. Leaving aside the costs and the operational complexities, there simply seems to be no reason for a firm to run multiple sets of models on the same sets of transactions, one for the Commission, one for the SEC, another for the Prudential Regulators and, in the case of non-U.S. firms, another for home country regulators. Firms need to have a single method of computing regulatory capital requirements.

Of course, this does not preclude firms from being subject to more than one regulatory authority. But it is essential for regulators to work in concert. In fact, perhaps the best example of this is the Commission's capital requirements applicable to FCMs that are dually registered with the SEC as broker-dealers, where the Commission accepts as the foundation to its requirements the SEC's capital requirements and supplements those with requirements applicable to the products and transactions primarily regulated by the CFTC. Perhaps even more on point, with respect to SDs that are foreign banks potentially subject to capital regulation by the Prudential Regulators, the Prudential Regulators have deferred wholly to the home country capital regulator of a foreign bank where the home country regulator is Basel-compliant. Dual, or triple, regulation leaves nonbank SDs particularly vulnerable to the risk that regulators may adopt inconsistent written regulations or informal interpretations and approaches. Given that a firm would need to develop and maintain multiple overlapping risk, liquidity, capital computation and recordkeeping systems, the costs and operational complexities of which would be substantial, any inconsistency in requirements may potentially create significant practical issues and costs. Inconsistent or duplicative capital requirements could result in competitive inequalities as nonbank SDs would bear costs from which bank SDs were exempt, and would undermine effective group-wide risk management. Imposing further costs could diminish the ability of medium-sized firms to compete and the ability of all SDs to provide commercially useful services.

* * * *

We appreciate the Commission's consideration of our comments on the Proposal. As it considers our comments and those of others, we emphasize the extent to which it is critical for the Commission to work closely with the SEC, the Prudential Regulators and relevant Qualifying Foreign Regulators so that each regulated SD is subject to only one set of capital requirements.

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 Mary Kay Scucci, the undersigned, or

Steven Lofchie (212-504-6700) of Cadwalader, Wickersham & Taft LLP, outside counsel to SIFMA in this matter, if you should have any questions with regard to the foregoing.

Respectfully submitted,

Mary Kay Scucci, Ph.D., CPA
Managing Director
SIFMA

cc:
Commission:

Acting Chairman: Christopher Giancarlo
Commissioner: Sharon Bowen
Director: Eileen Flaherty
Deputy Director: Thomas Smith

SEC:

Chairman: Jay Clayton
Commissioner: Michael Piwowar
Commissioner: Kara M. Stein

Financial Stability Oversight Council:

Treasury Department

Secretary of the Treasury: Steven T. Mnuchin
Counselor: Craig Phillips

Board of Governors of the Federal Reserve System

Vice Chairman of Supervision

Appendix A

Section 23.102 Calculation of market risk exposure requirement and credit risk exposure requirement using internal models.

(a) A swap dealer may apply to the Commission, or to a registered futures association of which the swap dealer is a member, for approval to use internal models under terms and conditions required by the Commission and by these regulations, or under the terms and conditions required by the registered futures association of which the swap dealer is a member, when calculating the swap dealer's market risk exposure and credit risk exposure under Section 23.101(a)(1)(i)(B), (a)(1)(ii)(A), or (a)(2)(ii)(A). For the avoidance of doubt, a swap dealer may seek and obtain Commission approval of either or both of internal market risk models and internal credit risk models.

(b) The swap dealer's application to use internal models to compute market risk exposure and credit risk exposure must be in writing and must be filed with the Commission and with the registered futures association of which the swap dealer is a member. The swap dealer must file the application in accordance with instructions established by the Commission and the registered futures association.

(c) A swap dealer's application must include the following:

(1) In the case of a swap dealer subject to the minimum capital requirements in Section 23.101(a)(1)(i) applying to use internal models to compute market risk exposure, the information required under 12 C.F.R. § 217 Subpart F, as if the swap dealer were a bank holding company subject to 12 CFR part 217.

(2) In the case of a swap dealer subject to the minimum capital requirements in Section 23.101(a)(1)(i) applying to use internal models to compute credit risk exposure, the information required under 12 C.F.R. § 217 Subpart E, sections 131-155, as if the swap dealer were a bank holding company subject to 12 CFR part 217.

(3) In the case of a swap dealer subject to the minimum capital requirements in Section 23.101(a)(1)(ii), the information set forth in Appendix A of this section.

(d) The Commission or the registered futures association may approve or deny the application, or approve an amendment to the application, in whole or in part, subject to any conditions or limitations the Commission or registered futures association may require, if the Commission or registered futures association finds the approval to be appropriate in the public interest, after determining, among other things, whether the applicant has met the requirements of this section, and the appendices to this section. A swap dealer that has received Commission or registered futures association approval to compute market risk exposure requirements and credit risk exposure requirements pursuant to internal models must compute such charges in accordance with ~~Appendix A~~12 C.F.R. § 217 Subpart F, 12 C.F.R. § 217 Subpart E, sections 131-155 or Appendix A of this section, as applicable per paragraph (c) of this section.

(e) A swap dealer subject to the minimum capital requirements in Section 23.101(a)(1) may use an internal credit risk or an internal market risk capital model without the prior written approval of the Commission or a registered futures association if:

(1) The relevant model has been approved and currently is in use, either by the relevant swap dealer or by an affiliated entity, under the supervision of the Securities and Exchange Commission, a prudential regulator or a foreign regulatory authority whose capital adequacy requirements are consistent with the Basel-based capital requirements for banking institutions;

(2) The swap dealer has made available to the Commission any copies of underlying documentation, including regulatory approvals, evidencing review, approval and supervision of the internal capital models, to the extent permitted by applicable law;

(3) In the case of a model approved by a foreign regulatory authority, the swap dealer has submitted to the Commission:

(i) A description of the objectives of the relevant foreign jurisdiction's capital adequacy requirements;

(ii) A description (including specific legal and regulatory provisions) of how the relevant foreign jurisdiction's capital adequacy requirements address the elements of the Commission's capital adequacy requirements for swap dealers, including, at a minimum, the methodologies for establishing and calculating capital adequacy requirements; and

(iii) A description of the ability of the relevant foreign regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's capital adequacy requirements. Such description should discuss the powers of the foreign regulatory authority or authorities to supervise, investigate, and discipline entities for compliance with capital adequacy requirements, and the ongoing efforts of the regulatory authority or authorities to detect and deter violations, and ensure compliance with capital adequacy requirements. The description should address how foreign authorities and foreign laws and regulations address situations where an entity is unable to comply with the foreign jurisdiction's capital adequacy requirements.

(f) A swap dealer must cease using internal models to compute its market risk exposure requirement and credit risk exposure requirement, upon the occurrence of any of the following:

(1) The swap dealer has materially changed a mathematical model described in the application or materially changed its internal risk management control system without first submitting amendments identifying such changes and obtaining the approval of the Commission or the registered futures association for such changes, or in the case of models approved under paragraph (e) of this section, without submitting proof of such approval received from the applicable supervising regulator;

(2) The Commission or the registered futures association of which the swap dealer is a member determines that the internal models are no longer sufficient, or in the case of a model approved under paragraph (e) of this section, are not sufficient, for purposes of the capital calculations of the swap dealer as a result of changes in the operations of the swap dealer;

(3) The swap dealer fails to come into compliance with its requirements under this section, after having received from the Director of the Commission's Division of Swap Dealer and Intermediary Oversight, or from the registered futures association of which the swap dealer is a member, written notification that the swap dealer is not in compliance with its requirements, and must come into compliance by a date specified in the notice; or

(4) The Commission by written order finds that permitting the swap dealer to continue to use the internal models is no longer appropriate.

Appendix B

Questionnaire: SIFMA Responses to Specific Questions Raised in the Proposal

(1) *Is the proposed $20 million fixed amount of minimum tier 1 capital appropriate? If not, explain why not. If the minimum fixed-dollar amount should be set at a level greater or lesser than $20 million, explain what that greater or less amount should be and explain why that is a more appropriate amount. [Request for Comment, Proposal at 91260, Question 1]*

SIFMA believes that the $20 million minimum tier 1 capital requirement under the RWA Approach is reasonable. Given the regulatory expenses and requirements of operating as a registered SD, it would not be practicable for a firm to operate with a lower of level capital.

(2) *Is the proposed minimum capital requirement based upon an SD's common equity tier 1 capital appropriate? If not, explain why, and suggest what modifications the Commission should make to the regulation. For example, should the proposal include tier 1 capital other than common equity tier 1 capital? Are there specific elements of tier 1 capital that the Commission should include in addition to common equity tier 1 capital? Are there specific elements of tier 2 capital that the Commission should include in the regulation? [Request for Comment, Proposal at 91260, Question 2]*

The capital requirements proposed by the Commission on SDs using the "RWA Approach" are not consistent with, and are well in excess of, the capital requirements adopted by the U.S. Prudential Regulators. Please see sections III, IV.E and IV.G of the letter.

(3) *Is the proposed minimum capital requirement based upon eight percent of the SD's risk weighted assets appropriate? If not, explain why not. Is the proposed requirement that the SD*

add to its risk-weighted assets market risk capital charges computed in accordance with Regulation 1.17 if the SD has not obtained the approval of the Commission or of an RFA to use internal models appropriate? Are there other options to compute market risk charges when models are not approved? Should the 8 percent be set at a higher or lower level? If so, what percent should the Commission consider? [Request for Comment, Proposal at 91260, Question 3]

> See our answer above. In addition, SIFMA does not believe that a firm subject to the standardized charges will be able to continue acting as an SD, at least to any material extent. Please see section IV.D of the letter.

(4) *Is the proposed minimum capital requirement based upon eight percent of the margin required on the SD's cleared and uncleared swaps and security-based swaps, and the margin required on the SD's futures and foreign futures appropriate? If not, explain why not. Should the percentage be set at a higher or lower level? Please explain your response. Is including in the computation margin for swaps and security-based swaps that are exempt or excluded from the uncleared margin requirements (e.g., legacy swaps and security-based swaps, and swaps with commercial end users) appropriate? If not, explain why these uncollateralized exposures do not result in risk to the SD without capital to address that risk. [Request for Comment, Proposal at 91260, Question 4]*

> The use of the 8% multiplier does not have an empirical basis and inappropriately aggregates the risks from individual customers. Please see section IV.D of the letter.

(5) *Commodity Exchange Act section 4s(e)(3)(A) only cites the risk of uncleared swaps in setting standards for capital. Additionally, in the Commission's final swap dealer definition rule, it said it will "in connection with promulgation of final rules relating to capital requirements for*

swap dealers and major swap participants, consider institution of reduced capital requirements for entities or individuals that fall within the swap dealer definition and that execute swaps only on exchanges, using only proprietary funds."?[46] Given these pronouncements, should the Commission exclude cleared swaps from the capital calculation requirements? [Request for Comment, Proposal at 91260, Question 5]

The Commission should not impose credit risk charges on cleared swaps and cleared security-based swaps. Further, proprietary swaps should not be included in the Commission's capital charges that are based on "theoretical initial margin amounts." Please see sections III, IV.A and IV.D of the letter.

(6) *In addition to swaps, the proposal includes security-based swaps, futures, and foreign futures in the capital calculation requirements. The SEC's capital proposal only included security-based swaps. Given the statements above in question 5 and the narrower scope of the SEC's proposal, should the Commission limit its capital calculation requirements to uncleared swaps only? [Request for Comment, Proposal at 91260, Question 6]*

SIFMA understands and acknowledges that any system of capital calculation must ultimately take account of all of the risks to which an entity will be exposed, including—in some circumstances—risks arising from instruments for which the Commission is not the primary regulator. That said, it is likewise important that regulated entities not be subject to differing requirements as to the same instrument. Therefore, to the extent that an SD is regulated by both the Commission and the SEC, we think it essential that the Commission defer to the SEC as to the charges imposed on "securities" primarily regulated by the SEC. We would likewise expect that the SEC would defer to the

Commission as to the charges on positions that are directly subject to the Commission's regulations.

This need for regulatory harmony emphasizes the importance of the Commission and the SEC acting jointly in issuing a common set of capital requirements applicable to firms that both of them regulate. This need for regulatory coordination particularly arises with respect to the need for the Commission to recognize models that have been approved by other regulators, as is discussed in the below questions.

Please see section I of the letter.

(7) *If the swap dealer de minimis level falls to $3 billion, what impact would the proposed capital rule have on any new potential registrants? Please provide any quantitative estimates. [Request for Comment, Proposal at 91260, Question 7]*

The costs of operating a firm subject to the SD registration and regulation scheme are extremely high. In the view of various SIFMA members, it would not be financially viable for firms to subject themselves to SD costs unless their annual level of business were substantially above the current $8 billion *de minimis* level. The impossibility of firms competing as registered SDs without developing market risk and credit models, and receiving regulatory approval for those models, which would add another very significant expense, further emphasizes how unlikely it is that any small SD could operate profitably under the Commission's regulatory scheme. Accordingly, we expect that lowering the *de minimis* level would likely cause smaller firms either to further reduce the volume of their swap dealing activities or to stop the activity completely.

That said, the Commission conducted a study of the *de minimis* level, so we believe that the Commission is in a better position than the industry to assess whether

small firms could bear the costs of registration. If the Commission wishes, SIFMA would be more than willing to collaborate in order to determine the appropriate *de minimis* level.

(8) *Is the proposed minimum $20 million fixed-dollar amount of net capital appropriate for SDs that elect a net liquid assets capital approach? If not, explain why not. If the minimum fixed-dollar amount should be set at a level greater or lesser than $20 million, explain what that amount should be and why that is a more appropriate amount. [Request for Comment, Proposal at 91262, Question 1]*

SIFMA believes that the $20 million capital requirement set under the LAC Approach is reasonable. Given the regulatory expenses and requirements of operating as a registered SD, it would not be practicable for a firm to operate with a lower level of capital.

(9) *Is the proposed minimum $100 million fixed dollar amount of tentative net capital appropriate for SDs that use market risk and credit risk models approved by the Commission or by an RFA? If not, explain why not. If the minimum fixed-dollar amount should be set at a level greater or lesser than $100 million, explain what that amount should be and explain why that is more appropriate. [Request for Comment, Proposal at 91262, Question 2]*

The proposed minimum $100 million fixed dollar amount of tentative net capital is higher than the requirement imposed on firms using models under the RWA Approach.

(10) *Is the proposed minimum capital requirement based upon eight percent of the margin required on the SD's cleared and uncleared swaps and security-based swaps, and the margin required on the SD's futures and foreign futures appropriate? If not, explain why not. Should the percentage be set at a higher or lower level? Is so, what percent should the Commission*

consider? Please explain your response. Is including in the computation margin for swaps and security-based swaps that are exempt or excluded from the uncleared margin requirements (e.g., legacy swaps and security-based swaps, and swaps with commercial end users) appropriate? If not, explain why these uncollateralized exposures would not result in an SD that is not adequately capitalized. [Request for Comment, Proposal at 91262, Question 3]

The use of the 8% multiplier does not have an empirical basis and inappropriately aggregates the risks from individual customers. Please see section IV.D of the letter.

(11) *Is the proposed requirement for an SD to compute its capital in accordance with the SEC proposed capital rules for stand-alone SBSDs (i.e., SEC proposed Rule 18a-1) appropriate? If not, explain why not. What other alternatives approaches should the Commission consider? [Request for Comment, Proposal at 91262, Question 4]*

We think that it is both appropriate and necessary for the Commission and the SEC to provide for a single set of capital requirements applicable to firms that are going to be subject to both sets of regulations. SIFMA commented extensively on the revisions that we believed were necessary to make the SEC's proposal workable. Please see sections I, II, III and IV of the letter.

(12) *Is the proposal to allow SDs to recognize as current assets margin funds deposited with third-party custodians as margin for uncleared swaps or security-based swaps in accordance with the Commission's margin rules or the SEC's proposed margin rules appropriate? If not, explain why not. [Request for Comment, Proposal at 91262, Question 5]*

SIFMA appreciates the Commission's recognition of the value of collateral held by appropriate third-party custodians and pledged to the SD. As a legal matter, SDs will have full access to this collateral, just as if they held it directly. Further, as a practical

matter, U.S. SDs will be put at a tremendous competitive disadvantage if they were required to hold collateral directly, but non-U.S. SDs would not be.

(13) *Are there other adjustments to the SEC's proposed capital rules for SBSDs that the Commission should consider in adopting such requirements for SDs that elect the net liquid asset capital approach? Is so, explain such adjustments and why the Commission should consider such adjustments. [Request for Comment, Proposal at 91262, Question 6]*

We do not believe that a firm not approved to use models will be able to compete. Please see sections I, II, III and IV of the letter.

(14) *If the swap dealer de minimis level falls to $3 billion, what impact would the capital rule have on any new potential registrants? Please provide any quantitative estimates. [Request for Comment, Proposal at 91262-63, Question 7]*

The costs of operating a firm subject to the SD registration and regulation scheme are extremely high. In the view of various SIFMA members, it would not be financially viable for firms to subject themselves to SD costs unless their annual level of business were substantially above the current $8 billion *de minimis* level. The impossibility of firms competing as registered SDs without developing market risk and credit models, and receiving regulatory approval for those models, which would add another very significant expense, further emphasizes how unlikely it is that any small SD could operate profitably under the Commission's regulatory scheme. Accordingly, we expect that lowering the *de minimis* level would likely cause smaller firms either to further reduce the volume of their swap dealing activities or to stop the activity completely.

That said, the Commission conducted a study of the *de minimis* level, so we believe that the Commission is in a better position than the industry to assess whether small firms could bear the costs of registration. If the Commission wishes, SIFMA would be more than willing to collaborate in order to determine the appropriate *de minimis* level.

(15) *Is the proposed minimum net capital requirement of $20 million plus the amount of the SD's market risk and credit risk charges for its dealing swaps appropriate for SDs that are eligible and elect the tangible net worth net capital approach? If not, explain why not. If the minimum dollar amount should be set at a level greater or lesser than $20 million, explain what that amount should be and explain why that is more appropriate. [Request for Comment, Proposal at 91264, Question 1]*

The Tangible Net Worth Approach is not applicable to the majority of SIFMA firms; therefore, SIFMA has not commented on this aspect of the proposal.

(16) *Should the market risk and credit risk associated with the SD's security-based swap positions be added to the market risk and credit risk associated with the SD's swap positions in setting the minimum capital requirement under proposed Regulation 23.101(a)(2)(A)? Explain why or why not such security-based swap positions should or should not be included in the minimum capital requirement. Provide any empirical data to support your analysis. [Request for Comment, Proposal at 91264, Question 2]*

Please see our response to question 15 above.

(17) *Is the proposed minimum capital requirement based upon eight percent of the margin required on the SD's cleared and uncleared swaps and security-based swaps, and the margin required on the SD's futures and foreign futures appropriate? If not, explain why not. Should the*

percentage be set at a higher or lower level? Please explain your response. Is including in the computation margin for swaps and security-based swaps that are exempt or excluded from the uncleared margin requirements (e.g., legacy swaps and security-based swaps, and swaps with commercial end users) appropriate? If not, explain why these uncollateralized exposures would not result in an SD that is not adequately capitalized. [Request for Comment, Proposal at 91264, Question 3]

Please see our response to question 15 above.

(18) *Is the Commission's proposed 15% revenue test and 15% asset test appropriate for determining whether an SD is predominantly engaged in non-financial activities? If not, explain why not. What other alternatives should the Commission consider? If the approach is appropriate, should the Commission consider raising or lowering the percentages in the 15% revenue test and the 15% asset test? [Request for Comment, Proposal at 91264, Question 4]*

Please see our response to question 15 above.

(19) *Is the Commission's proposed reference to the definition of the term "financial activities" in Rule 242.3 of the Federal Reserve Board (12 CFR 242.3) to define whether an SD's activities are "financial activities" for purposes of computing the 15% revenue test and 15% asset test appropriate? If not, explain why not. Provide other alternatives that the Commission should consider. [Request for Comment, Proposal at 91264, Question 5]*

Please see our response to question 15 above.

(20) *Is the Commission's adjustment in the application of Rule 242.3 to permit SDs to exclude receivables resulting from non-financial activities from the term "financial activities" in computing the 15% revenue and 15% asset tests appropriate? If not, explain why not. Are there other adjustments that the Commission should consider in the application of the 15% revenue*

and 15% asset tests? If yes, explain what those adjustments are and why it is appropriate for the Commission to make such adjustments. [Request for Comment, Proposal at 91264, Question 6]

Please see our response to question 15 above.

(21) *Is a tangible net worth test an appropriate standard for MSPs? If not, explain why not. Would the net liquid assets approach or bank-based capital approach be a more appropriate method for establishing capital requirements for MSPs? If so, please state which approach is more appropriate and describe the rationale for such approach. What other capital approaches should the Commission consider for MSPs? [Request for Comment, Proposal at 91265, Question 1]*

As mentioned in the Proposal, there are currently no MSPs in the swap dealing market.[62] We think it unlikely that any firm would conduct its business in a way that would subject it to the regulatory costs and operational difficulties associated with registering as an MSP, regardless of the details of the capital requirements. Therefore, we do not address questions regarding the MSP regulatory requirements.

(22) *Should the proposed minimum capital requirement for MSPs include a minimum fixed-dollar amount of tangible net worth, for example, equal to $20 million or some greater or lesser amount? Is so, explain the merits of imposing a fixed-dollar amount and identify the recommended fixed-dollar amount. [Request for Comment, Proposal at 91265, Question 2]*

Please see our response to question 21 above.

(23) *Should proposed Regulation 23.101(b) require an MSP to maintain positive tangible net worth in an amount in excess of the market risk and credit risk charges on the MSP's swaps and security-based swap positions? If so, please explain why. Should any other adjustments be made*

---

[62] 81 Fed. Reg. 91252, 91288 (Dec. 16, 2016).

to the MSP's minimum capital requirement? If so, please explain why. [Request for Comment, Proposal at 91265, Question 3]

Please see our response to question 21 above.

(24) *Is the proposed minimum adjusted net capital requirement of $20 million appropriate for an FCM that is dually-registered as an SD? If not, explain why not. If the minimum dollar amount should be set at a level greater or lesser than $20 million, explain what that greater or lesser amount should be and explain why that is a more appropriate amount. [Request for Comment, Proposal at 91269, Question 1]*

SIFMA believes that the $20 million capital requirement is reasonable. Given the regulatory expenses and requirements of operating as a registered SD, it would not be practicable for a firm to operate with a lower level of capital.

(25) *Is the proposed minimum net capital requirement of $100 million appropriate for an FCM that is dually-registered as an SD, and has been approved to use internal models to compute market risk and credit risk? If not, explain why not. If the minimum dollar amount should be set at a level greater or lesser than $100 million, explain what that greater or lesser amount should be and explain why that is a more appropriate amount. [Request for Comment, Proposal at 91269, Question 2]*

The proposed minimum $100 million fixed dollar amount of tentative net capital is higher than the requirement imposed on firms using models under the RWA Approach.

(26) *The proposal's minimum capital requirement based on 8% of margin, includes swaps exempt or excluded from the CFTC's margin requirements, such as inter-affiliate swaps. Please provide comment on the breadth of the definition. Should the scope be narrowed? If so, how? [Request for Comment, Proposal at 91269, Question 3]*

The use of the 8% multiplier does not have an empirical basis and inappropriately aggregates the risks from individual customers. Furthermore, inter-affiliate swaps should be excluded from the calculations. Please see section IV.D of the letter.

(27) *Should the 8 percent of margin capital requirement be set at a higher or lower level? If it should be adjusted, what percent should the Commission consider? Please provide analysis in support of the adjustment. [Request for Comment, Proposal at 91269, Question 4]*

Please see section IV.D of the letter.

(28) *Do the proposed models appropriately account for the market and credit risk of swaps and security-based swaps? If not, explain why and provide alternatives that the Commission should consider. [Request for Comment, Proposal at 91272, Question 1]*

Please see sections III and IV.B of the letter.

(29) *Is the proposed model review process appropriate? If not, explain why not and provide alternatives that the Commission should consider. [Request for Comment, Proposal at 91272, Question 2]*

Please see sections III and IV.B of the letter and Appendix A attached thereto.

(30) *The proposal states that the Commission expects that a prudential regulator's or foreign regulator's review and approval of capital models that are used in the corporate family of an SD would be a significant factor in NFA determining the scope of its review, provided that appropriate information sharing agreements are in place. Given the number and complexity of the model review process, please provide comments on the viability of the proposed model review process? What other alternatives should the Commission consider? [Request for Comment, Proposal at 91272, Question 3]*

SIFMA believes that the Commission should give automatic approval to models approved by a Prudential Regulator, by the SEC or by a Qualifying Foreign Regulator. Please see section IV.B of the letter and Appendix A attached thereto.

(31) *Should the Commission provide for automatic approval or temporary approval of capital models already approved by a prudential or foreign regulator? If so, please provide information regarding on what conditions such models should be approved? [Request for Comment, Proposal at 91273, Question 4]*

The Commission should automatically approve models that have been approved by a Prudential Regulator, by the SEC or by a Qualifying Foreign Regulator. Please see section IV.B of the letter and Appendix A attached thereto.

(32) *What factors should the Commission consider in setting an effective date for the capital rules given the application process and the model approval process? Are most SDs that would be subject to the rule already using models that are consistent with the proposed regulations? [Request for Comment, Proposal at 91273, Question 5]*

Please see sections III, IV.B and IV.K of the letter.

(33) *Are there other approaches available to facilitate the timely review of applications from SDs to use internal models? For example, could a more limited review be performed of models that have been approved by another regulator? If so, what conditions, if any, should the Commission consider prior to approving the model? [Request for Comment, Proposal at 91273, Question 6]*

The Commission should automatically approve models that have been approved by a Prudential Regulator, by the SEC or by a Qualifying Foreign Regulator. Please see sections III and IV.B of the letter and Appendix A attached thereto.

(34) *How much implementation time is needed for the Commission's proposed model review and approval process? [Request for Comment, Proposal at 91273, Question 7]*

There remain numerous firms that will require model approval and all of these firms must have the opportunity to have their models approved before the capital requirements become effective. Please see sections III, IV.B and IV.K of the letter.

(35) *Are the proposed methods of computing the credit risk charge appropriate for nonbank SDs? If not, explain why not. For example, are there differences between FCM/BDs that are also SDs and standalone SDs that would make the method of computing the credit risk charge appropriate for the former but not the latter. If so, identify the differences and explain why they would make the credit risk charge not appropriate for nonbank SDs. What modifications should be made in that case? [Request for Comment, Proposal at 91273, Question 8]*

Please see sections I and IV.A of the letter.

(36) *Is the method of computing the counterparty exposure charge appropriate for nonbank SDs? If not, explain why not. For example, is the calculation of the credit equivalent amount (i.e., the sum of the MPE and the current exposure to the counterparty) a workable requirement for nonbank SDs? If not, explain why not. [Request for Comment, Proposal at 91273, Question 9]*

Please see sections I and IV.A of the letter.

(37) *Are the conditions for taking collateral into account when calculating the credit equivalent amount appropriate for nonbank SDs? If not, explain why not. [Request for Comment, Proposal at 91273, Question 10]*

SIFMA believes that the conditions imposed by the Commission are appropriate.

(38) *Are the conditions for taking netting agreements into account when calculating the credit equivalent amount appropriate for nonbank SDs? If not, explain why not. [Request for Comment, Proposal at 91273, Question 11]*

SIFMA believes that the conditions imposed by the Commission are appropriate. Please see Appendix C attached to the letter.

(39) *Are the standardized risk weight factors (20%, 50%, and 150%) proposed for calculating the credit equivalent amount appropriate for nonbank SDs? If not, explain why not. [Request for Comment, Proposal at 91273, Question 12]*

Please see sections I and IV. A of the letter.

(40) *Is the method of computing the counterparty concentration charge appropriate for nonbank SDs? If not, explain why not. [Request for Comment, Proposal at 91273, Question 13]*

Please see sections I and IV. A of the letter.

(41) *Is the method of computing the portfolio concentration charge appropriate for SDs? If not, explain why not. [Request for Comment, Proposal at 91273, Question 14]*

Please see sections I and IV. A of the letter.

(42) *Should the Commission phase-in the implementation of any final capital rule? For example, the capital requirements would be implemented first and the liquidity requirements would be implemented second. Please provide recommendations and implementation time-periods. [Request for Comment, Proposal at 91275, Question 1]*

Yes, firms will require a significant amount of time to put in place procedures to comply with capital requirements. Early implementation of these requirements will force SDs to exit registration. Please see sections III, IV.B and IV.K of the letter.

(43) *Should the Commission consider alternative approaches to the proposed liquidity requirements? If so, explain the alternatives and the rationale for the alternatives. Please provide any quantitative analysis in support of alternative approaches, if possible. [Request for Comment, Proposal at 91275, Question 2]*

Please see section IV.H of the letter.

(44) *For SDs or MSPs organized and domiciled outside the U.S., is IFRS issued by the IASB an appropriate accounting standard that would allow the Commission and RFA to properly assess the financial condition of SDs and MSPs? If not, explain why not, and suggest what modifications the Commission should make to the proposed regulation. [Request for Comment, Proposal at 91280, Question 1]*

SIFMA believes that IFRS (issued by the IASB) accounting standards would allow the Commission to adequately asses the financial condition of SDs. Since 2002, the IASB and the FASB have collaborated to harmonize account reporting standards. The SEC has strongly supported this effort and has played a central part in the globalization of accounting principles. In one of her final speeches as Chair of the SEC, Mary Jo White emphasized the importance of global accounting and referenced the significant benefits the SEC has experienced since embracing IFRS standards.[63] We strongly support the Commission's decision to accept IFRS accounting standards.

Please see sections IV.K and IV.J of the letter.

(45) *Should the Commission accept financial statements prepared in accordance with local accounting standards from SDs or MSPs located in foreign jurisdictions and are not required to prepare financial statements in accordance with U.S. GAAP or IFRS? If not, explain why not.*

---

[63] Mary Jo White, Chairman, *A U.S. Imperative: High-Quality, Globally Accepted Accounting Standards* (Jan. 5, 2017).

Should such firms be required to submit a reconciliation of the local accounting to U.S. GAAP? Would such a reconciliation provide the necessary information for the Commission and RFA to fully understand the financial position of the SD or MSP? What costs would be incurred by the SD or MSP in preparing the reconciliation? [Request for Comment, Proposal at 91280, Question 2]

It is essential that Foreign SDs be permitted to operate under a regime of full substituted compliance and that U.S. SDs that are part of a foreign-based financial group be able to operate using models approved by the home or host country qualifying foreign regulator. Please see sections III, IV.K and IV.J of the letter.

(46) *Should SDs or MSPs that file non-U.S. GAAP financial statements also file a reconciliation of the non-U.S. GAAP financial statements to U.S. GAAP? Would such a reconciliation provide the Commission with necessary information to understand the non-U.S. GAAP financial statements? What costs would be incurred by the SD or MSP in preparing the reconciliation? [Request for Comment, Proposal at 91280, Question 3]*

SIFMA does not believe that any such reconciliation should be necessary as it would be expensive and provide little value. Please see sections III, IV.B and IV.J of the letter.

(47) *Are there competitive advantages to SDs and MSPs that would be permitted to prepare financial statements in accordance with IFRS or another non-U.S. GAAP reporting standard? If so, is it necessary for the Commission to address such advantages? How should the Commission address those advantages? [Request for Comment, Proposal at 91280, Question 4]*

SIFMA is skeptical as to whether there is any material advantage in the preparation of financial statements using IFRS vs. GAAP. However, we do note that

there are significant difference regarding netting and potentially the new credit impairment accounting standards. Unless such discrepancy impacts the amount of capital a firms will be required to hold, there does not seem to be a need for adjustment.

Please see sections IV.I and IV.J of the letter.

(48) *The Commission is proposing to require SDs and MSPs that are subject to the capital rules of a prudential regulator to file notices with the Commission and with the SDs' or MSPs' RFA. Such notices include if the SD's or MSP's regulatory capital is less than the applicable minimum requirements set forth in the prudential regulators' rules or an adjustment in the SD's or MSP's reported capital category. The proposal would also require SDs that are foreign banks to file notice with the Commission and with their RFA if they experience an adjustment in their regulatory capital category under the rules of a prudential regulator or a similar provision of the regulations of its home country supervisors, and to file notice with the Commission and with their RFA if their regulator capital is below the minimum required by the prudential regulators or their home country supervisors. Should the Commission require SDs that are subject to the capital rules of a prudential regulator to file notices with the Commission regarding changes to their capital status? If not, explain why not? Are SDs that are banks subject to any legal restrictions on disclosing such capital information to the Commission? If so, cite such legal restrictions. Should the Commission differentiate between SDs that are U.S. banks from SDs that are non-U.S. banks? If so, explain how and why the Commission should differentiate between such SDs. Are there other notices that the Commission should consider receiving from SDs or MSPs that are subject to the capital and margin rules of a prudential regulator? Do these rules adequately address SDs and MSPs that are foreign domiciled entities subject to prudential regulation by foreign banking authorities? Are there alternative provisions that the Commission*

should consider for both domestic and foreign SDs and MSPs that are subject to prudential regulation? [Request for Comment, Proposal at 91280, Question 5]

The notice provisions are not sufficiently tailored to SD specific concerns. Please see section IV. I of the letter.

(49) *Are the reporting elements to Appendix A adequately defined to capture the relevant information? If not, what specific changes should the Commission consider? [Request for Comment, Proposal at 91280, Question 6]*

The reporting requirements requested by Appendix A are not adequately defined. Please see section IV. I of the letter and Appendix C attached thereto.

(50) *Are the reporting elements to Appendix B adequately defined to capture the relevant information? If not, what specific changes should the Commission consider? [Request for Comment, Proposal at 91280, Question 7]*

The reporting requirements requested by Appendix B are not adequately defined. Please see section IV. I of the letter and Appendix C attached thereto.

(51) *Should the Commission make public any other monthly unaudited or annual audited financial information filed by an SD or MSP under Regulation 23.105? If so, how would the public disclosure of such information be consistent with the FOIA and Sunshine Act exemptions? [Request for Comment, Proposal at 91280, Question 8]*

SIFMA believes that the long-existing requirements of other regulators provide adequate public disclosure of financial information. Please see section IV. I of the letter.

(52) *What SD or MSP financial information should the Commission make publicly available? [Request for Comment, Proposal at 91280, Question 9]*

SIFMA believes that the long-existing requirements of other regulators provide adequate public disclosure of financial information. Please see section IV. I of the letter.

(53) *Is it appropriate to have different disclosure rules for SDs and MSPs? If so, explain why disclosure rules should be different for SDs and MSPs? [Request for Comment, Proposal at 91280, Question 10]*

Please see our response to question 21.

(54) *Would disclosure of certain financial information provide SD and MSP counterparties with necessary information concerning some SDs or MSPs without adversely impacting that particular SD's or MSP's ability to maintain a trading book? [Request for Comment, Proposal at 91280, Question 11]*

The greater the information that the regulators make available as to the positions held by any SD, the greater the ability of other firms to trade against that SD, particularly in times of market stress. SIFMA believes that the information that is currently publicly available is sufficient for the purposes of counterparty credit evaluations. Please see section IV.I of the letter.

(55) *Should the Commission post SD and MSP financial data on the Commission's Web site? [Request for Comment, Proposal at 91280, Question 12]*

SIFMA believes that the currently established methods by which firms are required to make their information available to counterparties are sufficient for counterparty credit evaluations. Please see section IV. I of the letter.

(56) *Do proposed capital, liquidity, and financial reporting requirements properly protect market participants and the public? Please explain. [Request for Comment, Proposal at 91296 (Protection of Market participants and the Public)]*

SIFMA believes that significant aspects of the Proposal will impose capital requirements that are entirely disproportionate to risk. While excessive capital requirements may seem to promote market safety, it actually has the opposite effect. Most significantly, firms simply leave the business, as evidenced by the very significant decrease in the number of FCMs, as described in section V of the letter. This exit results in less customer choice and higher costs. Additionally, capital costs must be passed on to customers, at least they must be if SDs are to stay in business. Unduly high capital requirements means unduly high hedging costs for customers. Given the way in which the rules are drafted, the costs related to capital charges are likely to fall most heavily on commercial end users who were intended by Congress to be outside of the costs imposed by Dodd-Frank.[64] Please see sections III and IV of the letter.

(57) *Is market integrity adversely affected by the proposed rules? If so, how might the Commission mitigate any harmful impact? [Request for Comment, Proposal at 91296 (Efficiency, Competitiveness, and Financial Integrity of Swaps Markets)]*

The number of FCMs registered with the Commission has sharply declined over the last several years (see section V of the letter), likely at least partially in response to increased regulatory costs. At some point the exit of firms from Commission registration must have deleterious impact on market quality.

(58) *How might this proposal affect price discovery? Please explain. [Request for Comment, Proposal at 91296 (Price Discovery)]*

Please see our responses to questions 56 and 57.

---

[64] *See* Letter from Chairman Christopher Dodd and Blanche Lincoln to Chairmen Barney Frank and Colin Peterson (June 30, 2010) (asserting that "margin and capital requirements are not to be imposed on end users").

(59) *How might this proposal affect sound risk management practices? Please explain. [Request for Comment, Proposal at 91297 (Sound Risk Management Practices)]*

To the extent that the Commission's capital requirements are inconsistent with, for example, diversification of credit and counterparty risk, the need to meet Commission capital requirements could create conflict with sound risk management procedures. To the extent that the Commission's capital requirements unduly raise the costs imposed on commercial end users, this raised cost may have a negative effect on both individual end users and commercial markets generally.

Please see section IV. H of the letter.

(60) *Are there other public interest considerations that the Commission should consider? Please explain. [Request for Comment, Proposal at 91297 (Other Public Interest Considerations)]*

See generally our responses above. In addition, SIFMA is concerned that the Commission's capital requirements will not merely punish medium-sized firms, such firms will be entirely driven from the swap dealing business if the requirements are imposed before the margin requirements become effective or without giving all firms the opportunity to obtain model approvals. Please see sections III and IV.A of the letter.

(61) *Would the minimum capital requirements represent a barrier to entry to firms that may otherwise seek to trade swaps as SDs? If so, which types of firms would be foreclosed? [Request for Comment, Proposal at 91302, Question 1]*

The regulatory structure imposed on SDs generally, as well as on FCMs, has tremendous compliance costs. That is likely one reason for the exit of FCMs from the business and why the number of firms seeking SD registration may be fewer than the

Commission had expected. Capital is just one part of these expenses, although obviously a very significant part.

(62) *Is it correct to assume that firms part of U.S. BHCs that are subject to Basel III and stress testing requirements would be readily able to meet the proposed capital requirement? [Request for Comment, Proposal at 91302, Question 2]*

Firms can "meet" the capital requirement. The real question is whether it causes them to shrink their business due to capital requirements that are excessive in light of the risks. SIFMA believes that it is very likely that requiring CETI to be equal to 8% of RWA (plus an additional 20% early warning requirement) may very well have that effect. Further, the requirement that firms maintain capital equal to 8% of the Theoretical Initial Margin Level is wholly disproportionate to actual risks and may very well cause firms to shrink their business, and will certainly result in the "mispricing" of transactions relative to actual risk.

Please see sections II, III and IV of this letter.

(63) *Is it correct to assume that ANC firms would be readily able to meet the proposed capital requirement? [Request for Comment, Proposal at 91302, Question 3]*

Please see our response to question 62 above as to the undue capital requirements and the likelihood that firms may shrink their business and misprice transactions.

(64) *Is it correct to assume that it would not be too costly for firms or their parents already subject to SEC current BD and/or proposed SBSD capital requirement or CFTC's current FCM capital requirement to comply with the capital requirement? [Request for Comment, Proposal at 91302, Question 4]*

Firms that are not approved to use models will likely find it impossible to participate in the swap dealing market. Please see our response to question 62 above as to the undue capital requirements and the likelihood that firms may shrink their business and misprice transactions.

(65) *Is it correct to assume that proposed capital requirements would not be too burdensome for firms that are part of foreign BHCs subject to Basel? [Request for Comment, Proposal at 91302, Question 5]*

In the event that firms that are part of foreign BHCs were not permitted to use models approved by their home or host country regulators, then all of the negative issues described elsewhere in the letter with regard to costs and operational difficulties would be materially exacerbated.

(66) *Would it be too costly for the smaller SDs and SDs that are not subject to Basel or SEC or CFTC capital requirements to comply? [Request for Comment, Proposal at 91302, Question 6]*

SIFMA believes that the standardized capital requirements under the Commission's rules will make it impossible for smaller non-model firms to remain in the market.

(67) *What restrictions would smaller firms be willing to accept for a lower capital requirement? [Request for Comment, Proposal at 91302, Question 7]*

Lower capital requirements should be applicable to SDs that only enter into cleared swap transactions with customers and that generally attempt to run a matched book. Please see sections III and IV.A of the letter.

(68) *What alternative capital requirements might achieve the same policy goal? [Request for Comment, Proposal at 91302, Question 8]*

Please see the letter generally.

(69) *Does the proposed capital requirement reflect the increased risk associated with the use of models and trading in a portfolio of swaps? [Request for Comment, Proposal at 91303]*

Please see sections III, IV.A and IV.B of the letter.

(70) *How much additional cost would SDs incur resulting from the proposed liquidity requirements given their current practice? The Commission requests that commenters quantify the extent of the additional cost the proposed minimum liquidity requirement would incur based on its portfolios and financials, and provide the Commission with such data. The Commission also requests comments on alternative approaches to liquidity requirements to achieve the same policy goal. [Request for Comment, Proposal at 91304]*

Please see section IV.H of the letter.

Appendix C

Requests for Clarification Regarding Appendices A and B to Proposed Rule 23.105

Appendix A to Proposed Rule 23.105 (l): Schedule 1

1. Are lines 1-11 and 15-17 expected to mirror what firms report on page 9 of the SEC's FOCUS Report (*i.e.*, Aggregate Securities and OTC Derivatives Positions)?

2. Are Lines 12-14 (12. Security Based Swaps, 13. Mixed Swaps, and 14. Swaps) intended to expand on what was previously line 11 in the SEC's FOCUS Report (Derivatives including Options)?

If that is the intent, this reporting requirement will have **significant** operational issues. Firms will need to identify every transaction at its initiation and tag it based upon the type of swap, and repeat this process through all the subsystems (*i.e.*, trade detail subsystems, collateral subsystems, risk systems, credit risk systems, financial subledger for derivative contracts, etc.) all the way up to the general ledger, which is used for financial reporting. This tagging process would also have to be done to identify cleared and non-cleared swap positions. Additionally, the disaggregation of Line 11 of the SEC's FOCUS Report will create a gross-up issue as this number will not be traceable to the balance sheet.

SIFMA suggests that the Commission keep page 9 in the current SEC FOCUS Report as is and create a separate schedule for the swap break out per lines 12-14 in Appendix A to Proposed Rule 23.105. We also suggest notional reporting for this new schedule, which would effectively provide the information requested, without requiring the information to be linked back to the financial reporting requirements from the firm's general leger systems.

3. Should this new reporting schedule include cleared activity for affiliates or only firm trading for cleared activity?

Appendix A to Proposed Rule 23.105 (l): Schedules 2-4

1. What counterparty identifier would be required? Firms currently provide the actual name but would suggest the Commission consider other industry established identifiers such as a Legal Entity Identifier.

2. Currently in the SEC's FOCUS Report, firms provide the external rating and not the Internal Credit Rating ("**ICR**"). The industry believes we should continue with the existing approach instead of reporting ICRs as is proposed.

3. SIFMA requests that a definition be provided for Gross Replacement Value. We believe that this should be defined as gross gains and gross losses net after FIN 39 netting for U.S. GAAP reporting purposes.

4. Is the Net Replacement Value equal to Gross Receivable, which is defined as gross gains and gross losses net after FIN 39 netting?

5. Is Current Net Exposure equal to the Gross Receivable (*i.e.*, gross gains and gross losses net after FIN 39 netting) but **after** collateral has been applied?

6. Should Total Exposure be equal to the Credit Risk capital charge (*i.e.*, CCE, MPE and multipliers) currently reported in the SEC's FOCUS Report?

7. What does Margin Collected represent (is this collateral currently collected to get to Current Net Exposure or is this meant to be collateral collected T+1 to reduce charges)?

8. Are these schedules supposed to include cleared swaps? Current reporting requires only OTC derivatives in the SEC FOCUS Report.

9. Would we start to report cleared activity for affiliates on this new schedule or only report firm trading for cleared activity?

Appendix B to Proposed Rule 23.105 (o)

1. Appendix B assumes that all firms subject to "substituted compliance" will prepare a "bank style" computation; what if this is not the case?

2. Banks are required to file financial statements and supporting schedules known as "call reports" with their prudential regulator. The Commission's schedules are largely based upon Form FFIEC 031. However, banks submit a variety of call reports depending on the type of firm. For example, U.S. branches and agencies of foreign banks file Form FFIEC 002. Because the information contained on Form FFIEC 002 is not identical to that contained in Form FFIEC 031, the Commission is incorrect in assuming that banks will necessarily be able to complete the balance sheet and regulatory capital schedules based on call reports. Foreign bank SDs may need to generate new information to fill out these schedules.

Appendix D-1

SIFMA Comment Letter on SEC Capital and Margin Proposal

February 22, 2013

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: Capital, Margin and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers (Release No. 34-68071; File No. S7-08-12)

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] welcomes the opportunity to provide the Securities and Exchange Commission (the "**SEC**" or "**Commission**") with comments on the Commission's proposed capital, margin and segregation requirements (the "**Proposal**")[2] for security-based swap dealers ("**SBSDs**") and major security-based swap participants ("**MSBSPs**") pursuant to Sections 3E and 15F of the Securities Exchange Act of 1934 (the "**Exchange Act**"), as amended by Sections 763 and 764 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**"). SIFMA appreciates the Commission's careful and comprehensive approach to this complex and consequential rulemaking.

---

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

[2] SEC Release No. 34-68071 (Oct. 18, 2012), 77 Fed. Reg. 70,214 (Nov. 23, 2012) (the "**Proposing Release**").

EXECUTIVE SUMMARY

SIFMA greatly appreciates the Commission's thoughtful effort to reconcile the many difficult and, in some cases, conflicting objectives that must be addressed in fashioning capital, margin and segregation requirements for nonbank SBSDs and MSBSPs. These objectives include the mandate in Section 15F(e) of the Exchange Act for the Commission's capital and margin requirements to "help ensure the safety and soundness" of nonbank SBSDs and MSBSPs and "be appropriate for the risk associated with" uncleared security-based swaps ("**SBS**"). Section 15F(e) also requires the Commission, together with the Commodity Futures Trading Commission (the "**CFTC**") and the Prudential Regulators,[3] to the maximum extent practicable, to establish and maintain comparable capital and margin requirements for bank and nonbank swap dealers ("**SDs**"), SBSDs, major swap participants ("**MSPs**") and MSBSPs. Section 752 of Dodd-Frank similarly requires the Commission to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to SBS. Finally, Section 3(f) of the Exchange Act generally requires the Commission to consider whether its rules "will promote efficiency, competition, and capital formation," and Section 23(a)(2) prohibits the Commission from adopting any rule that "would impose a burden on competition not necessary or appropriate in furtherance of the purposes" of the Exchange Act.

SIFMA recognizes that, in implementing capital, margin and segregation requirements for nonbank SBSDs, the Commission has largely drawn from its existing broker-dealer financial responsibility rules and sought to adapt those rules for SBSDs. Nevertheless, we are concerned that this approach, without further modification, does not adequately address or conform to the statutory principles described above. We strongly believe that, in applying those principles, the Commission should take into account the broader context of regulatory reform, including the significant reduction in risks that will occur once dealers and major participants in the SBS markets are required to register and comply with basic capital requirements, standardized SBS become subject to mandatory clearing and, for uncleared SBS, variation margin is required to be exchanged. Accordingly, the modifications that we recommend the Commission make to the Proposal are intended to be evaluated within that broader context.

<u>The Proposal Would Impose Costs That Are Disproportionate to the Risks of SBS Dealing Activity</u>. Contrary to the statutory requirements that the Commission's capital and margin requirements "be appropriate for the risk associated with" uncleared SBS and "promote efficiency," the Proposal would impose duplicative and excessive capital and margin requirements.

In particular, we are concerned that the proposed requirement to tie a SBSD's minimum level of net capital to 8% of the level of margin required to be collected by it with respect to SBS would require the maintenance of resources far in excess of the actual risks presented by a SBSD's exposures. Similarly, the proposed requirements to apply deductions to net capital

[3] Under Dodd-Frank, the "**Prudential Regulators**" are the Board of Governors of the Federal Reserve System ("**FRB**"), the Federal Deposit Insurance Corporation ("**FDIC**"), the Federal Housing Finance Agency ("**FHFA**"), the Farm Credit Administration ("**FCA**") and the Office of the Comptroller of the Currency ("**OCC**").

based on the level of margin required for SBS would also be excessive, as well as inconsistent with the proposed capital regimes for SDs and banks SBSDs (*e.g.*, by requiring 100% deductions for collateral held by third-party custodians and legacy account positions). The six SIFMA member firms who operate alternative net capital ("**ANC**") broker-dealers have preliminarily projected that, in light of the severity of these requirements, the amount of capital that would be required for the single business line of SBS dealing under the Proposal would exceed $87 billion, the amount of capital currently devoted to *all* of those firms' securities businesses combined, including investment banking, prime brokerage, market making and retail brokerage.[4] There is no empirical evidence, nor do we believe, that the risks arising from the SBS dealing business are greater than the aggregate risks arising from all of these other businesses. Furthermore, we believe that Dodd-Frank's reforms, most notably the significant expansion of central clearing and daily exchange of variation margin for uncleared SBS, will significantly decrease the risk in the SBS dealing business.

We also believe that entity-level liquidity stress test requirements are likely to be destabilizing by trapping assets within SBSD subsidiaries and preventing centralized liquidity risk management. Given the limits on available liquid assets, it is more systemically sound for liquidity to be managed in an integrated, group-wide manner, so that a subsidiary with excess liquidity can provide resources to one that is under stress.

Additionally, SIFMA is concerned that mandatory initial margin requirements would replace potential exposure with actual exposure, reduce overall market liquidity, exacerbate pro-cyclical shocks and, if extended universally, place margin in the hands of entities not subject to prudential supervision. While we appreciate the Commission's efforts to mitigate these adverse impacts by proposing to limit initial margin requirements to the collection of initial margin by SBSDs from financial end users, even such limited initial margin requirements will have negative consequences. In this regard, SIFMA member firms have estimated that the liquidity demands associated with mandatory initial margin requirements are likely to range between approximately $1.1 trillion (if dealers are not required to collect from each other) to $3 trillion (if dealers must collect from each other) to $4.1 trillion (if dealers must post to non-dealers).[5] Moreover, in stressed conditions, we estimate that initial margin amounts collected by firms that use internal models could increase by more than 400%. These mandatory initial margin

[4] The firms estimated the amount capital currently devoted to their securities businesses by determining the amount of capital, after deductions for non-allowable assets and capital charges, that is necessary for them to have net capital in excess of the early warning level specified in Rule 17a-11.

[5] The ultimate amount would depend on the extent to which firms use models instead of standardized haircuts and the extent of any initial margin thresholds. A more detailed depiction of estimated initial margin levels is contained as Figure 1 in Appendix 2 to this letter. To create the estimates in Figure 1, we used data submitted by several SIFMA member firms in response to the Quantitative Impact Study ("**QIS**") conducted in connection with the international consultation on margin requirements for uncleared derivatives released in July 2012. Since SIFMA prepared these estimates, the results of the QIS were released as part of a second consultation. We are still studying those results. However, we note that the QIS results presented generally assume that all firms use approved internal models. Our estimates, in contrast, focus on a mix of model-based and haircut-based initial margin amounts. In addition, the QIS results do not take into account the increased initial margin associated with a movement from non-stressed to stressed market conditions.

requirements cannot be reconciled with the Commission's statutory mandate under Dodd-Frank and the Exchange Act, nor has the Commission offered a sufficient basis to justify their adoption consistent with that mandate. Indeed, in SIFMA's view, their adoption likely would substantially limit the availability of essential credit and magnify the adverse effects of financial shocks on the broader economy.

The Proposal Would Make Nonbank SBSDs Uncompetitive. It is essential, as both a statutory and a policy matter, for the Commission to take into account that bank and nonbank SBSDs are engaged in the same fundamental business – entering into SBS transactions with the same customers and in the same markets. Accordingly, while we recognize that there are relevant differences between bank and nonbank dealer business models (*e.g.*, relating to types of funding and access to backstop liquidity), it would be inconsistent with Dodd-Frank, and with preserving the competitiveness of nonbank SBSDs, to adopt capital and margin requirements that are not comparable to those of the Prudential Regulators to the maximum extent practicable.

Consistency between the Commission's and the CFTC's capital and margin requirements is also necessary for nonbank SBSDs to be competitive with bank SBSDs. Most SBSDs will also be registered as SDs. For nonbank SBSDs, this will mean compliance, at the same time, with both CFTC and Commission capital and margin requirements. Bank SBSDs, in contrast, will be subject to only to a single set of capital and margin requirements. As a result, subjecting dually registered nonbank SBSD-SDs to two sets of inconsistent capital and margin requirements would impair their ability to compete effectively, without offering any incremental safety and soundness benefits.

In addition, nonbank SBSDs compete for business with foreign SBSDs. Foreign SBSDs generally must comply with Basel-compliant capital requirements similar to those applied by the Prudential Regulators. They also will, in most cases, be subject to margin requirements that are consistent with emerging international standards. As noted above, Dodd-Frank requires the Commission to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of SBS. We appreciate the steps the Commission has taken to satisfy this mandate through its participation as part of the Working Group on Margining Requirements of the Basel Committee on Banking Supervision ("**BCBS**") and the International Organization of Securities Commissions ("**IOSCO**" and, together with BCBS, "**BCBS/IOSCO**"). Because BCBS/IOSCO has not yet finalized its recommendations for international margin standards, however, it is not possible at this time to evaluate the extent and likely impact of any inconsistencies between the Proposal and international standards. Accordingly, we urge the Commission, once the BCBS/IOSCO recommendations are final, to re-propose its margin rules for further public comment to address any modifications that might be necessary to conform to those recommendations or to seek input on any inconsistencies between them.

The Proposal's Inconsistencies with Other Regulators' Regimes Would Increase Costs and Risks. To the extent that the Commission's requirements for dually registered SD-SBSDs apply in addition to, or in a manner inconsistent with, CFTC requirements, such requirements would exacerbate the burdens imposed by those existing requirements and tend to promote

inefficiencies by discouraging dual registration. Discouraging dual registration is particularly problematic because conducting the swap and SBS dealing business in two different legal entities will reduce opportunities for netting, thereby increasing credit risk between the dealer and its customers and increasing the amount of margin required to be posted by, and the associated liquidity demands on, customers.

We see no justification, from a cost-benefit perspective, to applying inconsistent capital and margin regimes to a SBSD that is also registered as an SD, except to the minimum extent necessary to accommodate the applicable statutory regime created by Congress. Doing so would serve no purpose other than to require significant investment in the infrastructure necessary to monitor compliance with those regimes simultaneously without materially enhancing investor protection or safety and soundness.[6] For these reasons, we strongly urge the Commission to take every step possible to coordinate with the CFTC in the adoption of consistent capital and margin requirements.

We further note that similar considerations apply in respect of other registration categories. Many SBSDs will conduct an integrated equity derivatives business, dealing in SBS and OTC options, and so accordingly will be registered as OTC derivatives dealers.[7] In turn, many other SBSDs will, as the Commission acknowledges, be registered as broker-dealers; many such SBSDs will also be registered with the CFTC as futures commission merchants ("**FCMs**"). Consistency across the capital and margin requirements applicable under each of the SBSD, SD, broker-dealer, OTC derivatives dealer and FCM regimes should be a key objective of the Commission.

A More Risk-Sensitive Approach Would Better Achieve Dodd-Frank's Objectives. SIFMA has suggested below modifications to the Proposal that are intended to achieve Dodd-Frank's objectives while also addressing these considerations. In particular, we strongly urge the Commission to (i) adopt a more risk-sensitive minimum capital requirement, (ii) eliminate its proposed 100% capital deductions for collateral held by third-party custodians and undermargined legacy accounts, (iii) harmonize its liquidity stress test requirements with the applicable FRB and Basel requirements and (iv) focus on establishing a robust, two-way variation margin regime, rather than a mandatory initial margin regime.

In each case we believe that the suggested modification is both necessary and appropriate to make the relevant requirement more risk-sensitive or to prevent unintended risks and costs, to SBSDs or the financial system more generally. Moreover, we believe that the capital and margin regime, as modified to reflect our suggestions, would still ensure that nonbank SBSDs hold adequate capital (including for illiquid assets and unsecured exposures), prevent the buildup of unsecured exposures with respect to SBS, and generally reduce leverage in the financial system.

---

[6] We observe that differences in the regimes applicable to bank and nonbank SBSDs raise similar issues for firms that conduct SBS activities through both bank and nonbank subsidiaries.

[7] References in this letter to stand-alone SBSDs that are approved to use internal models are also intended to apply to OTC derivatives dealers that are dually registered as SBSDs.

A summary of our specific recommendations for a more risk-sensitive approach is set forth below.

CAPITAL REQUIREMENTS

- ***Minimum Capital Requirements*.** We support the Proposal's fixed dollar minimum capital requirements. However, for the adjustable minimum capital requirement, we suggest two alternative ratios to the proposed 8% margin factor that we believe will be better tailored to the actual overall risk presented by a SBSD's activities: (a) for stand-alone SBSDs that use internal models and ANC broker-dealers, a ratio based on a percentage of the entity's market and credit risk charges to capital and (b) for stand-alone and broker-dealer SBSDs that do not use internal models, a ratio based on a credit quality adjusted version of the proposed 8% margin factor.

- ***Market Risk Charges*.**

  - *Adoption of Banking Agencies' Market Risk Capital Rule Revisions*. We support the incorporation of Basel 2.5 market risk standards into capital requirements for ANC broker-dealers, OTC derivatives dealers and nonbank SBSDs that use internal models, with a conforming adjustment to reflect that Basel 2.5 add-ons should not apply to assets for which the Commission already requires a firm to take a 100% haircut.

  - *VaR Model Standards and Application Process*. We request that the Commission adopt an expedited model review and approval process for models that have been approved and are subject to periodic assessment by the FRB or a qualifying foreign regulator.

  - *Standardized Market Risk Haircuts*. We suggest several modifications to the proposed standardized market risk haircuts for SBSDs that do not have approval to use internal models:

    - For cleared swaps and SBS (regardless of asset class), the capital charge should be based on the clearing organization's initial margin requirement, similar to the Commission's current treatment of futures in Appendix B of Rule 15c3-1.

    - For credit default swaps ("**CDS**"), we believe that the disparity between the proposed haircuts and capital charges derived from internal models is sufficiently wide to merit further review by the Commission of empirical data regarding the historical market volatility and losses given default associated with CDS positions.

    - For interest rate swaps, the capital charge should be calculated using solely the U.S. government securities grid, without the proposed 1% minimum haircut.

    - For transactions in highly liquid currencies, the capital charge should be based on the current haircuts for similar maturity commercial paper, bankers acceptances and certificates of deposit or U.S. government securities. The capital rules also should recognize offsets between foreign exchange transactions and swaps, SBS and securities forward transactions.

- ***Credit Risk Charges*.** We recommend that, in the case of an ANC broker-dealer or a stand-alone nonbank SBSD approved to use internal models, the Commission should not limit the use of a credit risk charge in lieu of a 100% deduction for uncollateralized receivables to SBS with a commercial end user.

- ***Capital Charge In Lieu of Margin*.**

  - *Third Party Custodian Deduction*. We strongly urge the Commission to eliminate its proposed 100% deduction for collateral held by a third-party custodian. Instead, the Commission should address any concerns it has regarding custodial arrangements directly through rules regarding the terms and conditions of such arrangements, for bank and nonbank SBSDs alike.

  - *Legacy Account Deduction*. We strongly urge the Commission to modify the proposed 100% deduction for undermargined legacy accounts by instead adopting either a credit risk charge or a credit concentration charge, with an exception permitting SBSDs to elect to exclude from accounts subject to the charge any currently uncleared positions in a type of SBS for which a clearing agency has made an application to the Commission to accept the SBS for clearing.

  - *Cleared SBS Deduction*. We request that the Commission eliminate the proposed 100% deduction for a shortfall between clearing agency minimum margin requirements and proprietary capital charges, and instead address any concerns regarding clearing agency minimum margin requirements directly through its regulation of clearing agencies.

- ***Liquidity Stress Test Requirements***. While we support enhancing liquidity requirements for financial institutions, we strongly urge the Commission to modify its proposed stress test requirements to align them with applicable Basel and FRB requirements, including by adopting an exception for firms subject to consolidated stress test requirements.

- ***OTC Derivatives Dealers*.** We request that the Commission modify its OTC derivatives dealer framework through conditional exemptions that would allow an OTC derivatives dealer to dually register as a stand-alone SBSD.

- ***SBS Brokerage Activities.*** A broker-dealer SBSD that is approved to use internal models should not be subject to the higher minimum capital requirements applicable to an ANC broker-dealer if it limits the scope of its brokerage activities to brokerage activity incidental to clearing SBS and accepting and sending customer orders for execution on a SBS execution facility.

MARGIN REQUIREMENTS

- ***Initial Margin Requirements*.** As noted above, mandatory initial margin requirements would replace potential exposure with actual exposure, reduce overall market liquidity, exacerbate pro-cyclical shocks and, if extended universally, place margin in the hands of entities not subject to prudential supervision. Accordingly, we strongly urge the Commission (as well as the CFTC and the Prudential Regulators) to focus on establishing a robust, two-way variation margin regime, while continuing to evaluate, in consultation with interested constituencies, including international regulators, effective methodologies to further mitigate systemic risk without causing the adverse impacts that would result from initial margin collection requirements

- ***Exceptions to the Margin Collection Requirement***. We request that the Commission make the following modifications to the exceptions to the margin collection requirement:

    - *Commercial End Users*. We request that the Commission make the definition of commercial end user for the margin exception consistent with the definition for the mandatory clearing exception, and the margin proposals of other U.S. and international regulators.

    - *Sovereign Entities*. We request that the Commission ensure that its treatment of sovereign entities is consistent with international standards.

    - *Affiliates*. We request that the Commission apply margin requirements to inter-affiliate transactions only when one of the affiliates is unregulated.

    - *Structured Finance or Securitization SPVs*. Where alternative security arrangements are in place, we request that SBS with a structured finance or securitization SPV be excluded from margin requirements. Furthermore, a SBSD's security interest in accordance with the SPV's governing documents should be considered a substitute for the collection of collateral and no capital charge for foregone margin should be required.

- ***Eligible Collateral*.** We support the Commission's proposed requirements regarding the scope of eligible collateral, except that we request that it clarify that the requirement that the SBSD maintain possession and control of the collateral should apply only to "excess securities collateral" as defined in its proposed segregation rules.

SEGREGATION REQUIREMENTS

- ***Omnibus Segregation Requirements*.** We generally support the Commission's proposed omnibus segregation requirements, but have identified a number of technical issues and questions that we believe merit further consultation by the Commission with interested constituencies.

- ***Individual Segregation Requirements.*** We request that the Commission clarify certain aspects of the individual segregation requirements, including who should receive the notice regarding the counterparty's right to elect individual segregation, the time at which a segregation election takes effect and the scope of transactions to which it applies.

- ***Segregation Requirements for Bank SBSDs***. For a SBSD that has a Prudential Regulator, we request that the Commission adopt an exception from segregation requirements, except those pertaining to the customer's right to elect individual segregation.

PHASED IMPLEMENTATION

- We request that the Commission provide a 24-month phase-in period for variation margin requirements, with a 12-month phase-in period for uncleared SBS between SBSDs.

- We also request that the Commission's proposed capital rules (other than the application of Basel 2.5) not take effect until the later of two years from the effective date of the Proposal's margin requirements or the effective date for Basel III's minimum capital requirements.

TABLE OF CONTENTS

I. Capital Requirements 1

A. Minimum Net Capital Requirement 2

1. The Proposed 8% Margin Factor Is Not Risk-Sensitive 3

2. SIFMA's Proposed Minimum Capital Requirements 8

B. Market Risk Charges 13

1. Adoption of Banking Agencies' Market Risk Capital Rule Revisions 13

2. VaR Model Standards and Application Process 14

3. Standardized Market Risk Haircuts 16

C. Credit Risk Charges 21

D. Capital Charge in Lieu of Margin Collateral 23

1. Third-Party Custodian Deduction 24

2. Legacy Account Deduction 27

3. Cleared SBS Deduction 29

E. Liquidity Stress Test Requirements 30

F. OTC Derivatives Dealers 32

G. SBS Brokerage Activities 33

II. Margin Requirements 34

A. Concerns About Mandatory Initial Margin Requirements 35

1. Mandatory Initial Margin Requirements Could Limit Credit Availability and Be Destabilizing 36

2. Mandatory Initial Margin Requirements Would Have Undesirable Pro-Cyclical Effects 37

3. Mandatory Initial Margin Requirements Would Increase, Not Decrease, Credit Risk 38

4. Initial Margin Requirements Are Not Needed to Promote Central Clearing 38

B. SIFMA's Margin Proposal 40

C. Additional Comments Relating to Margin Requirements 42

1. The Commission Should Harmonize its Exceptions to the Margin Collection Requirement 43

2. Eligible Collateral 46

III. Segregation Requirements 47

A. Omnibus Segregation Requirements 47

B. Individual Segregation Requirements 50

C. Segregation Requirements Applied to Bank SBSDs 52

IV. Phased Implementation 53

Appendix 1: Summary of Requirements for Dually Registered OTC Derivatives Dealers/SBSDs A1-1

Appendix 2: Modified Version of Alternative A A2-1

I. Benefits of Alternative A Relative to Alternative B A2-1

II. Proposed Modifications to Alternative A A2-3

A. Permissible Calculation Methodologies A2-3

B. Modifications to Mitigate Pro-Cyclicality A2-4

C. Initial Margin Thresholds A2-5

D. Legacy Account Exception A2-5

E. Portfolio Margining and Cross-Margining A2-5

F. Phased Implementation of Initial Margin Requirements A2-11

DISCUSSION

I. CAPITAL REQUIREMENTS

The Commission has based its proposed capital requirements for nonbank SBSDs in large part on the existing capital requirements for securities broker-dealers. This differs from the "risk-weighted assets" approach applicable to U.S. and non-U.S. banks under Basel and to nonbank SD and MSP subsidiaries of U.S. bank holding companies under the CFTC's capital proposal.[8] Instead, the Commission has proposed requirements based on the pre-Basel broker-dealer net capital regime, a regime the Commission has previously recognized as imposing substantial costs on the operations of an OTC derivatives business and making it difficult for U.S. securities firms to compete effectively with banks and foreign dealers in OTC derivatives markets.[9]

As noted above, bank and nonbank SBSDs engage in essentially identical SBS activities and compete for the same customers. When the Commission has adopted rules that facilitate the conduct of OTC derivatives business in a broker-dealer – whether a limited-purpose OTC derivatives dealer or an alternative net capital ("**ANC**") broker-dealer – it has generally sought to align its rules more closely with those of the Prudential Regulators.[10] Doing so is even more critical here because nonbank SBSDs will also, in many cases, dually register as SDs with the CFTC, which has proposed capital requirements based on the Basel Accords; additionally, these dually registered entities will be subject to consolidated capital and risk management requirements consistent with the Basel Accords.

Inconsistencies with these requirements will lead to many significant practical issues and costs, particularly since the Commission and the CFTC have not established rules for determining which agency's rules are to apply to a dual registrant. Assuming that a firm would therefore need to simultaneously monitor for compliance with both agencies' rules, it would need to develop and maintain multiple, overlapping risk and recordkeeping systems, the costs of which would be substantial. Such a burden would not apply if the firm conducted its SBS business in a bank subsidiary or, perhaps, in a foreign affiliate, nor would it apply to its competitors that conducted their SBS business in such entities. As a result, inconsistent capital requirements could result in competitive distortions and undermine effective group-wide risk management.

In addition, if expanded to cover the swap activities of a dual registrant, the Commission's proposed minimum capital requirement and capital deductions would pose major operational and risk management challenges. The Commission has proposed to require, for instance, minimum capital equal to 8% of the initial margin required for *both* cleared *and* uncleared positions, as well as capital deductions for collateral held by third-party custodians and undermargined legacy accounts. The CFTC has not proposed such requirements. These

---

[8] *See* 76 Fed. Reg. 27,802 (May 12, 2011) (the "**CFTC Capital Proposal**") at 27,805-06.

[9] SEC Release No. 34-39454 (Dec. 17, 1997), 62 Fed. Reg. 67,940, 6,7941 (Dec. 30, 1997).

[10] *See id.* at 67,947; *see, also* SEC Release No. 34-62872 (Oct. 24, 2003), 68 Fed. Reg. 62,872, 62,874 (Nov. 6, 2003).

requirements, which are unnecessary and unwarranted for stand-alone SBSDs, would be particularly harmful for dual registrants if they applied to CFTC-regulated swap products. Applying the requirements in this way would encourage firms to divide their swaps and SBS portfolios into separate legal entities, which would weaken risk management, increase credit risk by reducing opportunities for contractual netting and increase operational risk.

In the following sections, we elaborate on these considerations in the context of specific aspects of the Proposal's capital requirements. We also suggest modifications to those requirements, which are intended to better address these considerations, as well as to align the Commission's proposed requirements more closely with those proposed by the CFTC and the Prudential Regulators.

A. <u>Minimum Net Capital Requirement</u>

Under the Proposal, the minimum net capital requirement for a nonbank SBSD would be the greater of a fixed dollar amount or a financial ratio, which would vary depending on whether the SBSD is also registered as a broker-dealer and whether it is authorized to use internal models to compute market and credit risk charges to capital. The fixed dollar amount would be either $20 million (for stand-alone SBSDs, whether using internal models or not, and for broker-dealer SBSDs that do not use internal models) or $1 billion (for ANC broker-dealers). The financial ratio would be either 8% of the firm's "risk margin amount"[11] (for stand-alone SBSDs) or the sum of that 8% margin factor and the financial ratio requirement for broker-dealers under Rule 15c3-1 (for broker-dealer SBSDs).[12] In addition, stand-alone SBSDs that use internal models would be required to have tentative net capital of at least $100 million, and ANC broker-dealers would be required to have tentative net capital of at least $5 billion (with an early warning level of $6 billion).[13]

We support the proposed fixed dollar minimums because they are consistent with existing requirements and practices for OTC derivatives dealers and ANC broker-dealers and have not, in our experience, proven to produce significant disparities with other capital regimes. We also support the adoption of an alternative capital requirement that is scalable to the volume, size and risk of a SBSD's activities. Applying a risk-based minimum capital requirement would be consistent with the safety and soundness and risk appropriateness standards mandated by Dodd-

---

[11] The "risk margin amount" would be defined as the sum of: (1) the greater of the total margin required to be delivered by the nonbank SBSD with respect to SBS transactions cleared for SBS customers at a clearing agency or the amount of deductions that would apply to the cleared SBS positions of the SBS customer pursuant to the applicable SEC capital rule and (2) the total margin amount calculated by the SBSD with respect to non-cleared SBS pursuant to the proposed new margin rule. Proposal § 15c3-1(c)(16); Proposal § 18a-1(c)(6). We assume that the Commission did not include proprietary cleared SBS positions within this definition because the nonbank SBSD is not responsible for customer collateral for those positions. We believe that a similar rationale supports excluding SBS transactions for which the nonbank SBSD has not collected collateral because an exception applies.

[12] Rule 15c3-1(a) requires a broker-dealer to apply one of two financial ratios: (a) 15-to-1 aggregate indebtedness to net capital or (b) 2% of the aggregate debit items in Exhibit A to Rule 15c3-3.

[13] "Tentative net capital" means net capital after making deductions for illiquid assets but before applying deductions for market and credit risk charges. *See* Rule 15c3-1(c)(15).

Frank and the Basel Accords. It also would maintain comparability to the requirements established by the CFTC and the Prudential Regulators.

However, as described in more detail below, we are very concerned that the proposed 8% margin factor is not appropriately risk-based. Accordingly, we have suggested two alternatives that would be tailored more effectively to the overall risk, rather than simply the volume, of a SBSD's activities: (a) for stand-alone SBSDs that use internal models and for ANC broker-dealers, a ratio based on a percentage of the entity's market and credit risk charges to capital, which would be similar to the minimum capital requirements adopted under the Basel Accords and the capital rules of the Prudential Regulators, and (b) for stand-alone and broker-dealer SBSDs that do not use internal models, a ratio based on a credit quality adjusted version of the proposed 8% margin factor. These alternatives are designed to satisfy several key principles for a sound minimum capital requirement that the SEC and SIFMA share. In particular, we believe that a minimum capital requirement should: (1) reduce leverage and increase with the risk of a registrant's activities; (2) be simple to administer, drawing from existing measures of the risks of a registrant's activities; (3) recognize the complementary nature of margin and capital; (4) be consistent with prudent risk management practices; (5) for dual registrants, be consistently applied across the full range of regulated activities and (6) for firms subject to consolidated capital requirements, be consistent with those requirements.

1. The Proposed 8% Margin Factor Is Not Risk-Sensitive

The Proposal explains that the amount computed under the 8% margin factor generally would increase as a SBSD increases the volume, size and risk of its SBS transactions.[14] This is true to some extent. The larger the net position a SBSD has with a particular customer, and the more customers it has, the more initial margin it would be required to collect. There are, however, several respects in which the 8% margin factor would not be risk-sensitive. Specifically, as described in more detail below, it would not take into account offsets between uncleared positions with different customers within a well-managed dealing portfolio, interrelationships between a SBSD's SBS positions and its other positions, credit diversification, variations in creditworthiness across customers or the complementary relationship between margin and capital. It also is not calibrated to the margin levels that will be required for SBS, nor is it consistent with capital requirements that will apply at the holding company level. As a result, it would not align with prudent risk management practices or efficient capital allocation, would tend to increase concentration and barriers to entry in the SBS markets and would render nonbank SBSDs uncompetitive vis-à-vis bank SBSDs and foreign SBSDs.

a. The 8% Margin Factor Overestimates the Risk of a Dealing Portfolio

It is important to note the distinction between a dealing business and a clearing brokerage business. A dealer takes principal positions and is exposed to the market risk of those positions. In contrast, a clearing broker (such as an FCM) acts as an agent and guarantor of its customers in

---

[14] Proposing Release at 70,223.

connection with their cleared positions. A clearing broker is not generally exposed to the market risk of those positions unless a customer fails to post collateral. Because it is directly exposed to the market risk of its customer positions, a dealer, as opposed to a clearing broker, typically runs its business so that its customers positions offset each other or are otherwise offset. As a result, the volume, size and risk of a SBSD's overall portfolio is not merely a function of the number of SBS customers it has, the size of its SBS positions with a given customer or even the risk of individual positions. Even if a SBSD's positions are spread across a large number of customers, the *net* risk of these positions may be relatively small if the SBSD has effectively minimized the market risk of its overall portfolio. When such a SBSD has obligations to one set of customers, another set of customers will have obligations to it.[15] Recognizing these characteristics of dealing activity is critical to preserving the ability for SBSDs to provide liquidity to other market participants by making markets.

The 8% margin factor would not, however, distinguish between a dealer with a non-directional portfolio and another entity with a much riskier directional portfolio concentrated on one side of the market. This is because initial margin is calculated and collected by a SBSD on a gross basis across its customers. A SBSD that has exactly offsetting long and short positions with two different customers would still be required to collect initial margin from each of those customers. This requirement is based on the fact that initial margin is intended to protect the SBSD from its potential future credit exposure to each of those customers. Capital, on the other hand, is intended to address the full range of credit, market and other financial risks to which a SBSD is subject. Yet, because the 8% margin factor effectively conflates initial margin with capital, it would require a SBSD with exactly offsetting positions with two counterparties to hold the same level of capital as an entity with two non-offsetting positions with the same two counterparties.

In addition, many SBSDs, particularly those that use internal models, engage in business lines other than SBS dealing. These other business lines include dealing in securities and securities options, dealing in swaps, trading in futures and engaging in securities finance activities. In particular, SBS dealing is typically conducted as part of an integrated credit or equities business that involves both single-name and index swaps, securities options and cash trading activities. The 8% margin factor would not be sensitive to the overall level of risk arising from these business activities. In particular, it would not recognize natural market risk offsets between SBS and non-SBS positions; indeed, except to the extent portfolio margining is permitted, it would not even recognize such offsets within a portfolio of transactions between a SBSD and a single customer.

As a result, the proposed 8% margin factor would be inconsistent with prudent risk management practices and other aspects of the net capital rule, particularly for SBSDs that use internal models, which recognize market risk offsets. Any capital or risk management benefit

---

[15] Although we recognize that the SBSD's ability to meet its obligations to in-the-money customers depends on it prudently managing its credit risk to out-of-the-money customers, we do not regard the 8% margin factor as an effective means for addressing credit risk. Rather, as discussed below, the 8% margin factor is not sensitive to credit risk, nor would it be consistent with prudent credit risk management practices.

achieved from offsetting the market risk arising from a position with one customer would need to outweigh the increase in capital and margin that would be required if the SBSD's hedge increased its net position with another customer.

b. <u>The 8% Margin Factor Is Not Consistent With Prudent Credit Risk Management Practices</u>

In addition to overestimating the risk in a well-managed dealing portfolio, there are several respects in which the 8% margin factor would be inconsistent with prudent credit risk management practices. First, the 8% margin factor would not take into account the complementary relationship between margin and capital: the more margin a firm collects from a customer, the less capital the firm should need to hold to absorb potential losses arising from its exposure to that customer. In addition, because the same 8% factor would be applied to all customers, it would ignore variation in creditworthiness and would in fact discourage the separate evaluation of each counterparty's creditworthiness, a key objective of prudent risk management.

To illustrate these issues, we have prepared the below example, which compares the amount of capital that would be required by the 8% margin factor against the amount that would be required by Basel II, each as applied to a particular trade for which the initial margin requirement is $113,126,[16] and with a set of hypothetical customer exposures that vary based on whether the SBSD has collected variation margin and by the creditworthiness of the customer:

Variation Margin Collected from Customer

Customer Credit Rating	8% of Initial Margin ("**IM**")	Capital Required under Basel II	Ratio of 8% of IM to Basel II Capital
A	$9,050	$103	87.9
BBB	9,050	175	51.7
BB	9,050	440	20.6

Variation Margin Not Collected from Customer

Customer Credit Rating	8% of IM	Capital Required under Basel II	Ratio of 8% of IM to Basel II Capital
A	$9,050	$3,309	2.83
BBB	9,050	5,561	1.63
BB	9,050	13,645	0.66

As this example illustrates, for collateralized customer exposures, the 8% margin factor produces minimum capital requirements that are significantly and unnecessarily higher than equivalent risk-weighted capital requirements. This is because of the complementary relationship between margin and capital: when a firm collects variation margin, its remaining credit risk is significantly reduced. In contrast, for uncollateralized exposures to customers that are less creditworthy, the 8% margin factor may not require enough capital. By ignoring these

[16] This example assumes that the initial margin of the trade equals the loss that would be experienced from an adverse 10-day spread move at the 99% confidence level.

differences, the 8% margin factor would be inconsistent with prudent credit risk management practices, and would not incentivize prudent practices, such as seeking more creditworthy customers and collecting additional collateral from less creditworthy customers.

Additionally, the 8% margin factor would effectively reward concentration and penalize diversification of counterparty exposures. This is because, as noted above, initial margin is collected by a SBSD on a gross basis across customers. As a result, a SBSD that seeks to diversify its credit exposures by trading with a wider range of customers would face higher capital requirements than one that had concentrated exposures to fewer customers. Not only would this be inconsistent with prudent risk management practices by a particular SBSD, but it would also distort competition within the market as a whole. New entrants to the market, whether customers or other SBSDs, would find it more difficult to locate SBSDs willing to establish trading relationships with them because of the additional capital those relationships would require above and beyond the exposures they generate. Even established market participants would face less competitive pricing because the 8% margin factor would discourage SBSDs that did not already have well-established portfolios with them from competing aggressively for their business. Significantly, this facilitation of market concentration would run counter to financial stability objectives.

c. The 8% Margin Factor Is Not Appropriately Calibrated to Initial Margin Levels for Swaps or SBS

As the Proposal observes, the 8% margin factor is similar to an existing requirement in the CFTC's net capital rule that requires FCMs to maintain minimum adjusted net capital in excess of 8% of the risk margin for futures, options and cleared OTC derivatives.[17] This requirement was developed based on the CFTC's analysis of the futures markets.[18] Applying it to the SBS markets would, again, overestimate (and in some cases underestimate) risks and fail to account for the complementary relationship between margin and capital.

As the Commission notes, because exchange-traded futures are generally more liquid and have lower margin levels than non-cleared SBS with the same notional amount, the proposed 8% margin factor (which includes margin for both cleared and non-cleared SBS) would require substantially more capital to support a non-cleared SBS contract than a futures contract.[19] Beyond this, however, the Commission has not quantified the impact of applying the 8% margin factor to SBS. Additionally, when the CFTC expanded its existing 8% margin factor in 2009 to

[17] CFTC Rule 1.17.

[18] Specifically, prior to 1998, FCMs were required to maintain adjusted net capital greater than 4% of their segregated funds. In 1998, several futures exchanges established the 8% margin factor as a more risk-based substitute for that requirement. In 2001, the CFTC staff conducted a study comparing the 8% margin factor to the 4% of segregated funds requirement as applied to the 190 FCMs then registered. CFTC Division of Trading and Markets, "Review of SRO Risk-Based Capital Requirement and Comparison to the Commission's Minimum Net Capital Requirements" (Apr. 2001). That study served as the basis for the CFTC's adoption of an 8% margin factor for futures in 2004. 69 Fed. Reg. 49,784 (Aug. 12, 2004).

[19] Proposing Release at 70,310.

include cleared OTC derivatives,[20] it did not conduct any empirical analysis as to whether the 8% factor was appropriate, given the level of initial margin collected for OTC derivatives. Nor did the CFTC conduct such an analysis before proposing to apply the 8% margin factor to dually registered FCM-SDs as part of the CFTC Capital Proposal in 2011.

The difference in margin levels between futures, on the one hand, and swaps or SBS, on the other, can be quite substantial. We have illustrated the difference through the comparison below of a simple portfolio of two offsetting cleared interest rate swaps against a similar portfolio of Treasury note futures:[21]

	10-Year Cleared Interest Rate Swaps[1]				
	Client	**Direction**	**DVO1**[2]	**Notional**	**Estimated Client IM**
Client #1 ⇨	#1	Long	$100,000	$111,070,000	$3,872,355
Client #2 ⇨	#2	Short	(100,000)	111,070,000	5,208,839
	Aggregate	**Flat**	**0**	**222,140,000**	**9,081,194**

	10Y US Treasury Futures				
	Client	**Direction**	**DVO1**[2]	**# of Contracts**[3]	**Estimated Client IM**[4]
Client #1 ⇨	#1	Long	$100,000	1,211	$1,332,100
Client #2 ⇨	#2	Short	(100,000)	1,211	1,332,100
	Aggregate	**Flat**	**0**	**2,422**	**2,664,200**

1. **10-year $100 Million interest rate swaps (2.09% fixed rate)**
2. **DVO1 measures the dollar value of a one basis point change in interest rates**
3. **Contract Size is $100,000 in notional**
4. **Margin Limit per contract is $1,100**

As this comparison demonstrates, the initial margin required for a simple cleared swap portfolio can be more than three times greater than the initial margin required for a futures portfolio of comparable risk. Normally, a higher margin requirement for a portfolio of comparable risk would tend to decrease capital requirements, since the additional collateral reduces a firm's exposure and is thus a complement to capital. However, because the 8% margin factor is not calibrated to reflect the greater level of initial margin required for swaps or SBS, it

[20] 74 Fed. Reg. 69,279 (Dec. 31, 2009).

[21] We have chosen to compare interest rate swaps to Treasury note futures because they are examples for which there is readily available data for initial margin levels across an OTC derivative and a futures contract that have similar risk profiles.

simply scales upward, resulting in capital requirements that are disproportionate to the level of risk involved.

2. SIFMA's Proposed Minimum Capital Requirements

In light of the considerations described above, SIFMA recommends that the Commission adopt two alternatives to the proposed 8% margin factor that would more effectively be tailored to the risk presented by a SBSD's activities: (a) for stand-alone SBSDs that use internal models and ANC broker-dealers, a ratio based on a percentage of the entity's market and credit risk charges to capital and (b) for stand-alone and broker-dealer SBSDs that do not use internal models, a ratio based on a credit quality adjusted version of the proposed 8% margin factor.

In designing these alternatives, we have sought to create capital requirements that align with prudent risk management practices for each category of firms, yet retain the benefits of the 8% margin factor. Compared with estimated capital requirements derived from the Proposal's approach, our alternatives would establish capital requirements that are better correlated to the risk of a firm's activities and more consistent with the capital requirements of the CFTC and the Prudential Regulators. Therefore, consistent with the statutory mandate for the agencies to adopt consistent capital requirements to the maximum extent practicable, our alternatives would foster a more harmonized approach to risk management across corporate structures and between regulated entities that engage in similar activities. At the same time, the alternatives would maintain important characteristics of the 8% margin factor. In particular, they would still reduce a SBSD's leverage and increase its required capital with the volume of its activities, while being relatively simple to administer.

In addition, we have designed these alternatives to be appropriate to the differences between firms that do, and those that do not, use internal models. Stand-alone SBSDs that use internal models and ANC broker-dealers are more likely to have multiple business lines than are SBSDs that do not use internal models. As a result, it is more important for the minimum capital requirement for these firms to take into account the interrelationships between SBS and non-SBS activities. Such firms are also more likely to be subject to the Basel Accords on a consolidated basis, making it more important that their minimum capital requirement be consistent with the Basel Accords. Otherwise, there will be distortions in the way in which such firms allocate capital among their subsidiaries, since the level of capital that they are required to have at the holding company level for a particular subsidiary would be inconsistent with the level required at the subsidiary level.

SBSDs that do not use internal models, on the other hand, could not readily apply a capital requirement based on a percentage of their market and credit risk charges because those charges are of necessity blunt instruments that tend to overstate the risk of their activities. For those firms, a modified version of the 8% margin factor would scale more accurately to the size, volume and risk of their activities.

a. Stand-alone SBSDs Using Internal Models and ANC Broker-Dealers: Risk-Weighted Minimum Capital Requirement

For stand-alone SBSDs that use internal models and ANC broker-dealers, we suggest that the Commission adopt an adjustable minimum capital requirement equal to a specified percentage of an entity's market and credit risk charges.

This minimum capital requirement is designed to scale directly to the risk of the entity's overall activities, providing a buffer for those instances under which applicable deductions may not, in all circumstances, fully cover the losses that might arise from a particular position or exposure. It also would limit leverage because, as the entity's credit risk charges increase, so would its minimum capital requirement. It would be relatively simple to administer, since it would be based on the market and credit charges that will already be a part of the entity's net capital computation. As a result, it would not require the Commission to determine how to apply and interpret the Basel Accords.

Concurrently, such a risk-weighted capital requirement would generally be based on market and credit risk charges calculated using the same internal models used by the entity's parent to compute its consolidated capital requirements for those activities. Thus, as those models dictate that the entity's holding company increase its minimum capital because of an increase in the risk of its portfolio, they also would dictate an increase in minimum net capital for the entity itself. Consequently, it would promote integrated group-wide risk management and reduce incentives for regulatory arbitrage within a holding company group.

In addition, because the risk-weighted capital requirement would take into account risks across all of an entity's trading activities, not just SBS or securities, it could be applied uniformly across registration categories. Thus, the same uniform minimum capital requirement could apply under the Commission's broker-dealer and SBSD capital rules and the CFTC's FCM and SD capital rules.

We have prepared the below example to illustrate how an entity would calculate its net capital under the risk-weighted approach. This table shows (1) the total amount of the entity's regulatory capital (*i.e.,* its equity capital and subordinated debt), (2) the deductions the entity would take for illiquid assets and operational charges (which results in the entity's tentative net capital), (3) the deductions the entity would take for market and credit risk charges (which results in the entity's net capital), (4) the calculation of the entity's minimum capital requirement as a percentage of market and credit risk charges and (5) the entity's excess net capital over its minimum capital requirement:[22]

[22] This example is solely illustrative, although it is based on a rough approximation of the capital position of a large firm based on members' experiences. All numbers are in millions of dollars.

Illustration of SIFMA's Proposed Risk-Weighted Approach

Equity Capital	$7,500
Subordinated Debt	7,500
Total Regulatory Capital	15,000
Operational Charges	(100)
Un-admitted Assets	(900)
Securities with 100% Haircuts	(3,000)
Tentative Net Capital	11,000
Market Risk Charges	(2,000)
Credit Risk Charges	(2,000)
Net Capital	7,000
Market Risk Haircuts	2,000
Credit Risk Capital Charges	2,000
Base for Computation	4,000
Multiplier	x 12.5%*
Minimum Capital Requirement	500
Excess Net Capital	6,500

***This 12.5% multiplier is solely illustrative**

We note that, in the Proposal, the Commission suggested that a minimum capital requirement of 25% of the firm's market risk deductions could better scale the requirement to the risk of the proprietary positions held by the SBSD.[23] The above illustration, in turn, uses a 12.5% multiplier applied to the firm's market risk *and* credit risk charges, although for illustrative purposes only. However, we emphasize that both the multiplier and the scope of the charges to which it applies should not be chosen arbitrarily.

In particular, we observe that the multiplier should be set at a level that, depending on the market and credit risk framework, would be consistent with the U.S. implementation of Basel III, which is proposed to apply a 12.5% multiplier against risk-weighted assets.[24] Although the market and credit risk multiplier and the Basel multiplier would be applied to different amounts (total of market and credit risk charges or risk-weighted assets, respectively), the market and credit risk multiplier could be calibrated to create similar capital requirements for bank SBSDs and nonbank SBSDs vis-à-vis their overall activities. At the same time, the Commission's overall net liquid assets standard would be maintained, with full 100% capital charges applied to

[23] Proposing Release at 70,309.

[24] 77 Fed. Reg. 52,792 (Aug. 30, 2012).

illiquid assets.[25] The Commission's fixed dollar minimum capital requirements would also apply, which would provide a floor for the minimum capital requirement.

In addition, the minimum capital requirement should be designed to apply where, given the framework for market and credit risk deductions, an additional capital buffer might be necessary. In particular, where the net capital rule already applies a 100% deduction to net worth for a particular position or exposure, the maximum potential loss is already accounted for by the rule, and no buffer should be necessary. In this regard, we note that the Proposal would apply several additional 100% deductions, most notably for undermargined accounts (other than the SBS accounts of commercial end users), collateral held at a third-party custodian and legacy SBS accounts. Including these deductions within the base for any minimum capital requirement – whether it be the 8% margin factor or our proposed risk-weighted minimum capital requirement – would double-count those exposures, requiring a SBSD to hold capital equal to more than 100% of its potential losses.

Moreover, these deductions would significantly increase the level of capital required for a nonbank SBSD to conduct its activities, in effect already providing a substantial buffer above and beyond the estimated potential risk of those activities. In this connection, whether a particular multiplier is appropriate should be based on whether the minimum capital requirement it produces, when taken cumulatively with applicable deductions, produces an overall level of capital that is proportional to the risk of the firm's overall business and economical to the conduct of that business. Accordingly, in our view, the amount of the buffer provided by the minimum capital requirement should vary inversely to the level of capital required by other aspects of the SBSD capital rules (*e.g.,* 100% deductions, if any, ultimately adopted by the Commission), and based on an empirical analysis of the level of capital required to support the business after taking into account those deductions. We would be pleased to work with Commission staff to facilitate such an analysis.

b. Stand-alone SBSDs and Broker-Dealer SBSDs Not Using Internal Models: Credit Quality Adjusted Minimum Capital Requirement[26]

As discussed above, the 8% margin factor is inconsistent with prudent credit risk management practices. In addition, it would double-count exposures for which the SBSD is already applying a 100% capital charge in lieu of margin, requiring a SBSD to hold capital equal to 108% of an exposure. To address these issues for stand-alone SBSDs that do not use internal

---

[25] Because the entity would already be required to maintain net capital equal to the full market value of those assets and could not suffer losses greater than the level of capital it already holds for those assets, it should not need to include the 100% capital charges it has already taken against those assets in any calculation of additional required capital. The entity also should not be required to include any operational charges, nor the new charge that the Commission has proposed to apply for collateral held at a third-party custodian, should it be adopted.

[26] If the Commission decides not to adopt the proposed risk-weighted capital requirement for stand-alone SBSDs that use internal models and ANC broker-dealers, then we suggest that it apply this requirement to the SBS activities of those entities, too.

models, we suggest that the Commission adopt an adjustable minimum net capital requirement computed by modifying the 8% margin factor to adjust for the creditworthiness of customers and to take into account other mitigants to the SBSD's exposures. For broker-dealer SBSDs that do not use internal models, we suggest that this requirement apply in addition to the existing broker-dealer financial ratio requirement.

First, we urge the Commission to exclude from the risk margin amount[27] any amounts for SBS transactions for which the SBSD does not hold customer collateral because an exception applies. This modification would prevent double counting exposures for which the SBSD is already applying a 100% capital charge in lieu of margin. In addition, it would exclude other instances, such as when the customer has waived protection of its collateral, for which there is no customer protection objective to be served by requiring a SBSD to hold additional capital. In this regard, we note that the traditional purpose of the 8% margin factor has been to supplement requirements to safeguard customer property.[28]

We also urge the Commission to adjust the risk margin amount for any given customer by applying a credit against that amount for excess collateral collected by the SBSD and then multiplying the resulting amount by the credit risk weight for that customer under Appendix E of Rule 15c3-1. Adjusting the risk margin amount to account for excess collateral and creditworthiness would be consistent with prudent credit risk management practices by rewarding the collection of excess collateral and penalizing exposures to less creditworthy customers. Applying these adjustments would also help account for the higher margin requirements applicable to SBS transactions.

The following table illustrates how a firm would calculate minimum net capital under our credit quality adjusted approach for exposure to a hypothetical customer subject to a 0.2 risk weighting under Appendix E:

[27] As discussed in more detail below, it would not be appropriate, in our view, to require SBSDs to compute their capital, either for purposes of determining the risk margin amount or applying capital charges, based on the greater of the total margin required to be delivered by the nonbank SBSD with respect to SBS transactions cleared for SBS customers at a clearing agency or the amount of deductions that would apply to the cleared SBS positions of the SBS customer pursuant to the applicable SEC capital rule. Rather, solely the total margin required to be delivered should be relevant.

[28] *See* 68 Fed. Reg. 40,835 (July 3, 2003) (describing the CFTC's minimum capital requirement as intended to provide protection to customers by requiring FCMs to maintain a minimum level of assets that are readily available to be contributed to cover a shortfall in segregated customer funds).

Illustration of SIFMA's Proposed Credit Quality Adjusted Approach

Risk Margin Requirement	$1,000,000
Less: Margin Exceptions	(250,000)
Less: Excess Collateral	(250,000)
Adjusted Risk Margin Requirement	500,000
Credit Weight Multiplier	x 0.2
Credit-Adjusted Margin Requirement	(100,000)
8% Risk Margin Factor	x 8%
Minimum Capital Requirement	8,000

Finally, these modifications would also, in our view, be appropriate for swap dealing activities. Accordingly, an entity that is dually registered as a SBSD and an SD could apply a minimum capital requirement equal to the sum of this credit quality adjusted risk margin factor for swap and SBS transactions.

➢ ***Recommendation:*** *SIFMA recommends that the Commission adopt two alternatives to the proposed 8% margin factor that would more effectively be tailored to the risk presented by a SBSD's activities: (a) for stand-alone SBSDs that use internal models and ANC broker-dealers, a ratio based on a percentage of the entity's market and credit risk charges to capital and (b) for stand-alone and broker-dealer SBSDs that do not use internal models, a ratio based on a credit quality adjusted version of the proposed 8% margin factor.*

B. Market Risk Charges

1. Adoption of Banking Agencies' Market Risk Capital Rule Revisions

On June 7, 2012, the OCC, the FDIC and the FRB (collectively, the "**Banking Agencies**") approved revisions to their market risk capital rules intended to implement Basel 2.5.[29] These revisions enhance the use of financial models for capital purposes by adding (i) a stressed value-at-risk ("**VaR**") capital requirement, (ii) further specific risk "add-on" capital requirements, including for certain securitization positions that are not correlation trading positions, (iii) an "incremental risk" capital requirement for a bank that measures the specific risk of a portfolio of debt positions using internal models, where incremental risk consists of the risk of default and credit migration risk of a position, (iv) a "comprehensive risk" capital requirement relating to the measurement of price risk for correlation trading positions, where the comprehensive risk measure is based on a combination of modeled price risk and a specific risk add-on and (v) a capital requirement for *de minimis* exposures. The Proposal seeks comment on

[29] *See* 77 Fed. Reg. 53,059 (Aug. 30, 2012).

whether these revisions should be incorporated into the capital requirements for ANC broker-dealers, OTC derivatives dealers and nonbank SBSDs that use internal models.[30]

SIFMA generally supports the incorporation of these Basel 2.5 market risk standards into the capital requirements for all ANC broker-dealers, OTC derivatives dealers and nonbank SBSDs that use internal models. Adoption of these standards would promote consistent capital requirements across different subsidiaries for institutions affiliated with banks that already are subject to Basel 2.5. It would also prevent firms not subject to Basel 2.5 from gaining a competitive advantage over those that are subject to Basel 2.5.[31]

However, we believe that one modification to the Basel 2.5 market risk standards is necessary in order to apply them to ANC broker-dealers, OTC derivatives dealers and nonbank SBSDs. Unlike banks, these entities are required, consistent with the net liquid assets approach of Rule 15c3-1, to apply 100% deductions to their net capital for certain illiquid assets. These assets include some of the assets that would be subject to capital add-ons under Basel 2.5. In our view, the Commission should not apply a Basel 2.5 add-on to assets for which the Commission already requires a firm to take a 100% haircut, because the 100% haircut already covers the maximum possible loss.

- ***Recommendation**:* *The Commission should incorporate Basel 2.5 market risk standards into capital requirements for ANC broker-dealers, OTC derivatives dealers and nonbank SBSDs that use internal models, with a conforming adjustment to reflect that the Commission should not apply a Basel 2.5 add-on to assets for which the Commission already requires a firm to take a 100% haircut.*

2. VaR Model Standards and Application Process

The Proposal would permit a nonbank SBSD to use internal VaR models to compute deductions for proprietary securities positions, including SBS positions, in lieu of standardized haircuts, subject to an application to, and approval by, the Commission and satisfaction of qualitative and quantitative requirements set forth in Appendix E of Rule 15c3-1.[32] SIFMA supports this aspect of the Proposal.

In addition, the Proposal seeks comment on whether there are ways to facilitate the timely review of applications from nonbank SBSDs to use internal models if a large number of applications are filed at the same time, such as by using a more limited review process if a banking affiliate of a nonbank SBSD has been approved by a Prudential Regulator to use the same model the nonbank SBSD intends to use.[33]

---

[30] Proposing Release at 70,230.

[31] In this regard, we note that the Banking Agencies' revisions incorporate standardized approaches for firms where they are not able to undertake additional model-based computations.

[32] Proposal § 18a-1(d).

[33] Proposing Release at 70,240.

We support the adoption of a more limited review process for applications pertaining to internal models that have already received approval by a Prudential Regulator or a qualifying foreign regulator, as described further below.[34] The Commission estimates that nonbank SBSDs will include 10 ANC broker-dealers and 6 stand-alone SBSDs that use internal models.[35] Since there are currently 6 ANC broker-dealers, this estimate suggests that the Commission expects to receive applications to use internal models from 4 new ANC broker-dealers and 6 stand-alone SBSDs; existing ANC broker-dealers may also seek to expand the range of products for which they are approved to use internal models. In our experience, the application process requires a significant investment of firm and Commission staff resources over several months, particularly when the staff is evaluating multiple applications simultaneously. In addition, requiring firms to comply with the new capital and margin requirements before their initial application process is complete would place them at a severe competitive disadvantage. As a result, an expedited review process would help facilitate timely implementation of those requirements.

To ensure that the models approved through the expedited review process are rigorous and reliable, we suggest that the Commission apply several conditions to their approval: (1) the model must be approved by (a) the FRB or (b) a foreign regulator that has adopted a capital regime in accordance with the Basel Accords and whose implementation of the Basel Accords yields risk-weighted assets that are comparable to the U.S. implementation of the Basel Accords, based on the findings of the Basel Standards Implementation Group (such foreign regulator, a "**qualifying foreign regulator**"); (2) the FRB or qualifying foreign regulator requires the SBSD's holding company to maintain uniform policies, procedures and governance requirements relating to the use of models across all the subsidiaries within its holding company group; and (3) the SBSD's use of internal models is subject to (a) prior approval by the FRB or qualifying foreign regulator of any new models or material changes to existing models, (b) notification to the FRB or qualifying foreign regulator of any non-material changes to existing models, (c) periodic assessment by the FRB or qualifying foreign regulator and (d) remediation of any material weaknesses identified by the FRB or qualifying foreign regulator. Once a model had received Commission approval based on a full, non-expedited review process, it would no longer be subject to these conditions. Consistent with the existing ANC broker-dealer capital rules, we understand that the Commission will closely examine backtesting exceptions when considering whether to approve or disapprove models approved by foreign regulators.

- ***Recommendation:*** *The Commission should adopt an expedited model review and approval process for models that have been approved and are subject to periodic assessment by the FRB or a qualifying foreign regulator.*

[34] We note that such a process would be similar to the CFTC's proposal to rely on models approved by the FRB or the SEC. CFTC Capital Proposal § 23.103(e).

[35] Proposing Release at 70,293. We note that this estimate does not appear to account for the possibility of foreign entities registering with the Commission and, therefore, may be too low.

3. Standardized Market Risk Haircuts

Under the Proposal, a nonbank SBSD (both stand-alone and broker-dealer) that does not have approval to use internal models would be required to apply standardized market risk haircuts to its swap and SBS positions. These haircuts, which are based on modified versions of the haircuts applicable under current Rule 15c3-1, are generally calculated by applying a multiplier to the notional amount of the relevant swap or SBS, subject to reductions in specified cases in which the swap or SBS position offsets or is offset by a related position.

The Proposal requires a SBSD to protect itself against credit exposure by collecting initial and variation margin for its SBS transactions, with initial margin intended to ensure the performance or close-out of a contract without loss to the SBSD. If a SBSD fails to collect the required amount of margin, it generally must take a capital charge equal to the amount of the margin deficiency. In this way, credit risk is already addressed by the Proposal. The Proposal's capital requirements for market risk, on the other hand, are intended to ensure that a SBSD has sufficient capital to absorb market losses on its principal positions. Because credit risk is already accounted for, there is no need to apply haircuts in excess of expected potential market losses.

SIFMA has extensive experience with the Commission's methodologies for computing capital requirements to account for market risk. While we recognize that standardized haircuts are blunt instruments that overstate risks, we believe that, for a number of commonly assumed hedged positions, the disparities between model-based capital requirements and capital requirements generated from standardized haircuts are wide enough to merit the Commission's review and revision of its standardized haircut requirements. Similarly, given that the CFTC Capital Proposal would apply a different set of haircuts, based largely on Basel I, we believe that it is critical for the Commission to coordinate its rules with the CFTC to ensure a consistent set of haircuts for dual registrants. As noted previously in this letter, it would not be justifiable for a dual registrant to be subject to inconsistent capital requirements for the same positions.

Accordingly, in the following sections, we have suggested ways to modify the proposed standardized haircuts to better reflect the risk in a derivatives portfolio.

a. Cleared Swaps and SBS

The primary reason why a firm would be subject to the net capital rule's standardized haircuts is because it has not developed, or received approval for, internal models. In such a case, however, we believe that it would be appropriate for the firm to use external models that have been approved. The Commission has already recognized this approach implicitly in Appendix B of Rule 15c3-1, which bases a broker-dealer's haircut for futures positions on the maintenance margin requirement of the relevant exchange. Futures exchanges typically use risk-based models, including VaR models, to calculate maintenance margin requirements. Consistent with this approach, for cleared swaps and SBS (regardless of asset class), we suggest that the broker-dealer and SBSD capital rules be modified to apply a capital charge based on the clearing

organization's initial margin requirement, similar to the Commission's current treatment of futures in Appendix B of Rule 15c3-1.[36]

Because clearing organizations typically use risk-based models to calculate initial margin requirements, applying the Appendix B methodology to cleared swaps and SBS would allow those firms that are not eligible to use internal models nonetheless to use risk-based models to calculate minimum net capital. In addition, clearing organizations incorporate a liquidation time assumption into initial margin requirements for cleared swaps and SBS that is longer than what is used for futures contracts. In this way, differences in the liquidity profiles of futures contracts, on the one hand, and cleared swaps and SBS, on the other, are already addressed by the clearing organization's initial margin requirement.

- ***Recommendation:*** *For cleared swaps and SBS, the Commission should apply a standardized capital charge based on the clearing organization's initial margin requirement, similar to the treatment of futures in Appendix B of Rule 15c3-1.*

b. Credit Default Swaps

The Proposal would apply standardized haircuts to CDS using a "maturity grid" approach based on two variables: the length of time to maturity of the CDS and the amount of the current offered basis point spread on the CDS.[37] The deduction for an unhedged long position in a CDS (*i.e.*, when the broker-dealer or nonbank SBSD is the buyer of protection) would be 50% of the applicable deduction in the grid. The Proposal also contains several scenarios under which long and short positions in the same or related products could be netted or a reduced deduction could be taken.

Based on our estimates, the haircuts specified in the Proposal's maturity grids would be significantly greater than the capital charges that would apply to the same positions using a VaR model in accordance with Appendix E of Rule 15c3-1. We have illustrated this difference through the below chart, which compares the proposed haircuts with the VaR capital charge[38] for three long positions in single-name corporate CDS with a maturity of 5 years and spreads of 100 or less, 101-300 and 301-400.

---

[36] Rule 15c3-1b. Applying this methodology to cleared swaps and SBS would require broker-dealers and SBSDs to take the following deductions from net worth: (1) for firms that are members of the clearing organization, deduct the clearing organization's initial margin requirement and (2) for other firms, deduct 200% of the clearing organization's initial margin requirement. In both cases, the deduction would be reduced by any overcollateralization for the swap or SBS, if such overcollateralization is not otherwise included in net worth.

[37] Proposal § 15c3-1(c)(2)(vi)(O)(1); Proposal § 15c3-1b(b)(1)(i); Proposal § 18a-1(c)(1)(vi)(A); Proposal § 18a-1b(b)(1)(i).

[38] Consistent with Appendix E of Rule 15c3-1, this VaR capital charge is based on three times a VaR measure using a 99%, one-tailed confidence level with price changes equivalent to a ten-business-day movement in rates and prices.

Single-Name CDS Basis Point Spread	Proposed Standardized SEC Market Risk Haircut	Rule 15c3-1e VaR Capital Charge
55	4%	1.9%
218	7%	2.9%
323	15%	4.1%

We believe that this disparity between the proposed haircuts and VaR capital charges is sufficiently wide to merit further review by the Commission of relevant empirical data regarding the market risk associated with CDS positions. In particular, we believe that it would be relevant for the Commission to consider such factors as the historical volatility of CDS positions, the probability of default for CDS underliers and the recovery rates for CDS that have been triggered. SIFMA would be pleased to work with Commission staff to facilitate such a review.

➢ ***Recommendation:*** *In light of the wide disparity between the proposed haircuts and capital charges derived from internal models, we recommend that the Commission conduct further review of empirical data regarding the historical market volatility and losses given default associated with CDS positions.*

c. Equity SBS

The Proposal would apply haircuts for portfolios of equity SBS and related equity positions using the methodology set forth in Appendix A of Rule 15c3-1.[39] We support this proposal. As the Commission observes, using Appendix A would allow broker-dealer and nonbank SBSDs to employ a more risk-sensitive approach to computing net capital than if the position were treated in isolation. We also note that there are ongoing efforts to enhance Appendix A to take into account portfolio diversification, better recognize offsetting long and short positions across underlying values, and penalize portfolio concentration, which we support.

➢ ***Recommendation:*** *As proposed, the Commission should apply haircuts for portfolios of equity SBS and related equity positions using the methodology set forth in Appendix A of Rule 15c3-1.*

d. Interest Rate Swaps

The Proposal would apply haircuts for an interest rate swap equal to a percentage of the notional amount of the swap derived by converting each side of the interest rate swap into a synthetic bond position that would be placed into the standardized haircut grid in Rule 15c3-1 for U.S. government securities.[40] However, unlike for government securities, any synthetic bond equivalent that would be subject to a standardized haircut of less than 1% under this approach, including fully hedged positions, would be subject to a minimum deduction equal to a 1% charge against the notional value of the swap. This minimum haircut of 1% is designed to account for

---

[39] Proposal § 15c3-1a(a)(4); Proposal § 18a-1a(a)(4).

[40] Proposal § 15c3-1b(b)(2)(i)(C); Proposal § 18a-1b(b)(2)(i)(C).

potential differences between the movement of interest rates on U.S. government securities and interest rates upon which swap payments are based.[41]

SIFMA generally supports the application of the standardized haircut grid for U.S. government securities to interest rate swaps. However, we believe the proposed minimum 1% haircut is far too onerous. To illustrate the extent to which the proposed minimum would result in disproportionate capital charges if left unaddressed, we have created the following simple portfolio containing three interest rate swaps comprising $123 million in notional, of which $50 million is fully hedged:

Sample Interest Rate Swap Portfolio #1					
Swap	**Side**	**Type**	**Notional**	**Next Reset Date**	**Maturity**
1	Receive	Floating 3-Month LIBOR	$70,000,000	12/27/2012	12/30/2020
	Pay	Fixed 3.857%	70,000,000		12/30/2020
2	Receive	Floating 3-Month LIBOR	18,000,000	01/03/2013	04/07/2021
	Pay	Fixed 3.9775%	18,000,000		04/07/2021
3	Receive	Fixed 3.556%	25,000,000	02/26/2013	02/28/2021
	Pay	Floating 3-Month LIBOR	25,000,000		02/28/2021

The below table compares the capital charges for this portfolio under the Proposal to those capital charges that would apply if an approach that is more consistent with the existing U.S. government securities grid were used instead. As this table illustrates, the 1% minimum haircut would result in a very significant increase in capital charges (roughly 45%), which in our view far outweighs the movement of the rates underlying interest rate swaps relative to the more volatile movement of the rates that drive the pricing of U.S. government securities.

(In 000's)			**Capital Charge**					
			Proposed Rule			**Government Grid**		
Maturity Category	**Short**	**Long**	**Hedged @ 1%**	**(A) Unhedged**	**Total**	**Hedged @ 1%**	**(B) Unhedged**	**Total**
Less than 3 months	$ 25,000	$ 88,000	$ 250	$ 630	$ 880	$ -	$ -	$ -
5 - 10 years	88,000	25,000	250	2,520	2,770	-	2,520	2,520
Grand Total	**$113,000**	**$113,000**	**$ 500**	**$ 3,150**	**$3,650**	**$ -**	**$ 2,520**	**$2,520**

(A) The haircut applied to the un-hedged positions under the proposed rule is 1% for the less than 3 months category and 4% for the 5 - 10 year category.

(B) The haircut applied to the un-hedged positions under the government grid is 0% for the less than 3 months category and 4% for the 5 - 10 year category.

---

[41] Proposing Release at 70,249.

We have also estimated that, for a well-hedged dealing portfolio of $12.05 trillion gross notional with only $216 billion notional in directional risk, the proposed haircuts would require a firm to hold $123 billion in capital, of which over $119 billion results from the application of the proposed 1% minimum haircut to fully hedged positions. In comparison, the related VaR for the same portfolio would be significantly less. This disparity would effectively prevent broker-dealers and nonbank SBSDs that do not use internal models from dealing in interest rate swaps.

- ***Recommendation:*** *The Commission should eliminate the proposed 1% minimum haircut for interest rate swaps, and solely apply the existing U.S government securities grid.*

e. Foreign Exchange Transactions

Under the Proposal, the haircut for un-hedged foreign exchange transactions referencing the euro, British pounds, Canadian dollars, Japanese yen or Swiss francs, would be 6%.[42] In our view, this haircut does not reflect the deep liquidity of the foreign exchange markets, which, for the major currencies, are at least as liquid as markets for sovereign debt. At least for transactions in the top 13 deliverable currencies (by volume) described in the Bank for International Settlements' Triennial Central Bank Survey, Report on Global Foreign Exchange Market Activity,[43] we suggest that the Commission apply a haircut that is based on the current haircuts for similar maturity commercial paper, bankers acceptances and certificates of deposit under Rule 15c3-1(c)(2)(vi)(E). These haircuts are applied to the greater of the long or short position, and range from 0% for a maturity less than 30 days to 0.5% for a maturity between 271 days and 1 year. For a maturity beyond one year, the U.S government securities haircuts in Rule 15c3-1(c)(2)(vi)(A) should be applied. These haircuts would better reflect the deep liquidity of these foreign exchange markets.

In addition, we note that the Proposal's method for computing haircuts for foreign exchange transactions would only permit offsets between two foreign exchange transactions or between an open futures contract or commodity option and a foreign exchange transaction. However, firms commonly use foreign exchange transactions to hedge other positions. For instance, a firm with an equity swap position denominated in a foreign currency might use a foreign exchange derivative to hedge its foreign exchange exposure. Accordingly, we suggest that the Commission treat a foreign exchange transaction that is covered by an open swap, SBS or securities forward in the same manner as a foreign exchange transaction that is covered by an open futures contract or commodity option.

- ***Recommendation:*** *For transactions in highly liquid currencies, the Commission should apply a haircut based on the current haircuts for similar maturity commercial paper,*

---

[42] Proposing Release at 70,249.

[43] Those currencies are the U.S. dollar, Euro, Japanese yen, Pound sterling, Australian dollar, Swiss franc, Canadian dollar, Hong Kong dollar, Swedish krona, New Zealand dollar, Singapore dollar, Norwegian krone and Mexican peso.

bankers acceptances and certificates of deposit or U.S. government securities. It also should recognize offsets between foreign exchange transactions and swaps, SBS and securities forward transactions.

C. **Credit Risk Charges**

Under current Appendix E of Rule 15c3-1, an ANC broker-dealer or an OTC derivatives dealer is permitted to add back to its net worth uncollateralized receivables from counterparties arising from OTC derivatives transactions, and then take a credit risk charge based on the uncollateralized credit exposure to the counterparty instead of the 100% deduction for the receivable. Under the Proposal, however, an ANC broker-dealer, as well as a stand-alone nonbank SBSD approved to use internal models,[44] would only be permitted to apply a credit risk charge under Appendix E for a SBS with a commercial end user. All other uncollateralized or under-collateralized OTC derivatives exposures outstanding more than one business day, including exposures to commercial end users under swaps, would be subject to a 100% deduction from net capital.

We urge the Commission not to limit the circumstances in which a credit risk charge may be taken in lieu of a 100% deduction. Under Dodd-Frank, a firm will fail to collect margin in only one of two situations. In the first situation, a customer has failed to post margin even when required to do so. Requiring a firm to take a 100% deduction to net capital in this situation would immediately penalize it for an event that, in most cases, is only very temporary in nature. It effectively assumes that a customer will never post margin, when typically a delay is due to operational considerations that can be addressed in a matter of days. It also does not take into consideration that, if the customer's account remains undermargined for a longer period, the SBSD would typically act to liquidate the customer's positions. In this regard, we note that existing Rule 15c3-1 provides broker-dealers with five days to cure a margin deficiency, not one day. Even though we are not suggesting that a similar grace period be adopted for SBS, we do believe that a credit risk charge adequately addresses the risks of an undercollateralized position during the interim period before margin is posted. Therefore, a punitive 100% deduction is unnecessary.

In the second situation, a specific exception to the margin requirement applies. We discuss the exceptions proposed by the Commission in the following section. In addition, however, the CFTC has also proposed an exception from margin requirements for an SD trading with a non-financial entity.[45] Requiring a SBSD to hold additional capital for each dollar of margin it did not collect from a non-financial entity for a swap would effectively undermine that exception. It also would deter the dual registration of nonbank SBSDs as SDs. Neither of these consequences appears intended, nor consistent with the statutory mandate for the CFTC and the Commission to adopt consistent capital margin requirements to the maximum extent practicable. We cannot discern a clear policy basis for this distinction between swaps and SBS. Even taking into account the anticipated higher volume for swaps, we are aware of no empirical basis upon

---

[44] The Proposal does not address credit risk charges for OTC derivatives dealers.

[45] *See* 76 Fed. Reg. 23,732 (Apr. 28, 2011) at § 23.154.

which to conclude that counterparty credit risk charges are insufficient to account for the risk to the nonbank SBSD arising from its failure to collect margin. Accordingly, we urge the Commission to permit ANC broker-dealers and stand-alone SBSDs approved to use internal models to apply a counterparty credit risk charge in lieu of a 100% deduction for swaps with non-financial entities that qualify for an exception from CFTC margin requirements.

In addition, in Part II of this letter, we suggest that the Commission, if necessary to harmonize its rules with international standards, adopt exceptions to margin requirements for SBS with sovereigns, central banks and supranational institutions. We also suggest that the Commission adopt exceptions for SBS with certain affiliates to facilitate effective group-wide risk management. As with swaps or SBS with commercial end users, applying a 100% capital charge to undermargined accounts with these counterparties would undermine the exception. Accordingly, we also urge the Commission to permit ANC broker-dealers and stand-alone SBSDs approved to use internal models to apply a counterparty credit risk charge in lieu of a 100% deduction for swaps and SBS with sovereigns, central banks, supranational institutions and affiliates, to the extent that an exception to applicable margin requirements applies.

With respect to inter-affiliate swaps and SBS more generally, we strongly urge the Commission to permit firms a one-day grace period before a capital charge will apply to an undermargined account, provided that the undermargined account is held for an entity that is subject to U.S. or comparable non-U.S. prudential regulation. We recognize that this approach would differ from the one the Commission has historically taken with respect to broker-dealers' intercompany exposures, for which there has been no grace period before a broker-dealer is subject to a capital charge. Implicit in the Commission's historical approach is a desire to assure that intercompany transactions are not used as a means to transfer value from a broker-dealer to an unregulated affiliate in a manner that would contravene restrictions on the withdrawal of capital from the broker-dealer. Inter-affiliate swaps and SBS, following Dodd-Frank, generally do not present this risk. For the first time, swap and SBS dealing activities will be required to be conducted in registered entities subject to capital requirements.

In the circumstance in which a SBSD is trading with such a regulated affiliate, applying an immediate capital charge before there is operationally a means for transferring collateral to a SBSD would only serve to undermine beneficial risk management activities. Wholly-owned affiliated entities within a holding company group often engage in inter-affiliate swap and SBS transactions in order to manage risk effectively within their corporate group. For example, a parent company may issue floating rate notes and enter into an offsetting fixed-for-floating rate swap with one of its affiliates. Additionally, due to a range of commercial, tax, regulatory and market considerations, a counterparty may prefer to face one entity in a group (*e.g.*, a foreign affiliate) even though, from a risk management perspective, a different entity (*e.g.*, a U.S. affiliate) is better positioned to incur the exposure. Similarly, one affiliate may have a risk exposure that another affiliate is better positioned to manage. Inter-affiliate transactions are often used in each of these cases, and should not be penalized.

- ***Recommendation:*** *The Commission should not limit the circumstances in which a credit risk charge should be taken in lieu of a 100% deduction for uncollateralized receivables to SBS with a commercial end user.*

- ***Recommendation:*** *Inter-affiliate transactions between a SBSD and a regulated affiliate should have a 1-day grace period before the SBSD incurs a capital charge for a failure to collect margin, consistent with the treatment of transactions with third parties.*

D. Capital Charge in Lieu of Margin Collateral

The Proposal would require a SBSD, when calculating its net capital for regulatory capital purposes, to take capital deductions for the full value of: (1) the margin amount calculated for a SBS with a commercial end user, less any positive equity in the customer's account, unless the SBSD is approved to use internal models (in which case it could apply a counterparty credit risk charge, as described above);[46] (2) the amount of cash required in the account of each SBS customer to meet the margin requirements of a clearing agency or the Commission, after application of calls for margin, marks to market, or other required deposits that are outstanding for one business day or less;[47] (3) margin collateral posted by a SBS customer held by a third-party custodian, less any positive equity in the account of the customer (the "**Third-Party Custodian Deduction**");[48] (4) the margin amount calculated for a legacy SBS customer, less any positive equity in the account of the customer (the "**Legacy Account Deduction**");[49] and (5) for each account carried by the SBSD for another person that holds cleared SBS transactions, the amount of the deductions that the positions in the account would incur pursuant to the applicable Commission capital rule if owned by the SBSD, less the margin value of collateral held in the account (the "**Cleared SBS Deduction**").[50]

As described in further detail below, each of the Third-Party Custodian Deduction, the Legacy Account Deduction and the Cleared SBS Deduction (collectively, the "**Deductions**") would adversely affect customers in ways that are either inconsistent with Dodd-Frank or that undermine competitiveness, or both. The Deductions would also impose punitive economic costs on SBSDs that are not necessary to achieve the underlying policy goal of ensuring that SBSDs have sufficient resources to manage risks associated with their SBS transactions. These Deductions would also not apply under the capital regimes proposed by the CFTC and the Prudential Regulators. As a result, only nonbank SBSDs would be subject to the Deductions, thereby leading to significant competitive disparities. Further, if the Commission required the Deductions to apply to all customer accounts of a SBSD, including swaps and SBS accounts, the

---

[46] Proposal § 15c3-1(c)(2)(xiv)(B)(1); Proposal § 18a-1(c)(1)(viii)(B)(1).

[47] Proposal § 15c3-1(c)(2)(xv); Proposal § 18a-1(c)(1)(ix).

[48] Proposal § 15c3-1(c)(2)(xiv)(B)(2); Proposal § 18a-1(c)(1)(viii)(B)(2).

[49] Proposal § 15c3-1(c)(2)(xiv)(B)(3); Proposal § 18a-1(c)(1)(viii)(B)(3).

[50] Proposal § 15c3-1(c)(2)(xiv)(A); Proposal § 18a-1(c)(1)(viii)(A).

capital deductions required for swap accounts under the Commission's rules may force market participants to remove all swap activity from nonbank SBSDs. This would lead to capital reallocation and netting inefficiencies without any meaningful improvement in risk management.

1. Third-Party Custodian Deduction

SIFMA strongly urges the Commission to eliminate the Third-Party Custodian Deduction. It would be harmful to customers by frustrating their ability to enter into custodial arrangements that are beneficial to them and expressly provided for by Congress. Moreover, under these arrangements, the SBSD is fully protected, with well-established and enforceable legal rights to obtain and dispose of collateral upon a customer's default. Applying a punitive deduction in such a circumstance would be disproportionate to the risks presented, imposing a unique burden on nonbank SBSDs and their customers.

a. The Third-Party Custodian Deduction Is Inconsistent with Dodd-Frank and Would Harm Customers

In Dodd-Frank, Congress amended the Exchange Act to require both bank and nonbank SBSDs, upon customer request, to permit a customer to segregate its initial margin at an independent third-party custodian.[51] By enacting this provision, Congress clearly intended that SBS customers be able to choose the custodian that holds initial margin posted in connection with uncleared SBS transactions. Congress did so because these custodial arrangements are considered to be beneficial to customers, protecting them from credit risk to the dealer for the return of initial margin.

The Third-Party Custodian Deduction, if implemented, would frustrate customers' ability to enter into these arrangements, and so is clearly at odds with Congress's manifest intent. In particular, it would impose unwarranted costs on a SBSD when a customer exercises the right to segregation established by Congress, making it more difficult for a nonbank SBSD to trade with a customer desiring to exercise that right at prices that are comparable to those offered by bank SBSDs and foreign SBSDs.

In this regard, initial margin for a SBS transaction that a customer requests be segregated at an account held by a third-party custodian is similar to other instances in which a contrary regulatory policy objective prevents a broker-dealer from being permitted to hold collateral pledged to it by a customer. These other instances include, for instance, investment companies registered under the Investment Company Act of 1940 and employee benefit plans and governmental plans subject to the Employee Retirement Income Security Act of 1974. As in those instances, a dealer should not be penalized simply for satisfying a separate regulatory policy objective.

---

[51] Exchange Act Section 3E. A similar requirement applies to swap transactions. *See* Commodity Exchange Act ("**CEA**") Section 4s(l).

b. **The Third-Party Custodian Deduction Is Not Necessary Because SBSDs Are Fully Protected Under Applicable Creditor's Rights Rules and Liquidity Risk Management Practices**

Consistent with Congress's intent, third-party custodial arrangements are already used today in SBS transactions. Such arrangements permit the SBSD to perfect a security interest in the collateral held by the custodian while giving the customer the option of selecting the custodian to which it will take credit risk.

While the terms of third-party custody arrangements are subject to bilateral negotiation, in each case they enable the SBSD to establish a perfected security interest in the collateral held by the third-party custodian and clearly specify the rights of the SBSD to access the collateral pledged to it. Accordingly, the Commission's concerns that the collateral is not in the "control" of the SBSD or capable of being liquidated by the SBSD are misplaced.

Although we recognize that there may be circumstances, following a SBSD's own default, when third-party custodial arrangements might slow the rate at which customers whose collateral is held by the SBSD are paid relative to those that elect individual segregation, such customers still retain rights to their requisite share of customer property. The Proposal would impose an additional cost on the SBSD when a customer elects to hold its collateral with a third party custodian, creating a tiered-cost structure that disadvantages those customers who so elect. It would not be consistent with Dodd-Frank for the Commission to favor those customers who do not opt for third-party custody over those who do, when the customers opting for third-party custody are merely exercising a right that Congress intended for them to have.

In addition to legal arrangements, firms manage risk in third-party custodial arrangements through liquidity risk management. In the unlikely event of a dispute with a custodian for the delivery of collateral, a SBSD may have delayed access to collateral in which it has a first-priority security interest. However, this risk is only *when*, not *if*, the SBSD will gain access to the collateral. SBSDs manage this risk through liquidity risk management practices, which account for timing gaps in the availability of collateral. In addition, bank holding companies with SBSD subsidiaries will be subject to the Basel III Liquidity Coverage Ratio, which excludes high-quality assets held by a custodian from inclusion in the pool of assets deemed available to meet short-term funding requirements. Accordingly, any liquidity risk in such custodial arrangements is adequately addressed through existing regulatory frameworks, and therefore does not require any additional treatment through the capital regime.

c. **The Third-Party Custodian Deduction Would Make Nonbank SBSDs Uncompetitive**

As noted above, Dodd-Frank expressly mandates that the Commission, together with the Prudential Regulators and the CFTC, "shall, to the maximum extent practicable, establish and

maintain comparable minimum capital requirements" for SBSDs.[52] Neither the Prudential Regulators nor the CFTC included the Third-Party Custodian Deduction in their proposed capital rules for SDs and SBSDs. The Commission's Proposal is inconsistent with these other proposed capital regimes, and would result in huge disparities in capital requirements for bank SBSDs and nonbank SBSDs engaged in identical market activities. Notably, we also are not aware of any major jurisdiction outside the United States that either has or has proposed to apply a capital penalty similar to the Third-Party Custodian Deduction.

If the Third-Party Custodian Deduction is included in the Commission's final rules, nonbank SBSDs will be forced to compete at a significant disadvantage with bank SBSDs and foreign SBSDs. The deduction may effectively force nonbank SBSDs to exit certain SBS markets entirely, which would have the unfortunate consequence of pushing such activity into less regulated, or even unregulated, global markets. This outcome would not be consistent with Congress's desire to create a well-regulated SBS market in the United States.

d. Segregation Rules Would Better Address the Commission's Concerns

To the extent that the Commission is concerned that there may be some types of custodial arrangements that pose unusual risks to a SBSD prior to its insolvency, it retains the authority under Section 3E to prescribe rules regarding the terms of third-party custodial arrangements. We emphasize that, to ensure that there is not a competitive disparity between nonbank SBSDs and bank SBSDs, any such rules should be adopted pursuant to Section 3E and apply equally to both classes of SBSDs, rather than as an exception from a requirement for a nonbank SBSD to take a capital charge for assets held away.

- ***Recommendation:*** *To address the SBSD's credit risk to the custodian, the Commission could require that, under the arrangement the custody account is maintained with a "bank" (as defined in Section 3(a)(6) of the Exchange Act), U.S. broker-dealer or non-U.S. bank or broker-dealer that has total regulatory or net capital in excess of $1 billion (such bank or broker-dealer, the "**custodian**").[53] Such custodian should be permitted to include an affiliate of the SBSD.*

- ***Recommendation****: To better assure that a SBSD has clear contractual rights to access collateral promptly, the Commission could require that:*

  (1) the custodian must either:

  (a) establish the custody account in the name of the SBSD and recognize the SBSD as the account holder; or

[52] Exchange Act Section 15F(e)(3)(D)(ii).

[53] *Cf.* SEC Release Nos. 34-61662 (Mar. 5, 2010) and 34-61975 (Apr. 23, 2010) (exemptions in connection with the clearing of CDS that placed similar conditions on the use of a third-party custodian).

(b) *establish the custody account in the name of the customer as pledgor and SBSD as pledgee;*

(2) *the custody agreement must:*

(a) *clearly specify the conditions under which the customer may instruct the custodian to transfer any amount of property from the custody account without the transfer-specific instruction or consent of the SBSD;*

(b) *restrict any such transfer to cases where the customer certifies that (i) such a specified condition has occurred, (ii) the customer has terminated any transactions secured by property in the custody account and (iii) the customer is entitled to the transfer of such amount following a net settlement calculation pursuant to the terms of governing transaction documentation;*

(c) *require the custodian to comply with any instruction given by the SBSD exercising its rights as a secured party under the transaction documentation with the customer to transfer or redeem property from or with respect to the custody account, or to sell or otherwise dispose of such property, without the customer's consent; and*

(d) *include an acknowledgement by the custodian that the property in the custody account is not subject to any right, charge, security interest, lien, or claim of any kind in favor of the bank, or any person claiming through the custodian, other than the SBSD's claim pursuant to the custody agreement and for fees, expenses and charges lawfully accruing in connection with the custodial arrangement and, if the custody agreement or the underlying transaction agreement includes a covenant on the part of the customer that it will deliver only cash or fully-paid for securities into the account, for any advances made by the custodian in connection with assets credited to the account; and*

(e) *if the account is in the customer's name, the custody agreement must not permit the custodian to disregard (or not to comply with) any instruction from the SBSD regarding the transfer or sale of assets in the custody account on the basis of any contrary instruction from the customer other than a previous instruction from the customer that complies with the restrictions set out in (2)(b) above.*

2. Legacy Account Deduction

SIFMA also urges the Commission to modify the Legacy Account Deduction.[54] The deduction, as currently proposed, would unfairly penalize SBSDs and their customers for

[54] We discuss other issues relating to legacy accounts in Part II.D of Appendix 2 of this letter.

transactions entered into before the effectiveness of the margin rules. Notably, no other regulator has proposed to impose a similar penalty.

By way of further background, regulatory margin requirements have not previously existed for SBS. In many cases, SBSDs have required their counterparties to post initial margin, recognizing that they should collateralize their credit and market risk on these transactions. These collateral arrangements, however, are commercial negotiations that do not generally permit the SBSD to demand any amount of initial margin from the counterparty at a subsequent point in the life of the trade. There are serious operational and market practice constraints that would prevent SBSDs from unilaterally demanding that counterparties post the full amount of margin for legacy trades as calculated under as-yet un-finalized margin rules. Recognizing this, the Commission has not required SBSDs to collect margin on legacy accounts, citing the "impracticality of renegotiating contracts governing security-based swap transactions that predate the effectiveness" of the Proposal.[55]

Even while recognizing the impracticality of forcing SBSDs to collect regulatory-specified margin amounts on legacy accounts, the Proposal would nonetheless require a SBSD to take a capital deduction for the full amount of any under-margined legacy accounts. Any SBSD with a sizeable legacy account portfolio would thus be placed in the untenable position of requiring legacy account counterparties to post regulatory margin for old trades (which the Commission itself recognizes is impractical) or take a capital deduction equal to the amount of any deficiency. Most troublingly, if put into effect immediately upon the effective date of the margin requirements, the Legacy Account Deduction would result in sudden capital shortfalls. To avoid choosing between collecting margin when doing so is impractical, on the one hand, and suffering a capital shortfall, on the other, some market participants may cease engaging in any new SBS activity so as to avoid registration as a SBSD, while others would be forced to terminate or novate existing portfolios. Instigating such a forced withdrawal from the market or liquidation of positions would not help ensure the safety and soundness of nonbank SBSDs.

Moreover, not only would the Legacy Account Deduction result in these negative consequences, it also is not necessary to protect SBSDs. The risk to a SBSD arising from a legacy account is, by definition, limited because such an account can only be used to hold SBS entered into prior to the effective date of the margin rules and collateral for those SBS.[56] In the worst case, those SBS will simply expire in the normal course, meaning that any risk to the SBSD will only be temporary in nature. Additionally, for legacy SBS that become eligible for central clearing, the SBSD will in many cases backload those SBS into the clearing agency, since doing so will increase the potential for multilateral netting and therefore tend to reduce the SBSD's overall margin requirements at the clearing agency for newly executed SBS. Once backloaded, the SBS would of course not be subject to the Legacy Account Deduction.

---

[55] Proposing Release at 70,269.

[56] Proposal § 18a-3(b)(9).

Given the limited risk profile for legacy SBS, we believe that the Commission should consider alternative measures to account for legacy SBS in its capital rules. For example, instead of applying the Legacy Account Deduction to all legacy accounts, the Commission could instead apply the deduction to (i) those accounts for which the margin amount less any positive equity in the accounts exceeds, in the aggregate, 50% of the SBSD's tentative net capital and (ii) any individual legacy account for which the margin amount less any positive equity in the account exceeds 5% of the SBSD's tentative net capital. This approach would ensure that the SBSD does not have undue concentration to legacy SBS counterparties to which its potential future exposure is uncollateralized. Alternatively, the Commission could require SBSDs to take credit risk capital charges for legacy accounts, *i.e.,* nonbank SBSDs approved to use internal models and ANC broker-dealers could simply apply Appendix E to Rule 15c3-1, and other nonbank SBSDs could apply a credit risk charge based on the CFTC Capital Proposal for SDs that do not use internal models (under which the credit risk charge would be equal to 8% of the credit risk factor-adjusted sum of current exposure plus potential future exposure).[57]

Additionally, regardless of the type of capital charge that the Commission requires for legacy accounts, we urge it to permit SBSDs to elect to exclude from accounts subject to the charge any currently uncleared positions in a type of SBS for which a clearing agency has made an application to the Commission to accept for clearing. Such an exception would provide an incentive for SBSDs to encourage an expansion of central clearing and to backload positions into central clearing once it becomes available.

- ***Recommendation:*** *The Commission should modify the Legacy Account Deduction by instead adopting either a credit risk charge or a credit concentration charge, with an exception permitting SBSDs to elect to exclude from accounts subject to the charge any currently uncleared positions in a type of SBS for which a clearing agency has made an application to the Commission to accept for clearing.*

3. Cleared SBS Deduction

The Cleared SBS Deduction would also harm customers because it would provide an incentive for the collection of margin by SBSDs beyond the amount determined by the clearing agency, under applicable Commission rules and supervision, to be appropriate to the risks of the relevant transactions. Such amount also would not, as has historically been the case when a clearing member collects excess collateral, be tied to any credit evaluation of the customer by the SBSD.

Accordingly, we urge the Commission to eliminate the Cleared SBS Deduction. If the Commission believes that clearing agency margin requirements are not sufficiently standardized or do not adequately address risk, it should address those considerations directly through its regulation of the clearing agency. For instance, the Commission could adopt similar

[57] Potential future exposure would be determined by applying a conversion factor to the notional amount for a position and, for multiple positions held under a master netting agreement, applying a 60% netting factor. *See* CFTC Capital Proposal at 27,809.

requirements to the CFTC, which requires derivatives clearing organizations to apply initial margin requirements calculated based on estimated price movements over a specified liquidation horizon that varies by product, with the coverage of the initial margin requirement, along with projected measures of the models' performance, required to meet an established confidence interval of at least 99%, based on data from an appropriate historic time period.[58] Establishing similar requirements would promote consistency in the regulation of clearing organizations while avoiding the adverse consequences to customers and SBSDs triggered by the Cleared SBS Deduction.

➢ ***<u>Recommendation</u>:*** *<u>The Commission should eliminate the Cleared SBS Deduction and instead address any concerns it has directly through its regulation of clearing agencies.</u>*

E. <u>Liquidity Stress Test Requirements</u>

Under the Proposal, ANC broker-dealers and stand-alone SBSDs approved to use internal models would be subject to liquidity risk management requirements to (i) perform a liquidity stress test at least monthly that takes into account certain assumed conditions lasting for 30 consecutive days, (ii) maintain at all times liquidity reserves, composed of unencumbered cash or U.S. government securities, based on the results of the liquidity stress test and (iii) establish a written contingency funding plan.[59]

SIFMA generally supports the enhancements of liquidity requirements for financial institutions; however, we urge the Commission in the strongest possible terms to modify the test to protect the management and use of liquidity in ways that are critical to the business of our member firms. In particular, we emphasize that it is critical to align the Commission's liquidity requirements with applicable Basel and FRB requirements. Enhanced liquidity has been a key focus of the Basel Committee following the 2008 financial crisis, and the FRB in particular has sought through its enhanced prudential standards under Title I of Dodd-Frank to ensure that systemically important financial institutions establish and maintain adequate liquidity reserves.[60]

First, the Commission should eliminate the requirement that liquidity reserves be maintained "at all times," because this will unfairly penalize the use of excess liquidity intraday or overnight. The ability to make use of excess liquidity intraday is critical to the business of our member firms. Instead, the Commission should adopt language similar to the Basel and FRB regimes, which would require institutions to monitor, measure and manage their intraday liquidity risk exposure. Second, the Commission should expand the range of assets that are allowable as liquidity reserves to be consistent with the Basel and FRB regimes, which allow liquidity reserves to include investment-grade corporate debt, certain foreign sovereign securities, certain unencumbered equities and certain mortgage-backed securities. Finally, the Commission

---

[58] CFTC Rule 39.13(g)(2)(ii).

[59] Proposal § 15c3-1(f); Proposal § 18a-1(f).

[60] *See* 77 Fed. Reg. 594 (Jan. 5, 2012).

should align its liquidity requirements with those regimes by permitting liquidity to be managed at an institution's holding company, rather than trapping assets in one or more particular subsidiaries. In particular, we recommend that the Commission adopt an exception from the Proposal's liquidity requirements for an ANC broker-dealer or stand-alone SBSD that is subject, on a consolidated basis, to comparable liquidity requirements administered by the FRB or by a foreign supervisor that has adopted requirements consistent with the Basel Accords, where those comparable liquidity requirements take into account the liquidity needs of the ANC broker-dealer or stand-alone SBSD. If this exception is not adopted, then, at a minimum, in light of the centralized liquidity management function at most large financial holding companies, and the comprehensive liquidity management requirements that apply to these companies on a consolidated basis, SIFMA respectfully submits that ANC broker-dealer and SBSD subsidiaries of such holding companies should be permitted to rely on intercompany funding sources for purposes of the Commission's stress testing regime.

If these inconsistencies are not addressed, the Proposal's liquidity requirements would give rise to unintended risks and adverse consequences. Trapping assets within a subsidiary, in particular, increases liquidity risk by preventing a subsidiary with excess liquidity from providing resources to one that is under stress. Given the limits on available liquid assets, it is more systemically sound for liquidity to be managed in an integrated, group-wide manner. Moreover, the Proposal's liquidity requirements should not be evaluated in isolation. The rest of the Proposal would seek to assure that ANC broker-dealers and SBSDs have sufficient resources in the form of additional capital and collateral to absorb the liquidity needs arising from their business. Layering additional entity-level liquidity requirements on top of entity-level capital and margin requirements would therefore require firms to sequester a level of resources in SEC-registered subsidiaries that would be highly disproportionate to such subsidiaries' actual liquidity risk. These disproportionate costs would, in turn, make business much more expensive for the customers of nonbank SBSDs and ANC broker-dealers.

➢ ***Recommendation:*** *The Commission should modify its liquidity risk requirements to make them consistent with FRB and Basel liquidity risk requirements by:*

- *Instead of requiring liquidity reserves to be maintained "at all times," requiring institutions to monitor, measure and manage their intraday liquidity risk exposure;*
- *Expanding the range of assets allowable as liquidity reserves to include investment-grade corporate debt, certain foreign sovereign securities, certain unencumbered equities and certain mortgage-backed securities;*
- *Adopting an exception from the Proposal's liquidity requirements for an ANC broker-dealer or stand-alone SBSD that is subject, on a consolidated basis, to comparable liquidity requirements administered by the FRB or by a foreign supervisor that has adopted requirements consistent with the Basel Accords, where those comparable liquidity requirements take into account the liquidity needs of the ANC broker-dealer or stand-alone SBSD; and*

- *Permitting ANC broker-dealer and SBSD subsidiaries of financial holding companies to rely on intercompany funding sources.*

F. OTC Derivatives Dealers

The Proposal seeks comment on whether (i) stand-alone SBSDs will seek to effect transactions in securities OTC derivatives products other than SBS, such as OTC options, that would necessitate registration as a broker-dealer; (ii) registering as a limited purpose broker-dealer under the provisions applicable to OTC derivatives dealers provides a workable alternative to registering as a full-service broker-dealer; and (iii) the requirements for OTC derivatives dealers should be amended (by exemptive relief or otherwise) to accommodate firms that want to deal in SBS.[61] The Proposal also suggests that merging the OTC derivatives dealer regime with the regime for stand-alone SBSDs could raise practical difficulties because, for instance, OTC derivatives dealers are not subject to a customer asset protection regime, while stand-alone SBSDs are.[62] As an alternative, the Proposal suggests that the Commission could provide conditional relief on a case-by-case basis to allow a firm that is registered as a SBSD to conduct dealing activity in derivatives other than SBS, pending further Commission consideration of how and whether to reconcile the SBSD and OTC derivatives dealer regimes.[63]

In response to the Proposals' request for comment, SIFMA recommends that the Commission modify its OTC derivatives dealer framework through conditional exemptions that would allow an OTC derivatives dealer to dually register as a stand-alone SBSD. The debt and equity derivatives business is conducted on an integrated basis, without regard to Dodd-Frank's distinctions between swaps and SBS, on the one hand, and OTC options, on the other. As a result, preventing a single legal entity from dealing in both types of instruments would result in significant inefficiencies, for dealers and customers alike. In addition, the economic distinctions between both types of instruments do not, in our view, prevent the SBSD regime from adequately protecting OTC options customers; the SBSD regime is generally at least, if not more, stringent than the broker-dealer regime.

➢ ***Recommendation:*** *The Commission should permit an OTC derivatives dealer that is dually registered as a SBSD is permitted, with appropriate customer disclosures, to deal in OTC options and qualifying forward contracts subject to the rules applicable to SBS.*[64]

---

[61] Proposing Release at 70,220.

[62] *Id.* at 70,310-11.

[63] *Id.* at 70,311.

[64] Appendix 1 to this letter provides a more detailed description of our proposal for accomplishing this result. In addition, as noted above, references in this letter to stand-alone SBSDs that are approved to use models are also intended to refer to OTC derivatives dealers that are dually registered as SBSDs. *See* Note 7, *supra.*

G. SBS Brokerage Activities

The Proposal observes that, because Dodd-Frank's SBSD definition does not include acting as a broker or agent in SBS, entities engaging in brokerage activities with respect to SBS could be required to register as broker-dealers.[65] As a result, to the extent these broker-dealer SBSDs wanted to use models to compute net capital, they would be subject to the higher minimum net capital requirements applicable to ANC broker-dealers.[66] The Proposal seeks comment regarding this topic, including whether broker-dealer SBSDs approved to use internal models to compute net capital and that register as broker-dealers only in order to conduct brokerage activities with respect to SBS, and that do not conduct a general business in securities with customers, should be subject to the minimum net capital requirements applicable to stand-alone SBSDs approved to use internal models.[67]

In addition, we note that there is ambiguity regarding whether a SBSD clearing SBS for customers should be required to register as a broker-dealer. Section 3E of the Exchange Act clearly contemplates that a person that accepts collateral from a customer for cleared SBS may register as either a SBSD or a broker-dealer. Consistent with this, the Proposal's "risk margin amount" definition, its proposed requirement for a capital charge in lieu of margin for cleared SBS and its proposed segregation requirements each contemplate that a stand-alone SBSD may act as a clearing member in SBS for customers. On the other hand, a person acting in such a capacity arguably is acting as a broker in SBS, since it is an agent for the customer in submitting SBS for clearing and facilitating the transfer of funds and securities in connection with the customer's clearance and settlement of SBS.[68]

- ***Recommendation:*** *We recommend that the Commission permit a broker-dealer SBSD that is approved to use internal models to comply with the minimum capital requirements applicable to a stand-alone SBSD approved to use internal models if it limits its securities brokerage activities to (i) performing brokerage activities incidental to accepting money, securities, or property from, for, or on behalf of a SBS customer to margin, guarantee, or secure a SBS cleared by or through a clearing agency and (ii) accepting and sending customer orders for execution on a SBS execution facility. In our view, these limitations on the entity's activities would ensure that it does not present the risks to customers and the public that are the basis for the higher minimum capital requirements applicable to ANC broker-dealers.*

---

[65] Proposing Release at 70,220.

[66] *Id.*

[67] *Id.*

[68] *See, e.g.,* SEC Release No. 34-64795 (July 1, 2011) (noting that the Exchange Act "broker" registration requirements will apply to broker activities involving SBS by persons that are members of a clearing agency that functions as a central counterparty).

II. MARGIN REQUIREMENTS

The Commission proposed two alternatives for a margin regime for SBSDs. Under both alternatives, a SBSD would collect daily variation margin. Under the first alternative ("**Alternative A**"), there would be an exception from the obligation to collect initial margin when a SBSD trades with another SBSD. Under the second alterative ("**Alternative B**"), SBSDs would be required to exchange and segregate initial margin exchanged with each other.

Sharp increases in initial margin requirements during periods of market stress can produce significant destabilizing and pro-cyclical forces. These forces have the potential to increase systemic fragility precisely at the point of greatest vulnerability. Even in times of relative market stability, regulatory requirements for initial margin could significantly reduce the supply of high-quality collateral that is necessary for the credit creation that supports economic activity. The full macro-economic impact of initial margin requirements must also be assessed against the background of multiple other regulatory requirements for the sequestration of high quality collateral. These assessments must consider impacts both during periods of market stability and market stress.

It must also be recognized that, at the level of an individual firm posting margin, the mandatory exchange of initial margin effects a net increase in credit risk, replacing potential future exposure to a counterparty for variation payments following a default with actual current exposure to that counterparty for the return of collateral. The Commission's net capital rule implicitly recognizes this effect by defining initial margin delivered by a SBSD as an unsecured receivable that is deducted from the SBSD's net worth.[69] Seeking to address this issue by requiring segregation, on the other hand, would significantly exacerbate the adverse liquidity and macro-economic effects noted above.

Each of these concerns would be magnified significantly if the two-way exchange of initial margin extended not only to trades between SBSDs, but also to trades between SBSDs and unregulated financial entities,[70] as proposed by the BCBS/IOSCO Working Group on Margining Requirements.[71]

In order to better address the credit risk management objectives associated with margin requirements, while avoiding unintended and undesirable consequences, SIFMA strongly supports the adoption of rigorous variation margin collection requirements. Rigorous variation margin requirements have the potential to significantly reduce systemic risk by eliminating the accumulation of uncollateralized current exposures, while avoiding the potentially destabilizing

---

[69] *See* Proposing Release at 70,267.

[70] Any requirement that a SBSD place its collateral in the hands of a non-prudentially supervised counterparty would be manifestly inconsistent with Dodd-Frank's requirements that margin requirements for uncleared SBS (and swaps) be established so as to ensure the safety and soundness of SBSDs.

[71] BCBS/IOSCO, Consultative Document, Margin Requirements for Non-Centrally Cleared Derivatives (July 2012) (the "**Initial BCBS/IOSCO Consultation**" and, together with the Second BCBS/IOSCO Consultation, the "**BCBS/IOSCO Consultations**").

and pro-cyclical effects of initial margin, and, at the same time, moderating unsustainable demands for the segregation of high quality liquid assets.

With respect to initial margin, recognizing the concerns noted above, the Commission proposed an initial margin collection, rather than a two-way exchange, requirement for SBSDs trading with financial end users. Additionally, if adopted, Alternative A would exclude a regulatory requirement for the two-way exchange of initial margin between SBSDs. However, SBSDs would be obligated to collect initial margin from financial end users, subject to certain exceptions.

While, for the reasons noted above, Alternative A would avoid some of the adverse impacts of Alternative B, we remain concerned by the inherent adverse consequences of initial margin requirements, even when limited to collection obligations. In light of other emerging demands for high quality liquid collateral and uncertainty regarding the scope and evolution of the over-the-counter SBS (and swap) markets as a result of the market structure reforms affected by Dodd-Frank, any effort to predict and measure these impacts would be fraught with unavoidable speculation and uncertainty. As a result, while we recognize that Dodd-Frank contains a mandate for the adoption of initial margin requirements for uncleared SBS (and swaps), we believe the adoption of those requirements would be premature at this time.

Accordingly, we urge the Commission (as well as the CFTC and the Prudential Regulators) to focus on establishing a robust, two-way variation margin regime, while continuing to evaluate, in consultation with interested constituencies, including international regulators, effective methodologies to further mitigate systemic risk without causing the adverse impacts that would result from initial margin collection requirements.

A daily variation margin requirement alone would bring the uncleared SBS market into conformity with practices in other financial markets, such as foreign exchange and repo, where initial margin is not generally considered to be necessary. Based on our experience with those markets, we do not believe that deferral of an initial margin regime would increase systemic risk; on the contrary, because it would moderate the excessive demands for access to liquid resources, reduce pro-cyclicality and mitigate credit risk, deferral of mandatory initial margin requirements may well significantly mitigate systemic risk.

In addition to discussing these issues further, we also provide below a few other targeted recommendations regarding (i) the application of margin requirements to transactions with commercial end users, sovereign entities, affiliates and structured finance and securitization special purpose vehicles ("**SPVs**") and (ii) eligible margin collateral.

A. Concerns About Mandatory Initial Margin Requirements

As noted above, while we fully support a robust, two-way variation margin collection requirement, we have very serious concerns that the adverse liquidity, pro-cyclicality, and credit and custodial risk consequences associated with initial margin – especially, the two-way exchange that would be required under Alternative B – would outweigh any incremental

potential to reduce systemic risk. Mandating the exchange of initial margin is also unnecessary to incentivize counterparties to clear SBS.

1. Mandatory Initial Margin Requirements Could Limit Credit Availability and Be Destabilizing

The net reduction in liquidity resulting from initial margin requirements, on a gross basis and subject to restrictions on re-hypothecation or re-use, would be very substantial. For example, the universal two-way margin proposal published by BCBC/IOSCO would, we estimate, require the collection and sequestration of approximately $4.1 trillion.[72] We estimate that the Commission's proposed Alternative B, if extended to all asset classes (not just SBS) and adopted across the relevant jurisdictions (not just for Commission registrants), would require the collection and sequestration of approximately $3 trillion.[73] By way of comparison, the total amount of U.S. federal debt currently held by the public is estimated at approximately $11.58 trillion.[74] The combined balance sheet assets of the FRB and the European Central Bank are approximately $6.9 trillion.[75] This figure also ignores the anticipated liquidity impact of initial margin requirements and guaranty fund contributions for cleared derivatives, which the International Monetary Fund ("**IMF**") has estimated at approximately $100-200 billion.[76]

One way to estimate the possible liquidity impact of a universal two-way initial margin requirement is to compare it to other circumstances involving a sharp decrease in the use/availability of collateral. According to an estimate by IMF staff economist Manmohan Singh, the decline in the use/re-use of collateral from 2007 to 2011 was approximately $4-5 trillion.[77] This decline was roughly equal to the aggregate increase in the traditional money supply in the United States and Europe over the same period, thereby potentially offsetting the entire monetary stimulus impact of the combined activities of the FRB, European Central Bank and Bank of England during this period.[78]

Additionally, a shortage of high-quality collateral can have destabilizing behavioral effects. For instance, the IMF has suggested that the growing demand for safe assets due to

---

[72] The ultimate amount would depend greatly on the extent to which firms use models instead of standardized haircuts and the extent of any initial margin thresholds. A more detailed depiction of estimated initial margin levels is contained as Figure 1 in Appendix 2 to this letter.

[73] These estimates are based on an assumption that firms could portfolio margin correlated swap and SBS positions. If they could not, then the estimates would naturally increase.

[74] U.S. Bureau of the Public Debt, *http://www.treasurydirect.gov/NP/BPDLogin?application=np* (last accessed Jan. 8, 2013).

[75] Federal Reserve Statistical Release H.4.1 (Jan. 2, 2013); European Central Bank, "Consolidated financial statement of the Eurosystem as at 28 December 2012" (Jan 2, 2013).

[76] IMF, Global Financial Stability Report (April 2012), at p. 96.

[77] Manmohan Singh, "The (Other) Deleveraging," IMF Working Paper 12/179 (July 2012), at p. 15.

[78] *Id.* at p. 14 (noting that a "shortage of acceptable collateral would have a negative cascading impact on lending similar to the impact on the money supply of a reduction in the monetary base").

prudential measures (including the increased collateralization of derivatives) and central bank operations, combined with a shrinking range of assets perceived as safe, could lead to adverse consequences such as increased short-term volatility jumps, herding behavior and runs on sovereign debt.[79]

These considerations suggest that unduly stringent margin requirements can have undesirable economic effects that include, but go well beyond, direct liquidity costs. As a result, the imposition of requirements that do not afford clear, meaningful and demonstrable financial stability benefits must be avoided.

2. Mandatory Initial Margin Requirements Would Have Undesirable Pro-Cyclical Effects

Initial margin requirements are unlikely to contribute significantly to financial stability and, indeed, may have destabilizing pro-cyclical effects. To be risk sensitive, initial margin models are typically dynamic, adjusting based on prevailing levels of market volatility and liquidity. We estimate that moving from normal to stressed conditions could increase initial margin requirements by more than 400%. The liquidity drain associated with increased initial margin requirements in conditions of increasing volatility are likely to create a pro-cyclical feedback loop, as calls for additional collateral force market participants to unwind positions, thereby potentially exacerbating volatility (and downward market forces) and, as a result, initial margin requirements.[80]

In contrast to cleared SBS, uncleared SBS have no central supervisory body, such as a clearing agency risk committee or global supervisor, to dampen the pro-cyclical feedback loop impact where necessary. Rather, decentralized market participants, each complying with their own regulatory and internal corporate mandates, could serve as vectors for propagating (and amplifying) this pro-cyclical feedback loop across markets and borders.

Although the use of fixed, standardized haircuts can mitigate the adverse volatility (and pro-cyclicality) impacts of an initial margin requirement, they cannot mitigate other credit and liquidity impacts. Moreover, because initial margin requirements would be significantly larger if only standardized haircuts are used (approximately $7.6-10.2 trillion vs. $600-800 billion),[81] such an approach would substantially exacerbate the credit and liquidity impact of initial margin requirements (and significantly increase the credit risk faced by all firms required to post initial margin). As a result, the mandatory exchange of initial margin necessarily entails an undesirable trade-off between mitigating the overall liquidity impact of the requirements versus mitigating the pro-cyclical impact of the requirements. Neither side of the equation would promote financial strength or stability.

---

[79] IMF, *supra* Note 76, at p. 81.

[80] *See* Daniel Heller and Nicholas Vause, "Expansion of Central Clearing," BIS Quarterly Review (June 2011), at p. 77.

[81] *See* Figure 1 in Appendix 2 for more details regarding these estimates.

3. Mandatory Initial Margin Requirements Would Increase, Not Decrease, Credit Risk

Initial margin is intended to cover the potential increase in mark-to-market exposure over a supposed liquidation horizon following default. As a result, initial margin inherently imposes some degree of over-collateralization relative to current exposure. Consequently, on a current basis, initial margin presents the posting party with credit risk to the collecting party for the return of the margin it has posted. The Commission's net capital rule recognizes this credit risk posed to a party posting initial margin by requiring a SBSD or broker-dealer to treat assets that are delivered by it as margin collateral to another party as unsecured receivables from the party holding the collateral to be deducted in full when calculating the firm's net capital.[82] Under a two-way margin regime, this overcollateralization effect is, almost by definition, more than doubled in the case of SBSDs, who have largely matched derivatives dealing books, even though it is a certainty that a SBSD cannot incur losses (and present or incur a credit risk) on both of its offsetting derivatives positions.

In addition to this over-collateralization effect, the exchange of initial margin requires a comparison of the direct and indirect benefits of protecting the collecting party from potential adverse mark-to-market movements following the posting party's default against the direct and indirect costs of exposing the posting party to the risk that its initial margin will not be returned following the collecting party's default. Whether requiring initial margin in a particular case will increase or mitigate credit risk depends on whether the defaulting party is the posting party or the collecting party, respectively, a fact that is unknowable *ex ante*. Thus, to require initial margin is to decide that the benefits of mitigating *potential future* credit exposure outweigh the creation of *current* exposure. Moreover, requiring a two-way exchange of initial margin under the BCBS/IOSCO Consultations or the Commission's proposed Alternative B would, by definition, increase credit risk in the system because both parties cannot each simultaneously default while owing the other money.

Accordingly, while it may seem intuitive that more initial margin equates to greater systemic safety, the risk mitigation benefits of expanding the collection of initial margin are actually far more mixed. There is simply no permutation under which the requirement that SBSDs exchange initial margin with each other will reduce the net amount of current credit risk in the system.

4. Initial Margin Requirements Are Not Needed to Promote Central Clearing

The Proposal requests comment regarding how initial margin requirements would promote the central clearing of SBS.[83] In our view, it is unnecessary to use initial margin requirements to incentivize counterparties to clear SBS because the Commission has the power to require standardized SBS to be cleared. We also respectfully submit that this operating

[82] *See* Proposing Release at 70,267.

[83] *See* Proposing Release at 70,270.

premise will produce inefficiencies and discontinuities that are not offset by financial stability or other social or economic benefits.

The counterparties subject to margin requirements in connection with uncleared SBS are the same counterparties that are subject to Dodd-Frank's mandatory clearing requirements. Under Dodd-Frank, all SBS that are sufficiently standardized and liquid to support widespread central clearing will become subject to a clearing mandate upon the Commission's determination that the SBS should be required to be cleared.[84] The most effective means to promote central clearing is to do so directly, by requiring standardized SBS to be cleared, when the Commission determines that such a mandate is appropriate. It would be a different matter entirely if counterparties subject to uncleared SBS margin requirements did not have to clear SBS subject to Dodd-Frank's central clearing mandate, or if there were not broad overlap in the communities eligible for clearing and margin exceptions.

Consistent with this, nowhere does Dodd-Frank suggest that margin requirements should be used to promote central clearing. Rather, Dodd-Frank solely requires that margin requirements be designed to ensure the safety and soundness of SBSDs and be appropriate for the risk of uncleared SBS.[85] As described above, mandatory initial margin requirements would be contrary to safety and soundness by increasing pro-cylicality and current credit risk. An approach more consistent with promoting safety and soundness and mitigating systemic risk would be to use the enhanced data collected through SBS data reporting to take a pro-active approach to the exercise of the Commission's mandatory clearing authority.

Calibrating margin requirements beyond a risk-appropriate level to promote central clearing other than in circumstances required by the clearing mandate would result in uneconomic decision making and could drive market participants to seek central clearing of SBS before they have the requisite level of standardization, price transparency or liquidity. Doing so may also force market participants to accept basis risk by unduly increasing the costs of non-standardized SBS even in circumstances where there is not a cost-effective or risk-correlated cleared substitute. These results would not be beneficial from either a systemic risk mitigation or economic efficiency perspective.

When a clearing mandate does not apply to a SBS, the cost of disincentivizing the uncleared transaction should be carefully considered. Capital requirements already differentiate the perceived differences in risk presented by cleared versus uncleared SBS. These differences, together with the multilateral netting benefits of central clearing, create significant incentives for the use of cleared SBS.

Counterparties' decisions to incur the greater costs associated with uncleared SBS, whether as a result of incremental capital or margin costs, reflects an implicit economic evaluation of the significance of the basis risk associated with the use of standardized products to

---

[84] *See* Section 3C of the Exchange Act (mandating that all financial entities clear SBS subject to the clearing mandate).

[85] Section 15F(e) of the Exchange Act.

mitigate bespoke risk exposures. The imposition of arbitrary, outsized disincentives, such as initial margin requirements that impose costs that outweigh the risk mitigation benefits, should be avoided. Such measures may prove economically detrimental by increasing systemic risk in circumstances where central clearing is encouraged for instruments that lack sufficient standardization, price transparency or liquidity to be risk managed effectively by clearing agencies. Applying punitive margin requirements for uncleared SBS will not help to overcome these obstacles to central clearing.

Moreover, establishing initial margin requirements for uncleared SBS for the purpose of promoting central clearing of SBS, and without regard for the impact on the market for uncleared SBS, fails to give due consideration to the significant benefits that non-standardized SBS have provided for many years. These products enable financial and other firms to more effectively hedge their actual risks without incurring exogenous basis risk. The ability to accomplish these results, in a cost-effective manner, is important. It avoids unnecessary (and actual) financial losses. It also more effectively dampens profit and loss volatility that, in turn, can directly increase an issuer's cost of capital or costs of operations. The imposition of these consequences should not be undertaken lightly and without a careful determination that the corresponding benefits warrant these adverse consequences.

B. SIFMA's Margin Proposal

For the reasons discussed above, we strongly urge the Commission to focus on establishing a robust, two-way variation margin regime, while continuing to evaluate, in consultation with interested constituencies, effective methodologies to further mitigate systemic risk without causing the adverse impacts that would result from initial margin collection requirements.

Requiring (on a phased-in basis) the daily exchange of variation margin between all financial entities (other than qualifying SPVs and affiliates, as noted below), with zero thresholds and subject only to low minimum transfer amounts, would largely address the most significant systemic risk and macro-prudential concerns associated with uncleared SBS. Under this regime, a SBSD should be required calculate its current exposure to its counterparty as of the end of each of its business days and call for variation margin (if and as required) at the beginning of its next business day. The SBSD should then be required to collect such variation margin from the counterparty by the close of the counterparty's business day. This timeframe is the shortest one under which a SBSD could collect daily variation margin, given the operational steps necessary to compute, request and collect collateral and possible time zone differences between the SBSD and its counterparty.[86]

To bolster this regime, we support improvements to the valuation infrastructure upon which variation margining depends, including requirements for regular portfolio reconciliation, dispute resolution and the reporting of material valuation disputes to supervisors. We also

---

[86] In this regard, we note that the Proposal's requirement that variation margin be collected by the SBSD by noon of each business day would not account for these operational steps or time zone differences.

support the Proposal's requirement that SBSDs implement risk management procedures and guidelines, including credit limits for all SBS counterparties and use of stress tests to monitor potential future exposure to a single counterparty and across all counterparties.[87] Such requirements will help minimize the risks the Commission seeks to avoid.

Across each of the dimensions identified above in Section II.A above, these variation margin requirements would have very significant systemic risk mitigation benefits, without the adverse consequences arising from initial margin requirements:

- The net liquidity impact of regular bilateral exchanges of variation margin is typically not material. This is because variation margin is by definition a net transfer of value and, as a corollary, is not typically subject to restrictions on re-hypothecation or re-use. Rather, variation margin payments can be used to fund other aspects of a collecting party's business, including funding variation margin payments for hedging transactions on the other side of the market.

- Variation margin requirements are likely to create desirable macro-prudential outcomes because they ensure that a counterparty will not be required to post a significant amount of collateral for its SBS when it is suffering significant liquidity strains, thereby preventing the type of destabilizing "runs" that were observed during the recent financial crisis. In this way, variation margin requirements prevent the build-up of leverage in good times and soften the systemic impact of subsequent deleveraging. Two-way variation margining on a net basis thus significantly mitigates the need for undesirable pro-cyclical conduct.

- Variation margin is designed to cover a SBSD's actual current exposure to a counterparty, *i.e.*, its net mark-to-market exposure at a point in time. Exchanging variation margin can be expected to mitigate systemic risk by reducing the contagion and spillover effects that result when a SBS counterparty defaults while owing a substantial amount to its counterparty on a current, mark-to-market basis.

With respect to initial margin, we believe that the best approach, at this time, would be to focus first on expanding and enhancing variation margin exchange practices, as described above. We are concerned that implementing initial margin requirements, even in the form envisioned by Alternative A, would give rise to the adverse consequences noted above before there is an opportunity to observe market dynamics, quantify predictable impacts, identify risks that are not addressed by a rigorous variation margin regime and consider all of the possible measures for reducing those risks.

In addition, we note that there is not yet a consensus within the regulatory community regarding the structure or content of initial margin requirements. Alternative A, which has been proposed solely by the Commission, differs significantly from Alternative B, which was also

---

[87] Proposal § 18a-3(e).

proposed by the CFTC and the Prudential Regulators, and both differ from the universal two-way exchange proposed by BCBS/IOSCO. Further, none of the proposals substantively address initial margin thresholds, if any. Adopting initial margin requirements before there is an international consensus on their structure and content would be extremely problematic. Some market participants would, following their fiduciary duty, conduct their activities so that applicable initial margin requirements suited their interests, whether that is collecting more collateral or posting less. Inconsistencies would narrow the range of counterparty pairs able to transact effectively with each other, thereby reducing liquidity. In the case of SBSDs specifically, a nonbank SBSD subject to margin requirements under Alternative A would be disadvantaged were it to transact with a bank SBSD subject to margin requirements under Alternative B, since it would be required to post initial margin but not required to collect it. As a practical matter, this is likely to deter transactions between nonbank and bank SBSDs, or force nonbank SBSDs to negotiate for the collection of initial margin and thereby lead to the *de facto* adoption of Alternative B.

- ***Recommendation:*** *For the above reasons, we view the implementation of rigorous variation margin requirements as a vital improvement that should be the principal and most immediate focus of the Commission and other regulators. In the meantime, whether market participants post initial margin should be a matter of bilateral negotiation, based on their own evaluation of the costs, risks, and prudential safety and soundness considerations.*

- ***Recommendation:*** *If the Commission decides to adopt initial margin requirements, SIFMA urges the Commission to adopt Alternative A, modified as described in Appendix 2 to this letter. We emphasize that the Commission should not adopt this regime unless there is first a consensus for the approach within the international regulatory community, since inconsistent margin requirements would undermine the benefits of this regime and produce other competitive market distortions. In particular, we note that, to avoid such distortions, any requirement to collect initial margin should apply in a consistent manner to bank and nonbank SBSDs that transact with each other and should allow for a broader use of models than would be permitted under the Proposal.*

C. Additional Comments Relating to Margin Requirements

As we have explained above, we believe strongly that mandatory initial margin requirements would not significantly increase systemic resiliency and could be destabilizing. In addition to this over-arching concern, we have offered below further comments relating to the Proposal's margin requirements.

1. The Commission Should Harmonize its Exceptions to the Margin Collection Requirement

(a) **Commercial End Users**

The Proposal includes an exception to the margin collection requirement for commercial end users.[88] As a result, SBSDs would not be required to collect initial or variation margin from commercial end users. Parties can, however, individually negotiate bilateral margin requirements, and SBSDs would be required to establish credit limits for commercial end user counterparties.[89]

We support the proposed exception to the margin collection requirements for commercial end users, since SBS with commercial end users do not generally pose the type of risks to the safety and soundness of SBSDs that would justify categorical application of margin requirements to them. However, we are concerned that the Commission would define "commercial end user" in a way that is inconsistent with the definition applicable under its own mandatory clearing requirements and with the Prudential Regulators' and CFTC's margin proposals.

The end-user exception for both mandatory clearing and margin requires, among other conditions, that the end-user is not "predominantly engaged in activities that are financial in nature as defined in the Bank Holding Company Act of 1956" ("**BHCA**") (the "**Predominantly Engaged Test**"). Market participants are currently uncertain about how to analyze whether an entity satisfies this standard because neither the Commission nor the Exchange Act specifies what "predominantly" means or whether the analysis is based on the consolidated assets and revenues of the relevant entity. Instead of clarifying this ambiguity, the Commission proposed a second, almost identical requirement as a result of which the margin exception would be applicable only to a commercial end user that "engages primarily in commercial activities that are not financial in nature" (the "**Engaged Primarily Test**"). Therefore, for the margin exception, not only will market participants have to determine whether an entity is "predominantly engaged" "in activities that are financial in nature as defined in the BHCA" but they will also have to determine whether that same entity is "engaged primarily" in "commercial activities that are not financial in nature." Adding to the ambiguity, in contrast to the Predominantly Engaged Test, there are no definitions or legal precedents to refer to for the Engaged Primarily Test.[90]

More specifically, it is unclear whether the Commission intends the test for 'primarily' to be the same as the test for 'predominantly' and, if primarily is a lower standard (*e.g.*, more than 50% instead of 85% or more), some commercial end users could qualify for the mandatory

---

[88] Proposal § 18a-3(c)(1)(iii)(A).

[89] Proposal § 18a-3(e).

[90] For the Predominantly Engage Test, although the Exchange Act does not clarify what it means to be "predominantly engaged" in a financial activity, the BHCA and Title I of Dodd-Frank add gloss to congressional intent for this test. *See* Dodd-Frank Section § 102(a)(6) and BHCA §§ 4(k), (n). There are no analogous statutory provisions, to our knowledge, that provide market participants with similar clarity about how to analyze the Engaged Primarily Test.

clearing exception but not the margin exception. There is no indication that this was Congress's intent and, to the contrary, Congress made clear its intention in Dodd-Frank that the Predominantly Engaged Test be the threshold for an end user to qualify as a commercial end user. The Proposal would thus impose margin requirements on commercial end users that do not satisfy the Engaged Primarily Test, resulting in increased liquidity pressures, pro-cyclicality and credit risks in the market, without any basis for concluding that Congress intended such a result. These entities are not systemically important and do not pose risks to the safety and soundness of SBSDs or the broader financial market. Furthermore, because the CFTC and Prudential Regulators only require the Predominantly Engaged Test, and not the Engaged Primarily Test, for their end user exception to margin requirements, nonbank SBSDs will be at a competitive disadvantage because they will be required to collect margin from certain end users when SDs and bank SBSDs do not.

- ***Recommendation:*** *The Commission should eliminate the Engaged Primarily Test to make the definition of commercial end user for the margin exception consistent with the definition for the mandatory clearing exception, and the margin proposals of other U.S. and international regulators.*

(b) **Foreign Sovereigns, Central Banks And Supranational Institutions**

BCBS/IOSCO expressed broad support for exceptions from margin requirements for uncleared derivatives in the case of sovereigns, central banks and supranational institutions.[91] However, the Commission did not propose a similar exception for uncleared SBS. We are very concerned that this inconsistency, if it is codified, would result in severe competitive disadvantages for nonbank SBSDs. Not only would nonbank SBSDs be uncompetitive relative to foreign SBSDs when trading with foreign sovereigns, central banks and supranational institutions, but also nonbank SBSDs' diminished competitive position is likely to extend to other local counterparties because local agencies, municipalities and corporations often follow the lead of their sovereign in determining the counterparties with whom they transact. Therefore, we urge the Commission to harmonize its approach to the margin requirements with respect to transactions with sovereigns, central banks and supranational institutions with the BCBS/IOSCO final recommendations.

- ***Recommendation:*** *The Commission should ensure that its treatment of sovereign entities is consistent with international standards.*

(c) **Affiliates**

The Proposal does not include an exception to the margin collection requirements for SBS transactions between affiliates. We recommend that variation margin requirements apply to an inter-affiliate transaction only when a SBSD is transacting with an unregulated/non-prudentially supervised affiliate.[92] As discussed above in Section I.C, we also urge the

[91] *See* Initial BCBS/IOSCO Consultation at 9 and Second BCBS/IOSCO Consultation at 9.

[92] If the Commission adopts initial margin requirements, it should not apply them to any inter-affiliate transaction.

Commission to permit firms a one-day grace period before a capital charge will apply to an undermargined account of an affiliate, provided that the undermargined account is held for an affiliate that is subject to U.S. or comparable non-U.S. prudential regulation.

Inter-affiliate SBS transactions enable improved hedging efficiencies and better facilitation of transactions with customers (*e.g.*, customers can transact with a single entity in their jurisdiction). Additionally, global financial entities typically centralize their market risk exposures through a series of back-to-back transactions. Centralizing this exposure allows firms to more effectively manage their risk by aggregating and netting portfolio and other risk offsets before hedging their exposure in the market. Imposing excessive margin requirements on inter-affiliate trades would frustrate these prudent risk-reducing techniques because the costs of allocating margin could outweigh the benefits gained from posting margin. Posting and collecting margin would also raise complicated cross-border operational issues and cost allocations and, in the case of segregated initial margin, would unnecessarily tie up substantial liquidity.

There are also other mitigants to the risks of inter-affiliate transactions that are less disruptive. In particular, SBSDs must hold capital against credit exposures to their affiliates. In addition, financial holding companies are subject to consolidated supervision and risk management requirements.

Nevertheless, where a SBSD has significant concentrations of current exposure to an unregulated affiliate, such exposure could pose a risk to third parties transacting with the SBSD without that risk being addressed through effective prudential supervision of the affiliate. Accordingly, we believe it would be appropriate to require the SBSD to collect variation margin from its unregulated affiliate in such circumstances.

- ***Recommendation:*** *The Commission should apply margin requirements to inter-affiliate transactions only when one of the affiliates is unregulated.*

(d) **Structured Finance or Securitization SPVs**

The Commission should adopt an exception from margin collection requirements in the case of SBS entered into with a structured finance or securitization SPV where the SBSD has rights as a secured creditor consistent with market practice for such SPVs. SBS with structured finance or securitization SPVs are subject to additional considerations not present in the context of transactions with other types of entities. In a typical structure, an SPV issues debt that is supported by a pool of assets that serves as collateral for the issued debt and obligations to other permitted creditors, and that usually over-collateralizes those exposures. Whether to hedge interest or foreign exchange risk, or to gain market- or credit-linked exposure, the SPV might enter into one or more derivatives. However, because the SPV is generally capitalized to the extent of its obligations, and does not have an operating business to generate free cash flow, nor the ability to raise additional capital, it is not able to post variation margin, much less initial margin, to its derivatives counterparties. Instead, a derivatives counterparty to the SPV has rights as a secured creditor, typically with payment rights senior to those of debt holders and other permitted creditors, or at the same level as certain payments on senior debt.

For SBS entered into by structured finance or securitization SPVs, the collateral arrangements may take the form most typical of securitizations generally, where there is a pledge of all or substantially all assets of the SPV to a trustee or collateral agent, and creditors are paid in accordance with a priority of payments. In some structures the SBS may be secured by a combination of cash assets of the SPV and a committed credit facility. In other cases, individual credit derivatives are "defeased" at the time of entry by dedicated assets in a separate securities account in which the derivatives counterparty has a first priority security interest and its recourse typically is limited to those assets. These arrangements generally have proven to be commercially effective methods for the SPV to structure its derivatives exposures and for a counterparty to manage its risk to the SPV. In contrast, subjecting the SPV to margin requirements would essentially prevent it from entering into any SBS at all. The imposition of an additional margin requirement in such cases would impose uneconomic costs upon the SPV and could increase the cost of capital and, indirectly, the cost of financing the underlying assets.

- ***Recommendation:*** *Where the alternative security arrangements prevailing in the marketplace, such as those described above, are in place, SBS with a structured finance or securitization SPV should be excluded from margin requirements. Furthermore, a SBSD's security interest in accordance with the SPV's governing documents should be considered a substitute for the collection of collateral and no capital charge for foregone margin should be required.*

2. Eligible Collateral

The Proposal would allow counterparties to deliver cash, securities and money market instruments, subject to specified conditions relating to liquidity and transferability, for initial and variation margin and would not limit eligible collateral to a narrow category of assets.[93] There are many factors that should be considered in determining what collateral should be accepted for each unique counterparty and trade and the Proposal provides counterparties with sufficient flexibility to make such determinations without negatively impacting the markets. Accordingly, we strongly support the Commission's approach to determining eligible collateral. SIFMA also supports the haircut methodologies in the Proposal and encourages the Commission to modify the haircut requirements in the future as necessary to maintain consistency with international standards.

The Prudential Regulators and CFTC proposed the opposite approach by specifying a limited category of assets that could be used as margin for uncleared swaps and/or SBS, as applicable. This approach would potentially increase market participants' risk by requiring them to accept collateral that could, in many cases, be inappropriate to the relevant trade. It would also increase costs and liquidity pressures on market participants by increasing demand for and placing undue pressure on the supply of such collateral. A fixed set of eligible assets is additionally likely to be unresponsive to future market evolution and the idiosyncratic needs of counterparties with particular asset portfolios or counterparties in emerging markets.

---

[93] Proposal § 18a-3(c)(3).

We also note that proposed Rule 18a-3(4)(i) would require collateral to be in the physical possession or control of the SBSD for it to be eligible. However, the segregation requirements in proposed Rule 18a-4 would only require excess securities collateral to be in the SBSD's physical possession or control. Accordingly, we request that the Commission modify Rule 18a-3(4)(i) to clarify that only excess securities collateral (and not any other type of collateral) is subject to the possession or control requirement. Imposing a broader possession or control requirement could impose serious funding costs on SBSDs, for instance by requiring them to fund initial and variation margin payments for offsetting transactions through their own resources rather than through the collateral posted by SBS customers in accordance with proposed Rule 18a-4.

➢ ***Recommendation:*** *The Commission should adopt its proposed requirements regarding the scope of eligible collateral, except it should clarify that the requirement that the SBSD maintain possession and control of the collateral should apply only to "excess securities collateral" as defined in its proposed segregation rules.*

III. SEGREGATION REQUIREMENTS

A. Omnibus Segregation Requirements

The Proposal would require that a SBSD comply with omnibus segregation requirements for cleared and uncleared SBS modeled on Rule 15c3-3, unless the counterparty waives segregation or elects individual segregation.[94] Under this proposal, the SBSD must maintain possession or control of "excess securities collateral"[95] and a reserve account containing cash and qualified securities equal in value to the excess of SBS customer credits over debits.[96]

We generally support the Commission's decision to model the SBSD omnibus segregation requirements on Rule 15c3-3. We believe that using Rule 15c3-3 as a model is appropriate in light of the insolvency treatment of SBS customers under the Securities Investor Protection Act ("**SIPA**") and the U.S. Bankruptcy Code. It also is an important complement to the Commission's proposal to permit cash positions, options and single stock futures to be held in a SBS account as collateral for SBS positions.[97]

We also support the Commission's objective of accommodating the current practice of dealers in OTC derivatives to collect collateral from an OTC derivatives counterparty and concurrently deliver collateral to another dealer for an OTC derivatives transaction that hedges the transaction with the counterparty.[98] To accomplish this objective, the Proposal would define "excess securities collateral" to exclude securities or money market instruments posted to

---

[94] Proposal § 18a-4(b)-(c).

[95] Proposal § 18a-4(b).

[96] Proposal § 18a-4(c).

[97] *See* Proposing Release at footnote 537 and accompanying text (indicating that short cash positions, options and single stock futures may be held in a SBS account as collateral for SBS positions).

[98] Proposing Release at 70,278.

collateralize current exposure of the SBSD to the customer and securities and money market instruments held in a "qualified registered SBSD account" to the extent they are being used by the SBSD to meet a margin requirement of another SBSD resulting from an uncleared SBS hedging transaction to mitigate the risk of an uncleared SBS transaction with the customer.[99] In addition, the SBS reserve formula would include as debit items the debit balance in a SBS customer's account, including the net replacement value of uncleared SBS in favor of the SBSD, and margin related to uncleared SBS transactions in accounts carried for SBS customers held in a qualified registered SBSD account at another SBSD.[100]

There are, however, several technical questions and issues that need to be addressed for the proposed requirements to be made consistent with Rule 15c3-3 and to accommodate the funding and hedging practices of dealers in OTC derivatives. Some key examples include the following:

- It is not clear to us that the proposal to require a broker-dealer SBSD to conduct separate possession and control and reserve account calculations for securities, on the one hand, and SBS, on the other, is necessary given the common insolvency treatment of securities and SBS customers. Requiring separate calculations also stands likely to increase operational risk, potentially significantly.

- The Proposal would only provide exceptions from the segregation requirements for collateral posted by the SBSD to another SBSD as margin for an uncleared SBS transaction that hedges a customer-facing SBS transaction. However, the strategies used to hedge SBS do not always involve another SBS. Instead, SBSDs use other products such as cleared and uncleared swaps, cleared SBS and futures. SBSDs may also use SBS customer collateral to finance the purchase of cash positions that are designed to act as a hedge for the SBS. As proposed, SBSDs would be penalized for using these hedging strategies – they would not be able to use the initial margin received for a SBS to hedge their exposure to the SBS and would instead have to use their own assets – even though these strategies may be more cost-effective and/or otherwise commercially more appropriate under the circumstances.

- The Proposal would use the market values of securities and money market instruments, rather than their haircut values. This would necessitate a SBSD to use its own resources to fund margin requirements for transactions that hedge customer SBS transactions, to the extent of the haircuts for the securities and money market instruments it posts as margin for those hedging transactions.

- It is unclear how the exceptions from the definition for "excess securities collateral" and the debit items in the reserve formula are intended to apply to a customer that posted a combination of cash and securities to collateralize its SBS

[99] Proposal § 18a-4(b).

[100] Proposal § 18a-4a.

transactions. For example, if a customer has posted $5 worth of securities and $5 of cash as margin for a SBS, and then the SBS position moves $3 in the SBSD's favor (without any further collateral posted by the customer), is there a $3 decrease in both the possession and control and reserve account requirements, just the possession and control requirement or just the reserve account requirement?

- It also is unclear how cash, securities and money market instruments posted by a SBSD as variation margin are to be treated under the requirements. For instance, should variation margin posted by a SBSD be included as a debit item in the reserve formula, which would offset a credit item for net replacement value of uncleared SBS in favor of a customer?[101]

- Unlike Rule 15c3-3, which excludes broker-dealers from the "customer" definition, the proposed requirements would not exclude SBSDs from the analogous definition for SBS customers.

- The SBS customer definition would only include a person from whom or on whose behalf the SBSD has received or acquired or holds funds or other property for the account of the person with respect to a cleared or uncleared SBS transaction. Under this definition, it is unclear what the treatment should be for property remaining in the account of a SBS customer that is party to a portfolio margining arrangement in a circumstance in which all the SBS positions in the customer's account are temporarily closed out or expire before the customer enters into a new SBS transaction with the SBSD.[102]

- The use of a single reserve account formula for both broker-dealer and stand-alone SBSDs generates confusion regarding how some of the formula items are intended to apply for a stand-alone SBSD and the extent to which a stand-alone SBSD can offer portfolio margining. Moreover, how the proposed requirements are to apply to a portfolio margining account more generally is unclear.

- The Proposal would not impose restrictions, similar to the restriction in Rule 8c-1, on commingling of hypothecated customer securities.

[101] The absence of debit and credit balance definitions also raises issues in connection with the Proposal's margin requirements. For instance, the Proposal suggests that the mark-to-market value of uncleared SBS positions would be included, simultaneously, as (i) either a debit or credit balance (as applicable) and (ii) the amount of "equity" in the account *prior to* the addition of any credit balance and the deduction of any debit balance. Proposing Release at 70,260. This would mean that the mark-to-market value of uncleared SBS positions would be double counted in the calculation of the equity in a counterparty's account. Accordingly, we ask the Commission to clarify that the mark-to-market value of SBS positions would only be counted in the "equity" definition as part of the credit balance or the debit balance, as appropriate.

[102] Similar issues are raised by the definition for the term "account" in the proposed margin rule. Proposal § 18a-3(b)(1).

- The Proposal would require a SBSD to perform its reserve account formula computation on a daily basis, rather than a weekly basis consistent with Rule 15c3-3. We urge the Commission to reconsider this position. Calculating the reserve account formula is an onerous process that is operationally intensive and requires a significant commitment of resources. However, SBSDs should be permitted to make an intervening daily calculation and deposit if necessary to reduce liquidity burdens caused by daily variation margin delivery requirements. We believe the Commission's existing framework is flexible enough to permit voluntary daily calculations and deposits. Indeed, under Rule 15c3-3, there are broker-dealers that make periodic daily calculations and deposits even though weekly computations and deposits are required. Accordingly, the Commission can achieve its objective of decreasing liquidity pressures on SBSDs while limiting operational burdens by requiring weekly, and permitting while not requiring daily, calculations and deposits.

- The Proposal would not permit SBS reserve account deposits to be held at a bank that is affiliated with a SBSD. We urge the Commission to reconsider this position, too. Currently, affiliated banks are commonly used as custodians for securities reserve accounts and for collateral held by SBSDs. Moreover, affiliated banks are subject to financial regulations that are the same as those applicable to unaffiliated banks. We therefore recommend that affiliated banks be treated in the same manner as unaffiliated banks for these purposes.

➢ ***Recommendation:*** *Before adopting omnibus segregation requirements, we urge the Commission to consult further with interested constituencies regarding the questions and issues noted above. SIFMA would be pleased to work with Commission staff to facilitate such a consultation.*

B. Individual Segregation Requirements

Section 3E(f)(1)(b) of the Exchange Act enables uncleared SBS counterparties of SBSDs to require their initial margin, but not variation margin, collateral to be held in a segregated account at an independent, third-party custodian. Under the Proposal, SBSDs would be required to notify their SBS counterparties in writing prior to the first uncleared SBS transaction (after the effective date of the Proposal) that the counterparty has the right to require individual segregation of its initial margin collateral. SIFMA supports these requirements but believes that clarification is needed to provide market participants with more certainty.

First, the Commission should confirm that initial margin can be segregated at a custodian that is an affiliate of a SBSD. In many cases, a customer's preferred custodian may in fact be an affiliate of the SBSD. In this regard, the statutory language only requires the custodian to be an independent third-party. A reasonable reading of this language would include an affiliate of a SBSD that is a separately incorporated entity. Such an affiliate would not be subject to the insolvency of the SBSD. Additionally, initial margin held at an affiliated custodian would be subject to the same protections afforded to initial margin held at a non-affiliate custodian.

We also support the Proposal's confirmation that SBSDs are required under the statute only to send a single notice informing existing or prospective SBS counterparties of their right to elect individual segregation, and that this requirement would become effective following the effective date of the Commission's final margin rules. Requiring this notice to be sent before the Commission adopts final rules would create uncertainty in the market about the nature of counterparties' respective rights and responsibilities.

The Proposal does not, however, clarify the individual at a customer to whom a SBSD must deliver the notice.[103] In this connection, we note that parties to uncleared SBS typically already agree to notice provisions as part of their relationship documentation. Accordingly, we request that the Commission clarify that the notice may be sent to the customer (or an investment manager that is authorized to act on behalf of a customer) in accordance with notice terms mutually agreed by the parties (or, absent such terms, to a person reasonably believed to be authorized to accept notices on behalf of a customer). Customers (or investment managers, as appropriate) would then be able to receive and direct notices to the appropriate decision-makers.

Once a customer has received the notice, it should be deemed to have elected not to require individual segregation until such time as it duly notifies the SBSD that it wishes to require segregation.[104] This clarification would prevent the market disruption that would result if the SBSD could not execute a new SBS with the customer without tracking and confirming the receipt of a notice acknowledgment and affirmative election by the customer.

Once a counterparty has elected individual segregation, the segregation requirement should not become effective until after the execution of custodial documentation satisfactory to the parties, provided that the parties are negotiating such documentation in good faith. This clarification would ensure that the parties can continue to enter into new SBS pending the execution of satisfactory custodial documentation, which can require a significant amount of time.[105]

After the custodial documentation is executed by the parties, the segregation requirement should apply only to uncleared SBS entered into after the customer made the election (including SBS entered into prior to the execution of the custodial documentation but after the election), unless otherwise agreed by the parties. The pricing and other terms of each SBS are dependent on many factors, including whether a counterparty elects individual segregation. Permitting counterparties to require individual segregation, on a retrospective basis with respect to preexisting SBS, would be tantamount to a unilateral post trade modification, without consideration, of the terms of the original trade, economically disadvantaging the affected SBSD. To the extent that the parties wish for segregation to apply to preexisting SBS, or to apply

---

[103] *Cf.* 75 Fed. Reg. 75,432 (Dec. 3, 2010) at § 23.601(c) (requiring delivery of the notice to the Chief Executive Officer or Chief Risk Officer of the customer).

[104] *Cf. Id.* at § 23.601(d) (prohibiting the execution of new swaps until the counterparty acknowledges receipt of the notice).

[105] Of course, existing custodial documentation should be sufficient for the segregation of initial margin for existing transactions.

segregation for only some, but not all, positions, then they could agree to modify the scope of segregation.

Finally, we believe that the ability for a customer to elect individual segregation should be sufficient to address concerns that customers may have regarding potential exposure to "fellow customer risk" under omnibus segregation arrangements. Thus, it would *not* be appropriate, in our view, for the Commission to adopt novel omnibus segregation requirements for SBS that have never before applied to the securities markets, such as a requirement for a SBSD to segregate individually the amount owed by it to each customer or a restriction on the extent to which customer credits, in the aggregate, can be used by a SBSD to fund customer debits. Placing such limitations on omnibus segregation would be inconsistent with Rule 15c3-3 and raise complex issues relating to the relative costs and benefits of such limitations, possible increased operational risk, obstacles to portfolio margining and the introduction of moral hazard for customers in their selection of SBSDs. At a minimum, it would be necessary for the Commission, for it to act in a manner consistent with the Administrative Procedure Act, to seek further public comments before adopting such a materially different omnibus segregation regime.

- ***Recommendation:*** *A SBSD should be required to send a single notice, in accordance with contractually agreed notice procedures, regarding its customer's right to elect individual segregation. The customer should be deemed to have elected not to require individual segregation until it duly notifies the SBSD that it wishes to require such segregation. Unless otherwise agreed, segregation should apply only to SBS entered into after the customer's election, and should not take effect until the parties have executed custodial documentation satisfactory to the parties.*

C. Segregation Requirements Applied to Bank SBSDs

Section 3E of the Exchange Act authorizes the Commission to impose segregation requirements on all SBSDs, not just nonbank SBSDs. The proposed segregation rules for SBS are largely based on the provisions of the broker-dealer segregation rules (Rule 15c3-3) applicable to broker-dealers. This proposal would not unduly burden broker-dealer SBSDs or ANC broker-dealers because these firms already have procedures and resources in place to implement proposed Rule 18a-4. This regime, and the proposed segregation rules, makes sense as applied to nonbank SBSDs because of the priority afforded to customers of nonbank SBSDs upon their insolvency.

Bank SBSDs, in contrast, are already subject to customer protection requirements by their primary regulators applicable to their custody of customer assets, and requiring them to comply with proposed Rule 18a-4 would be duplicative, burdensome and unnecessary. Rule 15c3-3 and proposed Rule 18a-4 are largely written to work in tandem with broker-dealer and SBSD insolvency laws providing customers with priority over other creditors, among other protections. However, banks are subject to a different insolvency regime that does not provide similar priority or protections to "customers." It is therefore unnecessary, from an insolvency policy perspective, to subject bank SBSDs to the same segregation requirements as nonbank SBSDs.

The Commission should instead adopt an approach similar to the one taken by the Treasury Department for the segregation rules applicable to banks that are government securities dealers.[106] Specifically, the Treasury Department provides an exemption to the government securities dealer customer protection requirements for banks that meet certain conditions and are subject to the "rules and standards of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation [or] the Office of Thrift Supervision governing the holding of government securities in a fiduciary capacity by depository institutions."[107]

➢ ***Recommendation:*** *A SBSD that has a Prudential Regulator, as provided in Section 1a(39) of the CEA, should not be subject to the proposed segregation requirements, except the proposed requirements implementing the Dodd-Frank statutory requirement that a SBSD offer individual segregation to its uncleared SBS counterparties. This approach would avoid an unnecessary burden on bank SBSDs who are already subject to adequate customer protection requirements.*

IV. PHASED IMPLEMENTATION

Implementing rigorous, two-way daily exchange of variation margin as proposed in Section II.B of this letter will take time. While market participants are aware of the Commission's intention to impose margin requirements for SBS transactions, there remain many unanswered questions about the general contours of these future requirements, not to mention the specific details. Market participants will be unable to negotiate revised collateral agreements, enhance valuation methodologies and modify operational systems until there is sufficient certainty about the requirements in the final margin rules for SBS transactions. To facilitate the implementation of these adjustments in an orderly manner, we suggest that the Commission provide 24 months from the publication of final rules until two-way daily variation margining is required for uncleared SBS between financial entities (other than qualifying SPVs and affiliates), with a 12-month phase-in period for uncleared SBS between SBSDs.[108]

In addition, the Commission has previously recognized the importance of appropriately sequencing the compliance dates for requirements under Title VII of Dodd-Frank in light of the interdependencies for those requirements.[109] In the instant case, there is a significant dependency of capital requirements on margin requirements. In particular, the Proposal would apply capital deductions for under-margined accounts. If the margin and capital rules were implemented simultaneously, SBSDs would likely be unable to restructure counterparty

---

[106] *See* 17 C.F.R. Part 450.

[107] 17 C.F.R. § 450.3.

[108] As discussed in Appendix 2, if the Commission does adopt mandatory initial margin requirements, the requirements should be phased in following the later of (a) 2 years after the adoption of mandatory variation margin requirements or (b) 6 months following the adoption of a mandatory clearing requirement for the relevant asset class or counterparty type.

[109] *See* SEC Release No. 34-67177 (June 11, 2012), 77 Fed. Reg. 35,625 (June 14, 2012).

relationships quickly enough to collect sufficient margin as required by the Commission, which would result in very significant capital deductions for a temporary period. Such temporary capital deductions are unnecessary, since they reflect a change in regulation rather than a change in the underlying economics of the business.

In addition, many nonbank SBSDs are subsidiaries of holding companies that are managing the implementation of the Basel III Standards. For such firms, there is an interdependency between revisions to the Basel Accords and capital requirements for SBSD subsidiaries. In this regard, the Banking Agencies have proposed a rule that would gradually phase-in the Basel III minimum capital requirements between 2014 and 2015, with full compliance with all Basel III requirements not mandatory until 2019.[110] That timetable was itself based on anticipated adoption of those requirements by the end of 2012; to date, the Banking Agencies have not finalized those requirements.

We note that the proposed three-plus year period for implementation of Basel III minimum capital requirements generally reflects an appropriate benchmark for an implementation period for the Proposal's capital requirements. Moreover, to comply with Basel III, firms will need to consider how most efficiently to raise additional capital and/or dispose of some of their assets or businesses. Similar decisions will also need to be made to prepare for compliance with the Proposal's capital requirements. Requiring firms to go through this process multiple times would be unduly disruptive.

In light of these considerations, we respectfully request a phase-in period for the Proposal's capital rules (other than the application of Basel 2.5) extending until two years from the effective date of the margin requirements in the Proposal, and in any event until the phase-in of Basel III's minimum capital requirements. Such a phase-in would provide adequate time for all market participants to renegotiate documentation and for SBSDs to begin collecting regulatory margin on all new positions, thereby avoiding market disruptions resulting from temporary capital deductions as the market adjusts to the new regimes. It would also provide market participants with the time necessary to backload transactions that are not currently, but that become, clearable. At the same time, it would avoid a sudden implementation of SBSD capital requirements that may disrupt the transition to new Basel III capital requirements at the holding company level.

- ***Recommendation:*** *The Commission should provide 24 months from the publication of final rules until two-way daily variation margining is required for uncleared SBS between financial entities (other than qualifying SPVs and affiliates), with a 12-month phase-in period for uncleared SBS between SBSDs.*

- ***Recommendation:*** *The Proposal's capital rules (other than the application of Basel 2.5) should not take effect until the later of two years from the effective date of the Proposal's margin requirements or the effective date for Basel III's minimum capital requirements.*

[110] 77 Fed. Reg. 52,792 (Aug. 30, 2012).

* * *

We appreciate the Commission's consideration of our comments on the Proposal. As it considers our comments and those of others, we emphasize the extent to which it is critical for the Commission to work closely with the CFTC, the Prudential Regulators and BCBS/IOSCO in conducting a detailed empirical analysis of the costs and benefits of these rules and establishing consistent requirements across all types of affected firms and jurisdictions. Capital, margin and segregation requirements for SBS are among the most consequential requirements that the Commission will adopt under Dodd-Frank. They will play a significant role in determining how firms structure their OTC derivatives business overall and the competitive dynamics of the entire OTC derivatives market. As described above, we believe that significant modifications to the Proposal are necessary to prevent adverse market-wide consequences and better achieve the objectives of Dodd-Frank.

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 the undersigned, or Giovanni P. Prezioso (+1 202 974 1650), Edward J. Rosen (+1 212 225 2820) or Colin D. Lloyd (+1 212 225 2809) of Cleary Gottlieb Steen & Hamilton LLP, outside counsel to SIFMA, if you should have any questions with regard to the foregoing.

Respectfully submitted,

____

Kenneth E. Bentsen, Jr.
Executive Vice President
Public Policy and Advocacy

cc: Elisse B. Walter, Chairman
Luis A. Aguilar, Commissioner
Troy A. Paredes, Commissioner
Daniel M. Gallagher, Commissioner

John Ramsay, Acting Director
Michael Macchiaroli, Associate Director
Division of Trading and Markets

Craig M. Lewis, Director and Chief Economist
Division of Risk, Strategy and Financial Innovation

Appendix 1: Summary of Requirements for Dually Registered OTC Derivatives Dealers/SBSDs

The below chart summarizes a proposed approach under which an OTC derivatives dealer could register as a SBSD.

Requirement	Proposal
Scope of Activities	The entity could engage in the following activities: • Dealing in eligible OTC securities derivatives (including SBS, forwards and options) • Issuing and reacquiring securities issued by the entity (*e.g.*, warrants and structured notes) • Ancillary, non-dealing cash and portfolio management securities activities • Non-securities activities (*e.g.*, interest rate swaps, commodity swaps, futures, etc.) in accordance with any applicable regulations
Registration	The entity would register using Form SBSE-BD, with conforming changes to reflect its status as an OTC derivatives dealer
Capital	The entity would apply the higher of the OTC derivatives dealer or SBSD minimum capital requirement and could use approved models for credit and market risk charges
Margin	With appropriate disclosure to customers and Commission approval, the entity could portfolio margin all eligible OTC securities derivatives together

Customer protection/segregation	With appropriate disclosure to customers and Commission approval, proposed Rule 18a-4 could apply to all eligible OTC securities derivatives
Insolvency	The entity would be exempt from SIPA, but subject to stockbroker liquidation provisions of the Bankruptcy Code for any customer that does not waive segregation
Sales practice/business conduct/associated persons	The entity would not be required to join FINRA. Dodd-Frank business conduct rules would apply to SBS. Securities and SBS transactions would be conducted through registered personnel of an affiliated full-purpose broker-dealer subject to FINRA rules (with relevant exemptions from those rules for SBS), unless (a) the counterparty is a broker-dealer, a bank acting in a dealer capacity or an affiliate, (b) for ancillary portfolio management transactions in foreign securities, a broker-dealer or bank acting as agent for the entity or (c) for contacts with a foreign counterparty, the contacts are conducted by an associated person of a an affiliated foreign broker-dealer that is registered under local law
Confirmations and other documentation requirements	Rule 10b-10 would apply to securities, except SBS, and proposed Rule 15Fi-1 would apply to SBS. Other SBS documentation rules, if any, would also apply
Books and records	Rules 17a-3, 17a-4, 17a-5, 17a-11, 17a-12 and any new SBSD recordkeeping rules would apply to the entity

Appendix 2: Modified Version of Alternative A

If the Commission determines to adopt initial margin requirements, SIFMA urges the Commission to adopt Alternative A, modified as described below. We emphasize that the Commission should not adopt this regime unless there is first a consensus for the approach with the international regulatory community, since inconsistent margin requirements would undermine the benefits of this regime and produce other competitive market distortions.

I. Benefits of Alternative A Relative to Alternative B

Adopting Alternative A, rather than Alternative B or the BCBS/IOSCO proposal, would significantly reduce the quantum of initial margin required to be collected. To illustrate this, we have prepared the chart on the following page, which compares the levels of initial margin that would be required to be collected under the BCBS/IOSCO Consultations, Alternative B and Alternative A, assuming that each proposal were adopted universally by each relevant regulatory authority.[111]

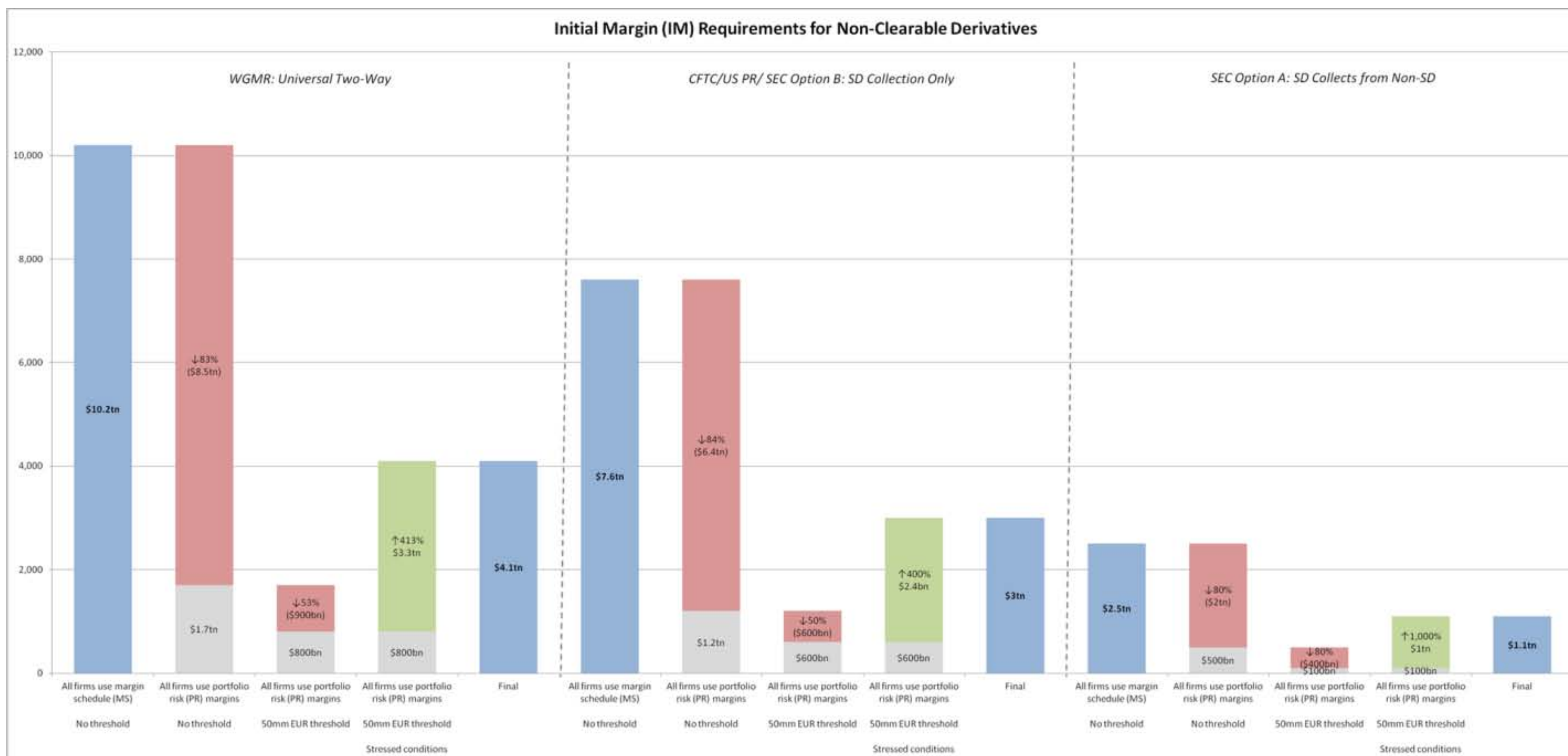
As the chart indicates, Alternative A is estimated to reduce the liquidity impact of initial margin requirements by roughly three to four times. At the same time, it would still assure that SBSDs obtain collateral to mitigate their potential future exposure to financial end users. If the Commission were to adopt an initial margin requirement, Alternative A would provide the most "bang for the buck."

Alternative A would also eliminate the potential for initial margin requirements to increase net credit risk to SBSDs because it would eliminate the scenarios under which SBSDs would be required to participate in a two-way exchange of initial margin. Financial end users would still, however, be exposed to SBSDs for the return of initial margin. In this regard, we note that there are important policy considerations on which the Commission could conclude that mitigating SBSDs' potential future exposure to their counterparties outweighs the possible adverse effects on those counterparties. These include principally that (i) the interconnected nature of SBSDs means that mitigating losses to them is more likely, all else equal, to prevent cascading losses throughout the financial system and (ii) SBSDs, unlike financial entities, will be subject to capital requirements that are designed to prevent their insolvency. Additionally, under the Proposal, SBSDs would be subject to segregation requirements that are designed to safeguard initial margin posted to them. It was clearly also Congress's objective that margin requirements be established for the safety and soundness of SBSD's and not for other purposes or market constituencies.

---

[111] As noted above, these estimates were prepared by SIFMA prior to the release of BCBS/IOSCO QIS results as part of the Second BCBS/IOSCO Consultation. While we are still studying those results, we have observed a number of respects in which they might under-estimate the impact of initial margin requirements. *See* Note 5, *supra*.

Figure 1. Comparison of Initial Margin Requirements



II. Proposed Modifications to Alternative A

Set forth below are modifications to an initial margin regime based on Alternative A that we urge the Commission to adopt if it decides to mandate the collection of initial margin by SBSDs. As discussed above, the imposition of a mandatory initial margin regime would be detrimental to liquidity and increase pro-cyclicality. The modifications described below would reduce the scale of these issues.

A. Permissible Calculation Methodologies

Under the Proposal, a nonbank SBSD would be required to use a standardized method drawn from Rule 15c3-1's market risk haircuts to compute the initial margin requirement for equity SBS, which would mean applying the methodology set forth in Appendix A of Rule 15c3-1.[112] For other SBS, nonbank SBSDs that are approved to use internal models for computing capital charges would be permitted to use those internal models to compute initial margin requirements.[113] Other nonbank SBSDs would, in turn, be required to use the standardized method for those SBS.[114]

We strongly support the proposal to permit nonbank SBSDs that are approved to use internal models for computing capital charges to use those internal models to compute initial margin requirements. Because of the complementary relationship between margin and capital, it is critical for there to be consistency between the calculation methodologies for margin and capital requirements. In this regard, we also urge the Commission to provisionally approve the use of internal models approved by other regulators (including qualifying foreign regulators) for the purpose of initial margin requirements, just as we have proposed that the Commission do for purposes of capital requirements.[115]

Moreover, the Prudential Regulators and the BCBS-IOSCO Consultation would each permit the use of approved models to compute initial margin requirements. Consequently, extending that approach to nonbank SBSDs would help foster consistency both domestically and internationally and ensure a level playing field for nonbank SBSDs competing with bank SBSDs and foreign SBSDs.

For similar reasons, however, we oppose the proposal to require the use of the standardized method for computing initial margin for equity SBS. So requiring would create discrepancies between capital and margin requirements and make nonbank SBSDs uncompetitive with bank SBSDs and foreign SBSDs for equity SBS. Moreover, we are concerned that applying the methodology set forth in Appendix A to Rule 15c3-1 would result in initial margin requirements that are substantially less sensitive to the economic risks of a SBS portfolio than a VaR-based model.

---

[112] Proposal § 18a-3(d).

[113] Proposal § 18a-3(d)(2).

[114] Proposal § 18a-3(d)(1).

[115] *See* Section I.B.2, *supra.*

In particular, although Appendix A's methodology yields results similar to VaR for a SBS portfolio that is only directionally long, it significantly overstates risk for a market-neutral portfolio. For instance, a long-only, diversified U.S. equities portfolio of $100 million in notional size would result in a $15 million initial margin requirement under Appendix A and a $10 million initial margin requirement under VaR. In contrast, a market-neutral, diversified U.S. equities portfolio with $100 million in long positions and $100 million in short positions would result in a $30 million initial margin requirement under Appendix A and a $2 million initial margin requirement under VaR. Thus, for such a market-neutral portfolio, Appendix A would overstate risk by more than 15 times relative to VaR.

➢ ***Recommendation:*** *For computing the margin amount for equity SBS, a nonbank SBSD should be permitted to use either the Appendix A methodology or approved internal models.*

B. Modifications to Mitigate Pro-Cyclicality

Even with these virtues relative to Alternative B, Alternative A has the potential to exacerbate pro-cyclicality, as SBSDs simultaneously adjust the assumptions underlying their initial margin models during increased volatility market environments to require their financial end user counterparties to post significant amounts of additional collateral. As noted above, one way to mitigate this effect might be to adopt standardized (and stable) initial margin requirements. Nonetheless, doing so would significantly increase the adverse liquidity and credit impact of the resulting higher collateral requirements.

Thus, adopting a mandatory initial margin regime requires the Commission and other regulators to identify a framework that would facilitate a risk-sensitive, empirically based method for computing initial margin while at the same time mitigating, to the greatest extent feasible, the potential for initial margin requirements to increase during periods of market stress. If they adopt mandatory initial margin requirements, we strongly urge the Commission and its counterparts to consider ways in which they might satisfy these two principles.

By way of example, the Commission could require that internal margin models use a static historical VaR approach. Under this approach, the initial margin level would be set at a level based on the actual losses observed during a specified historical time period, with the period chosen to include a variety of stressed market environments. If actual historical data is used rather than a current hypothetical distribution of losses, and the historical observation period is kept static, it would not be necessary to vary the level of initial margin based on dynamic volatility conditions. If, following a future period of market stress, the Commission wished to update the historical observation period, it could time the update in a manner that would not exacerbate volatility during that period.

➢ ***Recommendation:*** *The Commission should seek to apply parameters to internal margin models that limit the potential for pro-cyclical effects, such as requiring that such models use a static historical VaR approach.*

C. Initial Margin Thresholds

Initial margin thresholds can be a useful means for reducing the aggregate liquidity impact of mandatory initial margin requirements while still protecting a SBSD from large uncollateralized potential future exposures to counterparties.[116] Accordingly, if the Commission adopts mandatory initial margin requirements, then we recommend that it permit an initial margin threshold. Because initial margin thresholds are not proposed or discussed in the Proposal, we urge the Commission to seek comment from the industry before adopting one of several possible approaches for setting initial margin thresholds.

➢ ***Recommendation**: If the Commission adopts mandatory initial margin requirements, it should permit an initial margin threshold. The Commission should seek comment before adopting its framework for initial margin thresholds.*

D. Legacy Account Exception

The Proposal contains an exception from the initial margin collection requirement for a legacy SBS account, which would be defined as an account that holds no SBS entered into after the effective date of the margin rules and that only is used to hold SBS entered into prior to the effective date of those rules and collateral for those SBS. We request that the Commission confirm that this exception would apply to accounts that contain positions that were originally entered into by the customer prior to the effective date, but which were novated to the SBSD after such date. Such clarification is necessary to address the possibility that initial margin requirements for nonbank SBSDs may go into effect before the time at which bank SBSDs are required by Section 716 of Dodd-Frank to "push out" many of their SBS activities to nonbank affiliates. Nonbank SBSDs likely will not be in a position to negotiate for the ability to collect initial margin for transactions novated to them due to Section 716. At the same time, novating such transactions will facilitate the ability for firms to manage their SBS portfolios in a single legal entity.

➢ ***Recommendation**: The Commission should clarify that the margin exception for legacy SBS accounts would apply to accounts that contain positions that were originally entered into by the customer before the effective date for the margin rules, but which were novated to the SBSD after such date.*

E. Portfolio Margining and Cross-Margining

As the Commission has observed, calculating margin requirements on a portfolio basis offers many benefits, including greater efficiencies as a result of the recognition of off-setting positions and better alignment of costs and overall portfolio risk.[117] Portfolio margining alleviates excessive margin calls, improves cash flows and liquidity and reduces the impact of individual position volatility. The Commission has made great progress in the area of portfolio

---

[116] Thresholds do not, however, address the pro-cyclicality effect discussed above.

[117] SEC, Exemptive Order and Request for Comment, Order Granting Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection with Portfolio Margining of Swaps and Security-Based Swaps (Dec. 14, 2012), http://www.sec.gov/rules/exorders/2012/34-68433.pdf.

margining. However, there is more work to be done to provide market participants with the ability to use portfolio margining for all risk-offsetting products.

For the reasons discussed above, we support the Commission's efforts to allow parties to use portfolio margining. Specifically, we support the proposal to allow omnibus segregation and portfolio margining of initial margin held for cleared and uncleared SBS. We also commend the Commission's recent order permitting the commingling and portfolio margining of cleared CDS, which include both swaps and SBS, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA.[118] This is a valuable step in overcoming the gap between functionally equivalent products that are subject to different regulatory and insolvency regimes.

There are, however, other risk-offsetting products that should be included in the Commission's portfolio margining regime. For example, market participants offset the risk of both cleared and uncleared CDS SBS with cleared and uncleared index CDS. SBSDs that use internal models to calculate initial margin for these products have the capabilities to calibrate margin on a portfolio basis. However, regulatory and legal barriers prevent them from doing so and obtaining the benefits of portfolio margining.

In particular, we acknowledge that there are challenges to the comprehensive portfolio margining of Commission- and CFTC-regulated products as a result of different insolvency and customer protection regimes. Broker-dealers and SBSDs are subject to the Commission's customer protection rules that include, for broker-dealer SBSDs, access to Securities Investor Protection Corporation insurance for customers whereas, for swap dealers and FCMs, the CFTC does not have an equivalent customer protection regime.

Nevertheless, we believe portfolio margining can be achieved notwithstanding these challenges. In particular, the Commission and the CFTC have repeatedly recognized, through cross-margining orders, portfolio margining arrangements under which a securities counterparty subordinates itself to securities customers and has its positions carried in a commodities account (*i.e.*, a futures or, more recently, cleared swap account). Dodd-Frank also contemplates portfolio margining of futures positions in a securities account,[119] and the Commission's recent cross-margining order, noted above, contemplates portfolio margining of cleared swap positions in a securities account.[120]

Additionally, market participants have developed arrangements for cross-margining cleared and uncleared derivatives. Under these arrangements, the total initial margin would be calculated based on the risks of both cleared and uncleared derivative portfolios. Although this will result in a lower total initial margin requirement, it will more accurately reflect the risk of default on a portfolio basis. The clearing organization would receive the full amount of initial margin to which it is entitled and the uncleared derivative counterparty would receive the remainder. In an event of default, the clearing organization and clearing broker would be paid in

---

[118] *Id.*

[119] *See* CEA Section 4d(h).

[120] *See* Note 117, *supra*.

full with the initial margin they hold and any excess margin would be available (subject to the prior claims of the clearing organization, clearing brokers and customers) to satisfy the claim of the uncleared derivative counterparty. These arrangements have been in place for years to establish cross-margining between futures contracts and OTC derivatives, and have proven to be an effective mechanism for calibrating margin requirements to reflect accurately the overall risk presented by a counterparty's portfolio. Similar arrangements are also commonly used in other areas, such as to cross-margin derivatives and correlated cash positions (margin loans and short positions in prime brokerage arrangements), listed options, repo and/or securities lending positions.

Notably, these cross-margining arrangements generally should not result in a significant shortfall in customer property, if any, in the insolvency of the clearing broker or the dealer. By design, the amount of customer property available to customers of the clearing broker would not be diminished at all as a result of the arrangement. The dealer, in turn, would still be responsible for collecting the full amount of variation margin due on the uncleared portfolio, without offsetting that amount based on positions in the cleared portfolio. As a result, subject to intraday movements, no customers of the dealer would have negative equity in their accounts.[121] Therefore, to the extent that the amount of initial margin required to be delivered by the customer was reduced because of the cross-margining arrangement, that reduction would simply be reflected by a reduction in the customer's claim against the pool of customer property. This is no different from a case in which the dealer collects more initial margin from some customers than others based on its evaluation of the relative creditworthiness of those customers.

- ***Recommendation:*** *The Commission should build on existing precedent by working with the CFTC to facilitate the expansion of portfolio- and cross-margining arrangements. Set forth below are sample scenarios under which we propose the Commission and the CFTC, through rulemakings or cross-margining orders (as appropriate), should facilitate portfolio margining arrangements.*

[121] To the extent that the Commission has concerns about the possibility that a dealer might not collect sufficient initial margin to cover intraday movements, it could address that concern through its evaluation and approval of the dealer's initial margin model, in particular the extent of offsets that the model allows vis-à-vis the customer's cleared portfolio.

Scenario	Applicable Customer Protection and Insolvency Regime	Portfolio Margin Recommendation
(1) Eligible contract participant ("**ECP**") customer has SBS and OTC securities options positions with (i) a dual broker-dealer-SBSD or (ii) a dual OTC derivatives dealer-SBSD	• <u>Dual Broker-Dealer-SBSD</u>. An ECP's SBS and OTC securities options are currently subject to functionally equivalent customer protection regimes pursuant to proposed Rule 18a-4 and Rule 15c3-3, respectively. Upon a dual broker-dealer-SBSD's insolvency, SBS and OTC securities options would both be subject to resolution under SIPA. • <u>OTC Derivatives Dealer-SBSD</u>. Currently, OTC securities options would not be subject to either Rule 15c3-3 or proposed Rule 18a-4. SBS would, however, be subject to proposed Rule 18a-4. Upon an OTC Derivatives Dealer-SBSD's insolvency, customers' rights for both SBS and OTC securities options would be governed by the stockbroker liquidation provisions of the Bankruptcy Code.	We urge the Commission to allow OTC securities options to be held in a Rule 18a-4 SBS account at a dual broker-dealer-SBSD or OTC derivatives dealer-SBSD, with margining determined via an approved VaR or TIMS model. Subjecting OTC securities options to proposed Rule 18a-4 aligns it with the customer protections applicable to SBS, thereby eliminating the key legal impediments to portfolio margining.

(2) A SBS counterparty of a dual SD-SBSD waives segregation requirements for its SBS positions and contractually agrees to be subordinate to customers. The counterparty has an uncleared swap account with the SD.	• SBSD. Proposed Rule 18a-4 would provide customer protections for the SBS positions; however, the counterparty waived segregation and agreed to be subordinate to other customers, thereby making the customer protection rules inapplicable. Upon insolvency of a SBSD, a dual broker-dealer-SBSD's SBS counterparties' rights will be governed by SIPA and a stand-alone SBSD's counterparties' rights will be governed by the stockbroker liquidation provisions of the Bankruptcy Code. However, in both cases, the counterparty has waived customer status. • SD. The CFTC does not have customer protection rules equivalent to Rule 15c3-3 or proposed Rule 18a-4. An SD's insolvency is governed by the Bankruptcy Code.	SIFMA proposes that the SBS positions can be carried in an uncleared swap account of an SD-SBSD, with portfolio margining using an approved VaR model. The electing counterparty should also contractually agree to be subject to the CFTC's regulations and the insolvency regime applicable to CFTC-regulated entities. Under this scenario, the SBS counterparty's positions are no longer subject to the Commission's customer protection regime and the legal impediments to portfolio margining are eliminated.

(3) A SBSD counterparty elects segregation at an independent, third-party custodian and is subordinate to customers.	The Commission's reserve account and possession and control requirements are inapplicable to initial margin held at a third-party custodian. Upon a SBSD's insolvency, the customer would receive all of its collateral from the custodian and would have an unsecured claim against the SBSD's estate for any amount it is owed.	The Commission should allow customers to have their SBS positions held in a third-party segregated uncleared swap account held pursuant to Section 4s(l) of the CEA. Upon a SBSD's insolvency, the counterparty would not have a customer claim for initial margin held in the third-party account.
(4) An uncleared SBS customer also has cleared SBS and cleared swap positions with the SBSD or its affiliate.	• Either Rule 15c3-3 (for a dual broker-dealer-SBSD) or 18a-4 (for a standalone SBSD) would apply to the cleared and uncleared SBS positions. Upon insolvency of a SBSD, a dual broker-dealer-SBSD's SBS counterparties' rights will be governed by SIPA and a stand-alone SBSD's counterparties' rights will be governed by the stockbroker liquidation provisions of the Bankruptcy Code. • Section 4d of the CEA and Part 22 of the CFTC's rules would apply to collateral held for cleared swap positions. Upon an insolvency of an FCM, swap customers' rights will be governed by the commodity broker liquidation provisions of the Bankruptcy Code and Part 190 of the CFTC's Rules.	SIFMA encourages the Commission to allow SBSDs to determine the level of initial margin to collect for uncleared SBS (and swap) positions taking into account collateral provided by the customer for its cleared positions, provided that the SBSD has an enforceable second lien on the cleared positions allowing it to foreclose on the collateral remaining after claims by the clearing organization, FCM/broker-dealer and cleared swap/SBS customers.

F. Phased Implementation of Initial Margin Requirements

An appropriate phase-in for initial margin requirements is necessary to provide market participants with adequate time to adopt necessary operating procedures to implement margin requirements, negotiate or re-negotiate relevant agreements and enhance valuation methodologies and for the market to prepare for the drain on liquidity resulting from initial margin requirements. It also is needed to provide regulators with better empirical data on which to define and calibrate initial margin requirements and levels.

- ***Recommendation:*** *If the Commission does adopt mandatory initial margin requirements, the requirements should be phased in following the later of (a) 2 years after the adoption of mandatory variation margin requirements or (b) 6 months following the adoption of a mandatory clearing requirement for the relevant asset class or counterparty type.*[122]

[122] We note that BCBS/IOSCO have proposed to phase in initial margin requirements over 2015-2019 by prioritizing counterparty pairs based on each party's level of uncleared derivatives activity. *See* Second BCBS/IOSCO Consultation at p. 22. We are still evaluating this proposal.

Appendix D-2

Comment Letter on Reporting Proposal

September 5, 2014

Kevin M. O'Neill
Deputy Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers (Release No. 34-71958; File No. S7-05-14)

Dear Mr. O'Neill:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates the opportunity to provide the Securities and Exchange Commission ("**Commission**" or "**SEC**") with comments on the Commission's proposed recordkeeping, reporting, notification, and security count requirements for security-based swap dealers ("**SBSDs**"), major security-based swap participants ("**MSBSPs**"), and broker-dealers pursuant to Section 15F of the Securities Exchange Act of 1934 (the "**Exchange Act**"), as amended by Section 764 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**"), and Section 17(a) of the Exchange Act ("**SEC Recordkeeping Proposal**").[2]

SIFMA appreciates the Commission's ongoing effort to implement the provisions of Title VII of the Dodd-Frank Act ("**Title VII**") that relate to security-based swaps. In this regard, we note that, in a number of places, the SEC Recordkeeping Proposal would prescribe recordkeeping or reporting requirements based on requirements in other rules that have been proposed by the Commission but have not yet been adopted, in particular requirements relating

---

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] SEC Release No. 34-71958 (Apr. 17, 2014), 79 Fed. Reg. 25194 (May 2, 2014). As part of the same release, the Commission also solicits comments on a proposal to add a capital charge provision to proposed Rule 18a-1 under the Exchange Act that the Commission says was inadvertently omitted when that rule was originally proposed. *See* Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, Release No. 34-68071 (Oct. 18, 2012), 77 Fed. Reg. 70214 (Nov. 23, 2012) ("**SEC Capital and Margin Proposal**"), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2012-11-23/pdf/2012-26164.pdf.

New York | Washington
120 Broadway, 35th Floor | New York, NY 10271-0080 | P: 212.313.1200 | F: 212.313.1301
www.sifma.org

to capital, margin, and segregation for SBSDs and MSBSPs.[3] SIFMA has provided comments on many of these proposals, including the SEC Capital and Margin Proposal, and respectfully requests that the Commission consider all of those letters carefully before adopting any portion of the security-based swap regime established under Title VII of the Dodd-Frank Act.[4] In some cases where our previous comments are particularly relevant to the issues addressed in the SEC Recordkeeping Proposal, we have reiterated those comments below.

EXECUTIVE SUMMARY

The proposed recordkeeping, reporting, notification, and securities count requirements applicable to SBSDs and MSBSPs are designed to provide transparency into the business activities of SBSDs and MSBSPs, as well as assist the Commission in reviewing and monitoring compliance with the proposed capital, margin, and segregation requirements applicable to SBSDs and MSBSPs.[5] To accomplish this goal, the Commission has modeled the proposed rules

---

[3] In addition, the SEC Recordkeeping Proposal includes proposed requirements related to the SEC's proposed trade acknowledgment rules, security-based swap reporting rules, and external business conduct rules for SBSD and MSBSP. *See* Trade Acknowledgment and Verification of Security-Based Swap Transactions, 76 Fed. Reg. 3859 (Jan. 21, 2011) ("**SEC Trade Acknowledgment Proposal**"), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2011-01-21/pdf/2011-1218.pdf; Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75208 (Dec. 2, 2010) ("**SEC Proposed Regulation SBSR**"), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2010-12-02/pdf/2010-29710.pdf; Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 Fed. Reg. 42396 (July 18, 2011), as corrected in 76 Fed. Reg. 46668 (Aug. 3, 2011), ("**SEC Business Conduct Proposal**"), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2011-07-18/pdf/2011-16758.pdf and http://www.gpo.gov/fdsys/pkg/FR-2011-08-03/pdf/C1-2011-16758.pdf.

[4] *See, e.g.,* SIFMA, the Futures Industry Association, and the International Swaps and Derivatives Association, Inc. comment letter to the SEC on business conduct standards for SBSDs and MSBSPs (Aug. 26, 2011) ("**SIFMA Comment Letter on SEC Business Conduct Standards Proposal**"), *available at:* http://www.sifma.org/issues/item.aspx?id=8589935219; SIFMA comment letter to the SEC on the registration of SBSDs and MSBSPs (Dec. 16, 2011) ("**SIFMA Comment Letter on SEC Registration Proposal**"), *available at:* http://www.sifma.org/issues/item.aspx?id=8589936792; SIFMA comment letter to the SEC on capital, margin, and segregation requirements for SBSDs and MSBSPs (Feb. 22, 2013) ("**SIFMA Comment Letter on SEC Capital and Margin Proposal**"), *available at:* http://www.sifma.org/issues/item.aspx?id=8589942116; and the SIFMA comment letter to U.S. Federal Agencies on margin requirements for non-centrally cleared swaps and security-based swaps (Mar. 12, 2014) ("**SIFMA Comment Letter on Margin for Uncleared Swaps**"), *available at:* http://www.sifma.org/issues/item.aspx?id=8589947977.

[5] Section 15F(e)(1)(B) of the Exchange Act, as added by Section 764 of the Dodd-Frank Act, provides that the Commission shall prescribe capital and margin requirements for SBSDs and MSBSPs that do not have a prudential regulator. Section 3E to the Exchange Act, as added by Section 763 of the Dodd-Frank Act, provides the Commission with authority to establish segregation requirements for all SBSDs and MSBSPs, regardless of whether they have a prudential regulator. *See* SEC Capital and Margin Proposal at 70215.

The term "**prudential regulator**" is defined in Section 1a(39) of the Commodity Exchange Act ("**CEA**") and that definition is incorporated by reference in Section 3(a)(74) of the Exchange Act. Pursuant to that definition, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the

on existing rules applicable to registered broker-dealers, with certain modifications to address the more limited activities of stand-alone SBSDs and stand-alone MSBSPs[6] and the Commission's more limited authority over SBSDs and MSBSPs that are banks subject to regulation by a prudential regulator ("**bank SBSD**" and "**bank MSBSP**").[7]

SIFMA understands the Commission's desire to establish a recordkeeping and reporting regime for SBSDs and MSBSPs that is designed to provide the Commission with transparency into the business activities of SBSDs and MSBSPs and assist the Commission in reviewing and monitoring compliance with the proposed capital, margin, and segregation requirements applicable to SBSDs and MSBSPs. While we support the Commission's goals, we believe that the proposed rules could be better designed to achieve these goals in a more efficient and cost effective manner.

At the outset, it is important to highlight one type of regulated entity that is not explicitly addressed in the SEC Recordkeeping proposal: broker-dealers who are registered as OTC derivatives dealers. Unlike other broker-dealers, and like stand-alone SBSDs, OTC derivatives dealers are not permitted to act as dealers with respect to all types of securities. The Commission should explicitly treat OTC derivatives dealers that dually register as SBSDs as stand-alone SBSDs that are approved to use internal models.

In addition, as we explain more fully in the discussion section of this letter, we recommend that:

Harmonization with Other Regulatory Regimes

- **Consistency with CFTC Recordkeeping and Reporting Rules.** The Commission should harmonize its recordkeeping and reporting requirements for SBSDs and MSBSPs with the CFTC's final recordkeeping and reporting rules for SDs and MSPs to the maximum extent possible, with the goal of permitting firms to utilize a single recordkeeping and reporting system for swaps and security-based swaps.

Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration, or the Federal Housing Finance Agency is the prudential regulator of an SBSD or MSBSP if the entity is directly supervised by that agency.

[6] The Commission states its belief that stand-alone SBSDs and stand-alone MSBSPs will not engage in the same range of activities permitted to broker-dealers. For example, the Commission states that broker-dealers are permitted to act as dealers with respect to all types of securities, whereas stand-alone SBSDs would be permitted to act as dealers only with respect to security-based swaps. While this is true of stand-alone SBSDs established in the United States, SIFMA notes that it would not necessarily be true of foreign SBSDs, which may act as dealers in a wide range of securities outside of the United States and offer securities into the United States pursuant to Rule 15a-6 under the Exchange Act.

[7] Section 15F(f)(1)(B)(i) of the Dodd-Frank Act provides that SBSDs and MSBSPs for which there is a prudential regulator shall keep books and records of all activities <u>related to their business as an SBSD or MSBSP</u> in such form and manner and for such period as may be prescribed by the Commission by rule or regulation.

- **Deference to Recordkeeping and Reporting Rules Established by the Prudential Regulators**. The Commission should permit bank SBSDs and bank MSBSPs to satisfy the Commission's recordkeeping and reporting requirements by complying with recordkeeping and reporting rules established by their prudential regulator. These rules should be supplemented with additional requirements only to the extent that such additional obligations are necessary for the Commission to fulfill its limited oversight of the security-based swap activities of bank SBSDs and bank MSBSPs. Furthermore, the Commission should interpret the business of a bank as an SBSD or MSBSP narrowly, consistent with the Commission's limited regulatory interest in bank SBSDs and bank MSBSPs.

- **Deference to Recordkeeping and Reporting Rules Established by Foreign Regulators**. The Commission should permit a foreign SBSD or foreign MSBSP to satisfy its recordkeeping and reporting requirements by complying with recordkeeping and reporting rules established by its foreign regulator, provided such rules are comparable to Commission rules. Furthermore, the Commission should delay the cross-border application of its substantive requirements with respect to foreign SBSD and foreign MSBSP, including the proposed recordkeeping and reporting requirements, until the finalization of home jurisdiction regulations, plus the length of time it takes for the Commission to make an accompanying comparability determination.

Preliminary Considerations

- **Security-Based Swap Accounts**

  - ***General Considerations.*** The Commission should allow flexibility in how a "security-based swap account" is understood and operationalized to enable SBSDs and MSBSPs to have flexibility in how they keep and maintain required records relating to security-based swaps. Furthermore, the Commission should not define or interpret a "security-based swap account" in a way that would be inconsistent with the CFTC's concept of a "swap account."

  - ***Portfolio Margining and Cross-Margining.*** The Commission should not define a security-based swap account in such a way that an SBSD or MSBSP would be prevented from holding other types of securities in a security-based swap account. Furthermore, the Commission should build on existing precedent by working with the CFTC to facilitate the expansion of portfolio- and cross-margining arrangements.

- **Allocation of Duties.** The Commission should permit both U.S. and foreign SBSDs to allocate their Title VII obligations, including their obligations with respect to books and records, to an agent, provided that the SBSD ultimately remains responsible for compliance with the applicable requirements.

Recordkeeping

- **Transaction Information**

  - ***Trade Blotters.*** The Commission should make the use of legal entity identifiers ("**LEIs**") mandatory (subject to the qualification in footnote 25 below), although it should permit firms to use different counterparty identifiers for internal firm purposes as long as they are able to translate their internal counterparty identifiers into the standard LEI convention. Furthermore, the Commission should, as appropriate, provide SBSDs and MSBSPs flexibility in the manner in which they record security-based swap transactions, provided that all required information is recorded and retained and can be pulled together upon request to create something that recognizably would be a record of original entry.

  - ***Memoranda of Brokerage Orders*.** The Commission should confirm that the order ticket requirement only applies when there are in fact orders submitted for execution.

  - ***Memoranda of Proprietary Trades.*** The Commission should confirm that:

    - Order tickets are not required when the transactions are negotiated transactions; and

    - Although a U.S. broker-dealer will need to create and maintain trade tickets to the extent it participates in the execution of transactions as agent for an affiliated SBSD or MSBSP, the U.S. broker-dealer and its affiliated SBSD or MSBSP do not have to duplicate these records (*e.g.*, the affiliated SBSD could rely on records maintained by the registered broker-dealer).

  - ***Confirmations*.** The Commission should harmonize its trade acknowledgement and verification proposal with the CFTC rules relating to trade acknowledgment. Furthermore, the Commission should not require a bank SBSD or bank MSBSP to make and keep current copies of all confirmations of purchases and sales of securities (other than security-based swaps), except as required by bank regulations. In the alternative, the Commission should narrowly interpret when securities transactions are "related to the business" of a bank as an SBSD or MSBSP.

  - ***Unverified Security-based Swap Transactions.*** The Commission should not establish a rigid five-day timeframe for obtaining verifications and instead should enter into a constructive dialogue with interested constituencies to establish best practices for trade verification. SIFMA would be pleased to work with Commission staff to facilitate such a consultation.

- **Firm Records**

  - ***Option Positions.*** We support the Commission's proposal relating to recordkeeping for option positions, including its decision not to impose option positions recordkeeping requirements on bank SBSDs and bank MSBPs.

  - ***General Ledger***. The Commission should provide firms flexibility to keep general ledgers in various formats without mandating a particular format, so long as all required information is kept and accessible to the Commission.

  - ***Stock Record.*** The Commission should provide SBSDs and MSBSPs flexibility in the manner in which they create records for security-based swap transactions and not mandate a detailed specified format, particularly with respect to tracking collateral received and pledged, provided that all required information is recorded and retained and can be pulled together upon request to create something that recognizably would be a record of the firm's security-based swap transactions. Furthermore, the Commission should allow sufficient time for firms to build out the necessary collateral systems.

- **Accounts**

  - ***Ledger Accounts.*** The Commission should allow flexibility in how a "ledger account" is understood and operationalized, and not mandate a detailed specified format, to enable SBSDs and MSBSPs to have flexibility in how they keep and maintain required records relating to security-based swaps. Furthermore, the Commission should not define or interpret a "ledger account" in a way that would be inconsistent with the CFTC's concept of a "ledger account."

  - ***Daily Margin Calculation.*** We support the Commission's proposed recordkeeping requirements relating to the daily margin calculation, but we request that the Commission consider the concerns that we raised regarding the Commission's margin proposal in the SIFMA Comment Letter on SEC Capital and Margin Proposal and the SIFMA Comment Letter on Margin for Uncleared Swaps.

- **Accountholder, Associated Persons, and Business Conduct**

  - ***Accountholder Information.*** The Commission should make the use of LEIs mandatory (subject to the qualification in footnote 25 below), although it should permit firms to use different counterparty identifiers for internal firm purposes as long as they are able to translate their internal counterparty identifiers into the standard LEI convention. Furthermore, the Commission should permit broker-dealers, SBSDs, and MSBSPs to satisfy the requirement to obtain signatures of persons authorized to trade on behalf of counterparties

by establishing policies and procedures relating to counterparty trade authorization.

- ***Associated Persons.*** The Commission should harmonize its proposal with the CFTC's approach to addressing the statutory disqualification prohibition for associated persons of SDs and MSPs. At a minimum, however, the Commission should modify the recordkeeping proposal to make it consistent with the SEC Registration Proposal and, therefore, only require an SBSD or MSBSP to obtain information from associated persons that effect or are involved in effecting security-based swaps on its behalf. The Commission also should remove or narrow the scope of, and provide exceptions from, the associated person investigation requirement. Furthermore, the Commission should limit the requirement for a bank SBSD or bank MSBSP to obtain information from every associated person whose "activities relate to the conduct of the business of the SBSD or MSBSP" to those associated persons who effect or are involved in effecting security-based swaps on its behalf.

- ***External Business Conduct Standards.*** The Commission should confirm that the SEC Recordkeeping Proposal is not proposing to create additional recordkeeping obligations with respect to business conduct standards set forth in the SEC Business Conduct Proposal, particularly with respect to the requirements relating to compliance with such requirements. Furthermore, the Commission should not adopt additional recordkeeping rules relating to the pay to play provisions proposed in the SEC Business Conduct Proposal.

- **Capital, Liquidity, and Customer Protection**

  - We understand the importance of recordkeeping and reporting for demonstrating compliance with the capital, liquidity, and customer protection requirements applicable to SBSDs and MSBSPs and, therefore, generally support the proposed recordkeeping and reporting requirements in connection with these requirements. However, as set forth below, we have technical and substantive concerns regarding the Commission's proposed capital, liquidity, and customer protection requirements.

  - We are particularly concerned that the proposal to require SBSDs to maintain net capital equal to 8% of their customer's security-based swap margin requirements (and for broker-dealer SBSDs, for this 8% margin factor to be added to their other minimum net capital requirements) would require the maintenance of resources far in excess of the actual risks presented by the SBSDs actual exposures.

Record Retention

- **Voice Records**. We approve of the Commission's decision not to mandate voice recording, but the Commission should limit the record retention period for voluntarily recorded voice records to one year, consistent with the CFTC's approach.

- **WORM Storage Challenges**. The Commission should not mandate the use of WORM storage systems for SBSDs and MSBSPs. Furthermore, the Commission should not mandate the use of WORM storage systems more generally, including for broker-dealers who may be dually-registered as SBSDs.

Reporting

- We have a number of serious concerns with proposed Form SBS, some of which are as follows:

  - Proposed Form SBS is not tailored to the unique characteristics of security-based swaps.

  - Proposed Form SBS contains requests for information that are unclear or incomplete.

  - Parts 4 and 5 of proposed Form SBS contain schedules that are treated as part of proposed Form SBS rather than as supplemental to the form.

  - Proposed Form SBS does not adequately address the concerns of U.S. and foreign bank SBSDs and bank MSBSPs.

  - Proposed Form SBS reflects aspects of the SEC Capital and Margin Proposal that should be modified.

- Given these problems with proposed Form SBS, the Commission should enter into a constructive dialogue with interested constituencies with the goal of developing a reporting regime that both is workable for SBSDs and MSBSPs and achieves the Commission's regulatory objectives. At a minimum, the Commission should revise proposed Form SBS to reflect the differences between security-based swap activity and traditional securities activity and address the other concerns raised below.

Cross-Border Considerations

- **Classification and Application of Recordkeeping Requirements.** The Commission should classify requirements relating to daily trading records and confirmations as transaction-level requirements rather than entity-level requirements. Furthermore, the Commission should not apply such transaction-level requirements to transactions of foreign SBSDs (or registered U.S. SBSDs that engage in security-based swap dealing through foreign branches) with non-U.S. persons or foreign branches of U.S. banks.

- **Application of Recordkeeping and Reporting Rules to Foreign Branches**. Registered bank U.S. SBSDs that engage in security-based swap dealing through foreign branches ("**Foreign Branches**") should be permitted to rely on substituted compliance with respect to requirements relating to daily trading records, confirmations, and other recordkeeping requirements that are classified as transaction-level requirements in transactions with non-U.S. persons or other Foreign Branches.

- **Allocation of Duties.** We support the Commission's decision to permit an SBSD to allocate duties to an agent.

- **Foreign Privacy, Secrecy, and Blocking Laws.** The Commission should take into account the issue of foreign jurisdictions' privacy, secrecy, and blocking laws.

- **Other Cross-Border Issues**

    - ***Accounting Standards for Foreign SBSDs and Foreign MSBSPs.*** In advance of making substituted compliance determinations, the Commission should allow Foreign SBSDs to report information on a quarterly basis (in line with U.S. prudentially regulated SBSDs) in accordance with International Financial Reporting Standards ("**IFRS**") rather than U.S. Generally Accepted Accounting Principles ("**U.S. GAAP**").

    - ***Obtaining Information from Associated Persons.*** The Commission should not require foreign SBSDs, foreign MSBSPs, or Foreign Branches to obtain information regarding associated persons who effect or are involved in the effecting transactions solely with respect to their non-U.S. person counterparties.

<u>Phased Implementation of Recordkeeping and Reporting Requirements</u>

- The Commission should phase in the recordkeeping and reporting requirements the later of (i) 12 months after the adoption of the SBS Recordkeeping Proposal or (ii) 12 months after the adoption of the SEC Capital and Margin Proposal. Furthermore, we urge the Commission not to impose implementation deadlines that conflict with the "code freeze" which typically occurs at year-end.

DISCUSSION

I. Harmonization with Other Regulatory Regimes

As the Commission recognizes, different SBSDs and MSBSPs will use different business models to conduct their security-based swap business activity. Some SBSDs and MSBSPs may be dually registered as broker-dealers with the Commission, some SBSDs may be dually registered as OTC derivatives dealers with the Commission, some SBSDs and MSBSPs may be regulated as banks, and other SBSDs and MSBSPs may be stand-alone entities who are neither registered broker-dealers nor regulated as banks. In addition, some SBSDs and MSBSPs may be foreign entities subject to rules and regulation in a foreign jurisdiction ("**foreign SBSDs**" and "**foreign MSBSPs**"). Foreign SBSDs and foreign MSBSPs may be regulated as banks or as broker-dealers by a foreign regulatory authority. Furthermore, as the Commission also recognizes, SBSDs and MSBSPs may be dually registered with the Commodity Futures Trading Commission ("**CFTC**") as swap dealers ("**SDs**"), major swap participants ("**MSPs**"), and/or futures commission merchants ("**FCMs**").[8]

This wide diversity of business models creates the potential for overlapping jurisdiction over registrants, which are often subject to two or three different regulatory regimes with respect to similar activities. SIFMA believes this strongly weighs in favor of aiming for consistency in regulatory approaches, wherever possible, and deferring to comparable and consistent regulatory regimes where appropriate. Accordingly, in the following, we discuss: (i) consistency with CFTC recordkeeping and reporting rules applicable to SDs and MSPs; (ii) deference to recordkeeping and reporting rules established by the prudential regulators; and (iii) deference to foreign rules applicable to foreign SBSDs and foreign MSBSPs.

A. Consistency with CFTC Recordkeeping and Reporting Rules

As noted above, many SBSDs will be dually registered as SDs with the CFTC. As such, they are subject to a comprehensive recordkeeping and reporting regime established by the CFTC for SDs and MSPs.[9] Our members have invested, and continue to invest, an enormous amount of time, money, and effort in complying with the CFTC's rules, including by building systems and technologies to record and report swap activity.

The Dodd-Frank Act requires the SEC to consult and coordinate with the CFTC and the prudential regulators for the purposes of ensuring "regulatory consistency and comparability, to the extent possible."[10] Because the Commission's and the CFTC's approaches to rulemaking

---

[8] *See* SEC Capital and Margin Proposal at 25195 n.7.

[9] *See* CFTC, Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 Fed. Reg. 20128 (Apr. 3, 2012), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2012-04-03/pdf/2012-5317.pdf.

[10] Section 712(a)(2) of the Dodd-Frank Act.

and implementation timeframes and the content of their rules have not been sufficiently coordinated, market participants have had to develop systems to meet the CFTC's requirements and could be required, in many cases, to develop an entirely new infrastructure to comply with the Commission's security-based swap rules.

SIFMA believes that the Commission should further harmonize its approach to recordkeeping and reporting for dually registered SDs and SBSDs (and dually registered MSPs and MSBSPs). The underlying statutory requirements are virtually identical for SDs/SBSDs and MSPs/MSBSPs and the regulatory goals are the same.[11] By harmonizing the recordkeeping rules for dually registered SDs/SBSDs and MSPs/MSBSPs, the Commission will obtain the benefits the proposal was designed to achieve, while sparing dually registered SBSDs the enormous cost of building out different systems to comply with the SEC recordkeeping and reporting rules, as well as enable dually registered SBSDs to use similar systems for onboarding clients and managing client accounts. If the Commission deems full harmonization with CFTC recordkeeping and reporting rules for SDs and MSPs inappropriate, we still encourage the Commission to reconcile its recordkeeping and reporting rules for SBSDs and MSBSPs with CFTC rules to the maximum extent possible.

- ***Recommendation:*** *The Commission should harmonize its recordkeeping and reporting requirements for SBSDs and MSBSPs with the CFTC's final recordkeeping and reporting rules for SDs and MSPs to the maximum extent possible, with the goal of permitting firms to utilize a single recordkeeping and reporting system for swaps and security-based swaps.*

B. Deference to Recordkeeping and Reporting Rules Established by the Prudential Regulators

As the Commission recognizes, its authority over bank SBSDs and bank MSBSPs is limited.[12] The Commission is not responsible for establishing capital or margin requirements for banks, and its rulemaking authority with respect to recordkeeping requirements is limited to the books and records of activities related to the business of a bank as an SBSD or MSBSP. As such, the proposed requirements applicable to bank SBSDs and bank MSBSPs are narrower in scope than those applicable to stand-alone SBSDs and stand-alone MSBSPs. The Commission also recognizes that, as banks, these registrants are subject to existing recordkeeping and reporting requirements administered by the prudential regulators; therefore, to avoid potentially duplicative or conflicting requirements, the Commission has proposed fewer recordkeeping and reporting requirements for bank SBSDs and bank MSBSPs.

Thus, the Commission's interest in bank SBSDs and bank MSBSPs is significantly different from its interest in SBSDs and MSBSPs that are broker-dealers or that are stand-alone entities. Accordingly, SIFMA believes that the Commission should craft a much more tailored

[11] *See* Sections 4s(f) and (g) of the CEA, as added by Section 731 of the Dodd-Frank Act, and Sections 15F(f) and (g) of the Exchange Act, as added by Section 764(a) of the Dodd-Frank Act.

[12] *See* SEC Recordkeeping Proposal at 25197.

recordkeeping and reporting regime for bank SBSDs and bank MSBSPs. Such an approach should narrowly focus on the specific customer protection concerns that the Commission has for this category of registrant and avoid the imposition of duplicative or conflicting recordkeeping and reporting requirements on bank SBSDs and bank MSBSPs.

In addition, given the Commission's narrow regulatory interest in bank SBSDs and bank MSBSPs, SIFMA believes that the Commission should defer to the existing recordkeeping and reporting requirements administered by the prudential regulators. Such rules should be supplemented with additional requirements only to the extent that such additional obligations are necessary for the Commission to fulfill its regulatory oversight of bank SBSDs and bank MSBSPs.

Regardless of the approach the Commission ultimately decides to adopt, SIFMA believes that it is critical that the Commission clarify the meaning of "activities related to the business" of a bank as an SBSD or MSBSP, which appears a number of times in the rulemaking as a way of cabining the proposed requirements with respect to banks. However, banks do not operate their security-based swap activity as a walled-off unit within the bank, whose activities would be easy to circumscribe. For example, because hedging activity often occurs across business units, often hedging risk rather than specific product types, the question arises whether such activity would be considered by the Commission as part of the business of a bank as an SBSD or MSBSP if it were conducted, in part, for the purpose of hedging security-based swap activity. SIFMA's view is that the business of a bank as an SBSD or MSBSP should be interpreted narrowly, consistent with the limited regulatory interest that the Commission has in bank SBSDs and bank MSBSPs.

- ***Recommendation:*** *The Commission should permit bank SBSDs and bank MSBSPs to satisfy the Commission's recordkeeping and reporting requirements by complying with recordkeeping and reporting rules established by their prudential regulator. These rules should be supplemented with additional requirements only to the extent that such additional obligations are necessary for the Commission to fulfill its limited oversight of the security-based swap activities of bank SBSDs and bank MSBSPs. Furthermore, the Commission should interpret the business of a bank as an SBSD or MSBSP narrowly, consistent with the Commission's limited regulatory interest in bank SBSDs and bank MSBSPs.*

C. Deference to Recordkeeping and Reporting Rules Established by Foreign Regulators[13]

The Commission, the CFTC, and the prudential regulators are required to "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps, security-based swaps, swap entities, and security-based swap entities . . . in order to promote effective and consistent global regulation of swaps and security-based swaps."[14] The Commission has proposed a framework

[13] In Section VI.B below, we discuss the application of recordkeeping and reporting rules to foreign branches of U.S. banks.

[14] Section 752(a) of the Dodd-Frank Act.

that would allow a foreign SBSD to satisfy the requirements of Section 15F of the Exchange Act, and the rules and regulations thereunder, by complying with foreign law that the Commission has deemed comparable with the relevant SBSD regulations.[15] The Commission proposes to make such comparability determinations using an outcomes-based approach. Under such an approach, substituted compliance determinations would focus on the similarities in regulatory objectives, rather than requiring that the foreign jurisdiction's rules be identical.

SIFMA supports the Commission's proposed approach. We believe that it is consistent with the goal of international comity and is preferable to a rule-by rule comparison.

We note, however, that, while it is likely that most jurisdictions will have generally comparable recordkeeping and reporting requirements, as such requirements are foundational to the oversight of registrants in most jurisdictions, it still may be the case that some jurisdictions are in the process of adopting new rules, or amendments to existing rules, to address the specific characteristics of swap agreements. Accordingly, the deference to local regulation available under the Commission's proposed approach to substituted compliance may be significantly delayed for foreign SBSDs that intend to apply for substituted compliance but that may operate in jurisdictions where final rules will still be in the process of being adopted, or not have come into effect, when the Commission's recordkeeping requirements become effective. Similarly, the Commission may not have had the opportunity to make a comparability determination by the relevant time. In those circumstances, foreign SBSDs face the prospect of being subject to U.S. regulations for the period of time until the finalization of home-jurisdiction regulations, plus the length of time it takes for the Commission to make an accompanying comparability determination.

To address this issue, we believe that foreign SBSDs should be provided relief from compliance with the cross-border application of the SEC's substantive requirements, including the proposed recordkeeping and reporting requirements, until the Commission has had the opportunity to provide substituted compliance determinations. We believe that this is preferable to requiring foreign SBSDs to build the technological, operational, and compliance systems required to comply with U.S. law for a short, interim period.

- ***Recommendation:*** *The Commission should permit a foreign SBSD or foreign MSBSP to satisfy its recordkeeping and reporting requirements by complying with recordkeeping and reporting rules established by its foreign regulator, provided such rules are comparable to Commission rules. Furthermore, the Commission should delay the cross-border application of its substantive requirements with respect to foreign SBSD and foreign MSBSP, including the proposed recordkeeping and reporting requirements, until the finalization of home-jurisdiction regulations, plus the length of time it takes for the Commission to make an accompanying comparability determination.*

[15] *See* SEC, Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Release No. 34-69490 (May 1, 2013), 78 Fed. Reg. 30968, 31085-92 (May 23, 2013) ("**SEC Cross-Border Proposal**"), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2013-05-23/pdf/2013-10835.pdf.

II. <u>Preliminary Considerations</u>

In the following, we first discuss certain preliminary considerations relating to the concept of a "security-based swap account" and the permissibility of allocation of duties to agents, before going on in the next section to discuss the proposal in more detail.

A. <u>Security-Based Swap Accounts</u>

Because of its centrality in the SEC Recordkeeping Proposal, we discuss the concept of a "security-based swap account" before discussing the proposal in more detail. As explained below, we are concerned that the Commission may be construing a "security-based swap account" too rigidly and not appropriately accounting for the unique characteristics of security-based swaps. Among other things, we are particularly concerned that this may make it even more difficult for the Commission to accommodate portfolio margining and cross-margining.

1. General Considerations

Under existing rules, broker-dealers carry customer securities positions in a cash, margin, or good faith account. In proposed rulemaking under Title VII of the Dodd-Frank Act, including proposed rules relating to capital, margin, and segregation requirements, the Commission has proposed that SBSDs would need to treat security-based swap accounts separately from other securities accounts.[16]

SIFMA understands that security-based swaps would be subject, in some cases, to different requirements than apply to existing securities accounts. For example, the SEC Capital and Margin Proposal would require SBSDs to perform separate possession or control and reserve account computations for security-based swap positions and securities accounts, which is intended to keep separate the customer property related to security-based swaps from customer property related to other securities activities, including property of retail securities customers.[17]

Nonetheless, SIFMA believes that "security-based swap account" lacks clarity and is concerned that the Commission may be conceiving of a security-based swap account too closely along the lines of a traditional securities account, without fully appreciating the important differences between security-based swaps and most securities.

Unlike most securities, a security-based swap is a transaction that gives rise to ongoing obligations between counterparties during the life of the security-based swap. As a result, each party to the transaction is generally obligated to perform under the security-based swap in accordance with its terms until the transaction expires or is terminated. Thus, in a security-based swap, parties generally have ongoing obligations toward each other. This ongoing contractual relationship between parties distinguishes a security-based swap from most securities and is reflected in the different ways in which security-based swaps and most securities are treated for recordkeeping purposes. Most securities, such as debt and equity securities, are carried for a

---

[16] *See* SEC Capital and Margin Proposal; SEC Recordkeeping Proposal.

[17] *See* SEC Capital and Margin Proposal at 70277.

customer by a broker-dealer in its traditional role as an intermediary. This is reflected in how they are recorded on a broker-dealer's books. In a security-based swap, on the other hand, an SBSD or MSBSP will be entering into an ongoing contractual relationship with a counterparty. As such, the way in which it records the transaction on its books will be different from how it records most securities positions.

Because of the differences between security-based swaps and most securities, SIFMA believes that the Commission's recordkeeping and reporting rules should not be overly prescriptive, but should be flexible enough to permit SBSDs and MSBSPs to use existing systems to record the information that the Commission needs regarding security-based swap transactions to achieve its regulatory goals. In particular, we think the Commission should avoid using terms and concepts that are more appropriate for debt and equity securities, but which are not really applicable to security-based swaps – for example, terms like "stock records," "longs and shorts," and "purchase and sale."[18]

In this regard, we note that the CFTC has established reporting and recordkeeping requirements and daily trading records requirements for SDs and MSPs that require full and complete swap transaction information to be recorded and maintained, without prescribing a detailed format for such recordkeeping. This provides firms with flexibility in how they maintain a "swap account" under CFTC rules.

- ***Recommendation:*** *The Commission should allow flexibility in how a "security-based swap account" is understood and operationalized to enable SBSDs and MSBSPs to have flexibility in how they keep and maintain required records relating to security-based swaps. Furthermore, the Commission should not define or interpret a "security-based swap account" in a way that would be inconsistent with the CFTC's concept of a "swap account."*

2. Portfolio Margining and Cross-Margining

It is important that the proposal not define a "security-based swap account" in such a way that an SBSD or MSBSP would be prevented from holding other types of securities in such an

[18] In recognition of the difference between security-based swaps and most securities, Section 761(a)(3) of the Dodd-Frank Act amends the definitions of "buy" and "purchase" in Section 3(a)(13) of the Exchange Act to provide: "For security-based swaps, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require." Section 761(a)(4) of the Dodd-Frank Act amends the definitions of "sale" and "sell" in Section 3(a)(13) of the Exchange Act to provide: "For security-based swaps, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require."

These amendments, in some ways, create more confusion. For example, normally when there is a purchase there is also a sale, and a seller and a buyer. When parties execute swaps, however, there may be a purchase and a sale under these amended definitions, but it is not possible to identify a buyer or seller – or maybe both are buyers when the swap is executed and sellers when the swap is terminated?

account. Not only may this be appropriate for securities posted as collateral for security-based swaps, but it is particularly important in the case of portfolio margining and cross-margining. In this regard, we note that the Dodd-Frank Act amended both the Exchange Act and CEA to give the Commission and the CFTC additional tools to foster portfolio margining with respect to securities held in a portfolio margining account carried as a futures account.[19]

As we have previously commented to the Commission, calculating margin requirements on a portfolio basis offers many benefits, including greater efficiencies as a result of the recognition of off-setting positions and better alignment of costs and overall portfolio risk.[20] Portfolio margining alleviates excessive margin calls, improves cash flows and liquidity and reduces the impact of individual position volatility. The Commission has made great progress in the area of portfolio margining. However, there is more work to be done to provide market participants with the ability to use portfolio margining for all risk-offsetting products.

We support the Commission's efforts to date to allow parties to use portfolio margining. Specifically, we support the proposal to allow omnibus segregation and portfolio margining of initial margin held for cleared and uncleared SBS. We also commend the Commission's recent order permitting the commingling and portfolio margining of cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA.[21] This is a valuable step in overcoming the gap between functionally equivalent products that are subject to different regulatory and insolvency regimes.

There are, however, other risk-offsetting products that should be included in the Commission's portfolio margining regime. For example, market participants offset the risk of both cleared and uncleared CDS that are security-based swaps with cleared and uncleared index CDS that are swaps. SBSDs that use internal models to calculate initial margin for these products have the capabilities to calibrate margin on a portfolio basis. However, regulatory and legal barriers prevent them from doing so and obtaining the benefits of portfolio margining.

In particular, we acknowledge that there are challenges to the comprehensive portfolio margining of SEC- and CFTC-regulated products as a result of different insolvency and customer protection regimes. For example, net equity claims of securities customers of broker-dealers are eligible for up to $500,000 of protection from the fund maintained by the Securities Investor Protection Corporation, but no similar fund is maintained to protect customers of SDs and FCMs.

---

[19] *See* Section 15(c)(3) of the Exchange Act, as added by Section 713(a) of the Dodd-Frank Act, and Sections 4d and 20 of the CEA, as added by Sections 713(b) and (c) of the Dodd-Frank Act.

[20] *See* SIFMA Comment Letter on SEC Capital and Margin Proposal at A2-5 – A2-10; *see also* SIFMA Comment Letter on Margin for Uncleared Swaps at 14-15.

[21] *See* SEC, Exemptive Order and Request for Comment, Order Granting Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection with Portfolio Margining of Swaps and Security-Based Swaps, Release No. 34-68433 (Dec. 14, 2012), 77 Fed. Reg. 75211 (Dec. 19, 2012), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2012-12-19/pdf/2012-30553.pdf.

Notwithstanding these challenges, we believe portfolio margining can be achieved. In particular, the Commission and the CFTC have repeatedly recognized, through cross-margining orders, portfolio margining arrangements under which a securities counterparty subordinates itself to securities customers and has its positions carried in a commodities account (*i.e.*, a futures or, more recently, cleared swap account). As noted above, the Dodd-Frank Act also contemplates portfolio margining of futures positions in a securities account, and the Commission's recent cross-margining order, noted above, contemplates portfolio margining of cleared swap positions in a securities account.

In addition, market participants have developed arrangements for cross-margining cleared and uncleared derivatives. Under these arrangements, the total initial margin would be calculated based on the risks of both cleared and uncleared derivative portfolios. Although this will result in a lower total initial margin requirement, it will more accurately reflect the risk of default on a portfolio basis. The clearing organization would receive the full amount of initial margin to which it is entitled and the uncleared derivative counterparty would receive the remainder. In an event of default, the clearing organization and clearing broker would be paid in full with the initial margin they hold and any excess margin would be available (subject to the prior claims of the clearing organization, clearing brokers and customers) to satisfy the claim of the uncleared derivative counterparty. These arrangements have been in place for years to establish cross-margining between futures contracts and OTC derivatives, and have proven to be an effective mechanism for calibrating margin requirements to reflect accurately the overall risk presented by a counterparty's portfolio. Similar arrangements also are commonly used in other areas, such as in cross-margin derivatives and correlated cash positions (margin loans and short positions in prime brokerage arrangements), listed options, repo and/or securities lending positions.[22]

To the extent that portfolio margining involves holding security-based swaps in an account that is not a security-based swap account, SIFMA believes that the Commission should make it clear that security-based swaps do not necessarily have to be maintained in a security-based swap account and that records can be maintained in the form appropriate to such other type of account.

- ***Recommendation:*** *The Commission should not define a security-based swap account in such a way that an SBSD or MSBSP would be prevented from holding other types of securities in a security-based swap account. Furthermore, the Commission should build*

[22] Elsewhere, SIFMA has recommended: "We believe the [U.S.] Agencies should take whatever steps are available to them to permit portfolio margining to the fullest extent consistent with the BCBS-IOSCO Framework. In particular, the Prudential Regulators should permit a bank registrant voluntarily to include non-centrally cleared non-swap/non-security-based swap derivatives within a portfolio of non-centrally cleared swaps and security-based swaps, provided that the registrant otherwise complies with all the requirements applicable to it under the rules in connection with that portfolio, including the calculation of margin amounts, recognition of netting effects and segregation of collateral. With respect to the CFTC and the SEC, SIFMA continues to support the recommendations it has previously provided regarding steps that could be taken to facilitate portfolio margining across different categories of non-centrally cleared derivatives." SIFMA Comment Letter on Margin for Uncleared Swaps at 15.

on existing precedent by working with the CFTC to facilitate the expansion of portfolio- and cross-margining arrangements.

B. Allocation of Duties

As discussed below, the SEC Cross-Border Proposal allows an SBSD to allocate Title VII duties to an agent, provided that the SBSD ultimately remains responsible for compliance with the applicable requirements.[23] This provides firms the flexibility necessary for the broad range of business relationships that exist in the security-based swap markets. However, many U.S. SBSDs that are not themselves fully regulated broker-dealers will have affiliated fully regulated broker-dealers who act as agents. Front office personnel, for example, who trade security-based swaps also may be transacting in securities and will accordingly be employees, or otherwise associated persons, of affiliated fully regulated broker-dealers. Therefore, we believe that the Commission should permit, more generally, any SBSD (both U.S. and foreign) to allocate its Title VII obligations, including its obligations with respect to books and records, to an agent, provided that the SBSD ultimately would remain responsible for compliance with the applicable requirements. In this regard, we note that the Commission explicitly permits an OTC derivatives dealer's books and records to be maintained by an affiliated fully regulated broker-dealer.

- ***Recommendation:*** *The Commission should permit both U.S. and foreign SBSDs to allocate their Title VII obligations, including their obligations with respect to books and records, to their agent, provided that the SBSD ultimately remains responsible for compliance with the applicable requirements.*

III. Recordkeeping

The Commission's proposed recordkeeping and reporting rules are designed to provide transparency into the business activities of SBSDs and MSBSPs and assist the Commission in reviewing and monitoring compliance with the proposed capital, margin, and segregation requirements applicable to SBSDs and MSBSPs. The proposed rules also are designed to require information that would facilitate a comprehensive and accurate trade reconstruction for each security-based swap transaction. The Commission attempts to achieve these goals by proposing very prescriptive recordkeeping and reporting rules for SBSDs and MSBSPs that are modeled on existing rules applicable to broker-dealers, in particular Rules 17a-3 and 17a-4 under the Exchange Act. However, Rules 17a-3 and 17a-4 were not designed to address the activities of broker-dealers in security-based swaps but in ordinary securities, such as debt and equity securities. As such, they are, in many cases, ill-suited to capturing the details of security-based swap transactions.

Accordingly, in general, we recommend that the Commission adopt a less prescriptive approach to specifying the recordkeeping and reporting elements required for security-based swaps to ensure that firms have the flexibility to implement recordkeeping systems that are tailored to the unique characteristics of security-based swaps. The Commission's approach also

---

[23] *See* Section VI.C, *infra*.

should be compatible with the recordkeeping and reporting systems that SDs and MSPs have already developed to comply with the CFTC's recordkeeping and reporting requirements, to the extent possible. This would enable firms to comply with the SEC recordkeeping and reporting requirements by using the procedures and systems developed and implemented for compliance with the CFTC requirements. In addition, this would lower firms' compliance costs, while still enabling the Commission to achieve the goals of its reporting and recordkeeping regime.

In the following, we discuss each of the recordkeeping requirements in the proposed rule in detail.

A. Transaction Information

1. Trade Blotters

The proposal relating to trade blotters is modeled on paragraph (a)(1) of existing Rule 17a–3, which requires broker-dealers to make and keep current trade blotters (or other records of original entry) containing an itemized daily record of all transactions in securities, all receipts and deliveries of securities, all receipts and disbursements of cash, and all other debits and credits. The Commission is proposing an amendment to require that the blotters specifically account for security-based swaps, and proposing to include parallel blotter requirements in paragraphs (a)(1) and (b)(1) of proposed Rule 18a–5 that are modeled on paragraph (a)(1) of Rule 17a–3, as proposed to be amended. The Commission does this by proposing to clarify that the reference to "securities" includes security-based swaps and by requiring that the records include certain additional information regarding security-based swaps in order to document the attributes of security-based swaps. Under the proposal, the records would show the contract price of the security-based swap, and include for each purchase and sale, the following additional information: (1) The type of security-based swap; (2) the reference security, index, or obligor; (3) the date and time of execution; (4) the effective date; (5) the termination or maturity date; (6) the notional amount; (7) the unique transaction identifier; and (8) the unique counterparty identifier.

As noted above, security-based swaps are different from most types of securities transactions and, therefore, terminology that is appropriate for ordinary securities is not necessarily correct for security-based swaps – *e.g.*, "longs and shorts" and "purchases and sales." Because security-based swaps are not securities that are carried in a customer account as most securities (*e.g.*, debt and equity securities) are, but rather contractual relationships between counterparties, the concept of "trade blotter" must be expanded to accommodate these bilateral arrangements.

To some extent, the Commission has attempted to do this by specifying additional information that must be recorded regarding security-based swap transactions. However, because this information and other contractual terms regarding security-based swap transactions may not necessarily be gathered together in one place called a "trade blotter," firms should have flexibility in the manner in which they record security-based swap transactions, provided that all required information is recorded and retained and can be pulled together upon request to create something that recognizably would be akin to a "trade blotter." Such an approach would be

consistent with CFTC requirements and give firms flexibility to maintain information in a way that is consistent with the nature of swap transactions.

In addition, with respect to the requirement to make a record of the "unique counterparty identifier" on the trade blotter, we note that SIFMA, its global affiliate, the Global Financial Markets Association, and others globally, continue work to promote use of the LEI as an important foundation tool for better risk management and financial stability.[24] With the recent establishment of the Global LEI Foundation ("**GLEIF**") and the appointment of the GLEIF Board, we believe the LEI is now on a stable course for continued global adoption. Having a uniform, global legal entity identifier will help regulators, supervisors, researchers, and firms to better measure and monitor systemic risk, more effectively measure and manage counterparty exposure, and improve operational efficiencies. Progress toward the development of the GLEIS during the past several years has been good. Globally, there are now 17 pre-Local Operating Utilities ("**LOUs**") which issue and maintain LEIs, while nearly 300,000 LEIs, in more than 160 countries, have been issued to date. Creating a single LEI standard across regulators will allow for more effective regulatory oversight and be more efficient for firms. Accordingly, we believe that the Commission should make the use of LEIs mandatory.[25]

Although we believe strongly in the use of globally harmonized LEIs, some firms may use different counterparty identifiers for internal purposes. As long as such firms are able to translate their internal counterparty identifiers into the standard LEI convention[26] (both for their own regulatory reporting purposes and for regulatory examination purposes), they should be able to continue to use their internal counterparty identifiers on the trade blotter and other internal firm records.

➢ ***Recommendation:*** *The Commission should make the use of LEIs mandatory, although it should permit firms to use different counterparty identifiers for internal firm purposes as long as they are able to translate their internal counterparty identifiers into the standard LEI convention. Furthermore, the Commission should, as appropriate, provide SBSDs and MSBSPs flexibility in the manner in which they record security-based swap*

[24] *See, e.g.,* "Requirements for a Global Legal Entity Identifier (LEI) Solution" (May 2011), *available at:* http://www.gfma.org/uploadedfiles/initiatives/legal_entity_identifier_%28lei%29/requirementsforagloballeisolution.pdf.

[25] Of course, SBSDs and MSBSPs may not have LEIs for all of their counterparties. We recommend that the SEC require SBSDs and MSBSPs to follow the CFTC's three-step guidance regarding the use of LEIs. Specifically, SBSDs and MSBSPs should (i) contact each of their security-based swap counterparties to determine whether the counterparty has an LEI, (ii) obtain the counterparty's LEI if the LEI has already been issued, and (iii) if the counterparty does not yet have an LEI and the SBSD or MSBSP knows the counterparty has an obligation to obtain one, remind the counterparty of that obligation. See Division of Market Oversight and Office of Data and Technology Advisory Regarding Upcoming Legal Entity Identifier Deadline (Mar. 15, 2013), *available at:* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/dmo_odtadvisory.pdf. An SBSD or MSBSP that follows this process for counterparties who have not provided an LEI should be able to use some alternative identifier for the those counterparties until they provide an LEI.

[26] Where the firm has an LEI for the counterparty. *See* note 25, *supra*.

transactions, provided that all required information is recorded and retained and can be pulled together upon request to create something that recognizably would be a record of original entry.

2. Memoranda of Brokerage Orders

The proposal relating to memoranda of brokerage orders is modeled on paragraph (a)(6) of existing Rule 17a–3, which requires broker-dealers to make and keep current a memorandum of each brokerage order, and of any other instruction given or received for the purchase or sale of a security (an "order ticket"). The Commission is proposing to amend these requirements to require broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, to make and keep current a memorandum of each brokerage order given or received for the purchase or sale of a security-based swap. The Commission is not proposing to include a parallel provision applicable to stand-alone SBSDs and stand-alone MSBSPs because these registrants would not be permitted to engage in the business of effecting brokerage orders in security-based swaps without registering as a broker-dealer or a bank.[27] The Commission is, however, including a parallel memorandum requirements in paragraph (b) of proposed Rule 18a–5 applicable to bank SBSDs and bank MSBSPs proposed Rule 18a–5 that is modeled on paragraph (a)(6) of Rule 17a–3, as proposed to be amended. Bank SBSDs and bank MSBSPs would only be required to document key terms of brokerage orders with respect to security-based swaps.

SIFMA generally supports the proposal, but asks the Commission to confirm that the order ticket requirement only applies when there are in fact orders received for execution (*e.g.*, where the orders are potentially executed on a security-based swap execution facility), and not where there is a negotiation that results in a transaction without any executable order or other instruction given.[28] Similarly, SIFMA also asks the Commission to confirm no order ticket

[27] As noted above, the Commission should explicitly note that references to stand-alone SBSDs explicitly include stand-alone SBSDs that are registered as OTC derivatives dealers. In this letter, references to stand-alone SBSDs are intended to apply to OTC derivatives dealers that are dually registered as SBSDs (and such entities are also approved to use internal models).

[28] These negotiations often take place over the telephone, but can also make use of electronic systems, or even security-based swap execution facilities. For example, a market participant may submit to one or more SBSDs a request for quotation ("**RFQ**") for a specific security-based swap and receive back an offer from those SBSDs to enter the swap on specified terms. In that case, the market participant's acceptance of the offer from a SBSD will create a security-based swap transaction between the market participant and the SBSD without the market participant ever sending an order to the SBSD.

In other cases, a transaction negotiation will result in an agreement on conditional terms of a transaction, *e.g.*, a transaction where one or more terms will be determined by reference to a price at which the SBSD is able to execute a hedge transaction (within agreed price, time and/or method parameters) and/or by reference to the size of the hedge transaction that the SBSD is able to execute (within the agreed parameters). In these cases, we believe the SBSD should be required to record the negotiated transaction, after the conditional terms have been determined, in its trade blotter, but should not be required to create an order ticket since no executable order or other instruction is given. (To the extent the SBSD itself gives orders for the execution of a hedge transaction, a proprietary order ticket would need to be created for those orders.)

needs to be created by the broker-dealer or its affiliated SBSD when a registered broker-dealer acts as an agent in connection with negotiated transactions between an affiliated SBSD and its customers without any executable order being received.[29] Such an approach would be consistent with CFTC requirements and the purpose of an order ticket.

See also the discussion in Section VI.C below regarding allocation of duties in the cross-border context.

➢ ***Recommendation:*** *The Commission should confirm that the order ticket requirement only applies when there are in fact orders submitted for execution.*

3. Memoranda of Proprietary Trades and Orders

The proposal relating to proprietary trade and order tickets is modeled on paragraph (a)(7) of Rule 17a–3, which requires broker-dealers to make and keep current a memorandum of each purchase and sale for the account of the broker-dealer ("trade ticket") and where the purchase or sale is with a customer other than a broker-dealer, a memorandum of each order received ("order ticket"). The Commission is proposing to amend these requirements to require broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, to make and keep current a memorandum of the terms of security-based swap transactions when they are acting as a dealer or otherwise trading for their own account and, where the transaction is with someone other than a broker-dealer, a memorandum of each order received. The Commission also is proposing to include parallel memorandum requirements in paragraphs (a) and (b) of proposed Rule 18a–5 applicable to stand-alone SBSDs and standalone MSBSPs and, solely with respect to security-based swaps, bank SBSDs and bank MSBSPs.

The trade ticket would need to include certain information regarding the purchase or sale of a security-based swap for the account of the broker-dealer that is similar to the information currently required under paragraph (a)(7) of Rule 17a–3. In addition, to account for the attributes of security-based swaps, the trade ticket would need to include: (1) The type of security-based swap; (2) the reference security, index, or obligor; (3) the date and time of execution; (4) the effective date; (5) the termination or maturity date; (6) the notional amount; (7) the unique transaction identifier; and (8) the unique counterparty identifier.

While SIFMA generally supports the trade ticket proposal, we would like the Commission to confirm the following with respect to order tickets in the context of proprietary trades:

- Order tickets are not required when the transactions are negotiated transactions; and

---

[29] In the cross-border context, a U.S. broker-dealer acting as agent for an affiliated SBSD or MSBSP in the execution of negotiated security-based swap transactions of the affiliate and its counterparty should not be required to maintain an account for the affiliated SBSD or MSBSP or its counterparties (or record the agented transactions in such an account or on its "stock record").

- Although a U.S. broker-dealer will need to create and maintain trade tickets to the extent it participates in the execution of transactions as agent for an affiliated SBSD or MSBSP, the U.S. broker-dealer and its affiliated SBSD or MSBSP should not have to duplicate these records (*e.g.*, the affiliated SBSD could rely on records maintained by the registered broker-dealer).

➢ ***Recommendation:*** *The Commission should provide the confirmations requested above.*

4. Confirmations

The proposal relating to confirmations is modeled on paragraph (a)(8) of Rule 17a–3, which requires broker-dealers to make and keep current copies of confirmations of purchases and sales of securities. The Commission is proposing to require broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, to make and keep current copies of the security-based swap trade acknowledgments and verifications made pursuant to proposed Rule 15Fi–1 under the Exchange Act.[30] Paragraph (a)(6) of proposed Rule 18a–5 would require stand-alone SBSDs and stand-alone MSBSPs to make and keep current copies of confirmations of all purchases or sales of securities (including security-based swaps). Paragraph (b)(6) of proposed Rule 18a-5 would require bank SBSDs and bank MSBSPs to make and keep current copies of all confirmations of purchases and sales of all (i) security-based swaps and (ii) securities that are not security-based swaps but only if "related to the business" of an SBSD or MSBSP.

Although SIFMA generally supports the Commission's proposal with respect to broker-dealer SBSDs/MSBSPs and stand-alone SBSDs/MSBSPs, we urge the Commission to harmonize its trade acknowledgement and verification proposal with the final CFTC rules relating to trade acknowledgement.[31] In particular, we urge the Commission to reconsider the requirement that SBSDs and MSBPs promptly verify the accuracy of, or dispute with its counterparty, the terms of a trade acknowledgment that it receives, as current market practices do not universally follow an acknowledgement/verification model, particularly with respect to "mid-life" trade events.[32] Instead, we encourage the Commission to enter into a constructive dialogue with interested constituencies to establish best practices for trade verification. SIFMA would be pleased to work with Commission staff to facilitate such a consultation.

In addition, we are concerned that, with respect to bank SBSDs and bank MSBSPs, it is not clear when purchases and sales of securities are "related to the business" of a bank as an SBSD or MSBSP. For example, does the Commission intend to include hedging transactions entered into in connection with a security-based swap? This may be difficult to identify because financial entities typically hedge exposures on an aggregate basis, without necessarily identifying

---

[30] *See* SEC Trade Acknowledgment Proposal.

[31] *See* CFTC, Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 Fed. Reg. 55904 (Sept. 11, 2012), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2012-09-11/pdf/2012-21414.pdf.

[32] *See, e.g.*, ISDA comment letter on SEC Trade Acknowledgement Proposal (Feb. 22, 2011), *available at:* http://www.sec.gov/comments/s7-03-11/s70311-4.pdf.

a one-to-one relationship between the hedge and an underlying instrument such as a security-based swap. In addition, it is unclear what regulatory purposes would be served by the Commission having this information. In short, we are concerned that bank SBSDs and bank MSBSPs will have a difficult time identifying transactions that relate to their business as an SBSD or MSBSP and that it will impose unreasonable burdens without an apparent offsetting regulatory benefit.

- ***Recommendation:*** *The Commission should harmonize its trade acknowledgement and verification proposal with the CFTC rules relating to trade acknowledgment. Furthermore, the Commission should not require a bank SBSD or bank MSBSP to make and keep current copies of all confirmations of purchases and sales of securities (other than security-based swaps). In the alternative, the Commission should narrowly interpret when securities transactions are "related to the business" of a bank as an SBSD or MSBSP.*

5. Unverified Security-based Swap Transactions

To promote compliance with proposed Rule 15Fi–1 and the risk management practices of broker-dealers, SBSDs, and MSBSPs, the Commission is proposing to amend Rule 17a–3 to add a requirement to make a record of each security-based swap trade acknowledgment that is not verified within five business days of execution and to include parallel provisions in paragraphs (a) and (b) of proposed Rule 18a–5. Such requirements would apply to all types of SBSDs and MSBSPs.

SIFMA asks the Commission to consider our comment regarding the confirmation requirement above. As indicated in the preceding section, SIFMA urges the Commission to reconsider its security-based swap verification requirements. If verifications are required, we also disagree with this rigid five-day timeframe for obtaining them and instead recommend that the Commission enter into a constructive dialogue with market participants to establish best practices for trade verification.

- ***Recommendation:*** *The Commission should not establish a rigid five-day timeframe for obtaining verifications and instead should enter into a constructive dialogue with interested constituencies to establish best practices for trade verification. SIFMA would be pleased to work with Commission staff to facilitate such a consultation.*

B. Firm Records

1. Option Positions

The proposal relating to option positions is modeled on paragraph (a)(10) of Rule 17a–3, which requires broker-dealers to make and keep current a record of all option positions. The Commission is not proposing to amend paragraph (a)(10) of Rule 17a–3 to account for security-based swaps. However, in order to facilitate the monitoring of the financial condition of stand-alone SBSDs and stand-alone MSBSPs, the Commission is proposing to include a parallel provision in paragraph (a)(8) of proposed Rule 18a–5 applicable to stand-alone SBSDs and

stand-alone MSBSP. As such, these registrants would be required to make and keep current the same type of records broker-dealers must keep: A record of all puts, calls, spreads, straddles, and other options in which the stand-alone SBSD or stand-alone MSBSP has any direct or indirect interest or which the stand-alone SBSD or stand-alone MSBSP has granted or guaranteed, containing, at a minimum, an identification of the security and the number of units involved. This requirement would not be applicable to bank SBSDs or bank MSBPs.

➢ ***Recommendation:*** *SIFMA supports the Commission's proposal relating to recordkeeping for option positions, including its decision not to impose option positions recordkeeping requirements on bank SBSDs and bank MSBPs.*

2. General Ledger

The proposal relating to the general ledger is modeled on paragraph (a)(2) of Rule 17a–3, which requires broker-dealers to make and keep current ledgers (or other records) reflecting all assets and liabilities, income and expense, and capital accounts. These records reflect the overall financial condition of the broker-dealer and in the Commission's view can incorporate security-based swap activities without the need for a clarifying amendment. The Commission is proposing to include a parallel provision in paragraph (a)(2) of proposed Rule 18a–5 that mirrors paragraph (a)(2) of Rule 17a–3 requiring stand-alone SBSDs and stand-alone MSBSPs to make and keep current the same types of general ledgers. This requirement would not be applicable to bank SBSDs or bank MSBPs.

It is important that firms have flexibility to keep general ledgers in various formats so long as all required information is kept. Such an approach would be consistent with CFTC requirements and give firms flexibility to maintain information in a way that is consistent with the nature of their security-based swap business, thus lowering costs while still achieving the Commission's regulatory objectives.

➢ ***Recommendation:*** *The Commission should provide firms flexibility to keep general ledgers in various formats without mandating a particular format, so long as all required information is kept and accessible to the Commission.*

3. Stock Record

The proposal relating to a stock record is modeled on paragraph (a)(5) of Rule 17a–3, which requires broker-dealers to make and keep current a securities record (also referred to as a "stock record"). As the Commission notes, this is a record of the broker-dealer's custody and movement of securities. The "long" side of the record accounts for the broker-dealer's responsibility as a custodian of securities and shows, for example, the securities the firm has received from customers and securities owned by the broker-dealer. The "short" side of the record shows where the securities are located such as at a securities depository.

The Commission is proposing to amend paragraph (a)(5) of Rule 17a–3 to require that the securities record specifically account for security-based swaps, and to include parallel securities record requirements in paragraphs (a) and (b) of proposed Rule 18a–5 that are modeled on

paragraph (a)(5) of Rule 17a-3, as proposed to be amended. Specifically, this would require a broker-dealer, including a broker-dealer SBSD and broker-dealer MSBSP, to make and keep current a securities record or ledger reflecting separately for each security-based swap: (1) The reference security, index, or obligor; (2) the unique transaction identifier; (3) the unique counterparty identifier; (4) whether it is a "long" or "short" position in the security-based swap; (5) whether the security-based swap is cleared or not cleared; and (6) if cleared, identification of the clearing agency where the security-based swap is cleared. Stand-alone SBSDs and stand-alone MSBSPs would be required to make and keep current the same type of securities record, while bank SBSDs and bank MSBSPs would be required to make and keep current a securities record of the firm's securities positions but only with respect to positions "related to the business" of a bank as an SBSD or MSBSP.

For the reasons given above, firms do not normally create a "stock record" for security-based swaps. Firms also do not identify security-based swaps as being "long" or "short" in the way that they do with respect to most securities. To reflect the particular characteristics of security-based swaps, firms should have flexibility in the manner in which they create records for security-based swap transactions, provided that all required information is recorded and retained and can be pulled together upon request to create something that recognizably would be akin to a "stock record." Such an approach would be consistent with CFTC requirements and give firms flexibility to maintain information in a way that is consistent with the nature of security-based swap transactions.

Flexibility is particularly important in connection with tracking collateral received and pledged on the stock record. Building a collateral management system is a complex and time-consuming exercise. We therefore urge the Commission to allow sufficient time for firms to build out the necessary systems. In addition, it is important for bank SBSDs and bank MSBSPs to have the flexibility to use the existing recordkeeping systems they are required to establish by their prudential regulators.

➢ ***Recommendation:*** *The Commission should provide SBSDs and MSBSPs flexibility in the manner in which they create records for security-based swap transactions and not mandate a detailed specified format, particularly with respect to tracking collateral received and pledged, provided that all required information is recorded and retained and can be pulled together upon request to create something that recognizably would be a record of the firm's security-based swap transactions. Furthermore, the Commission should allow sufficient time for firms to build out the necessary collateral systems.*

C. Accounts

1. Ledger Accounts

The proposal relating to ledger accounts is modeled on paragraph (a)(3) of Rule 17a–3, which requires broker-dealers to make and keep current certain ledger accounts (or other records) relating to securities and commodities transactions in customer and non-customer cash and margin accounts. The Commission is proposing to amend paragraph (a)(3) of Rule 17a–3 to require that the ledgers (or other records) specifically account for security-based swaps, and to

include parallel ledger requirements in paragraphs (a) and (b) of proposed Rule 18a–5 that are modeled on paragraph (a)(3) of Rule 17a–3, as proposed to be amended. In particular, the proposal would include a requirement that broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, make and keep current ledger accounts (or other records) itemizing separately as to each security-based swap: (1) The type of security-based swap; (2) the reference security, index, or obligor; (3) date and time of execution; (4) the effective date; (5) the termination or maturity date; (6) the notional amount; (7) the unique transaction identifier; and (8) the unique counterparty identifier.

The proposal would require stand-alone SBSDs and stand-alone MSBSPs to make and keep current the same types of ledgers (or other records). However, it would require bank SBSDs and bank MSBSPs to make and keep current ledger accounts (or other records) relating to securities and commodity transactions, but only with respect to their security-based swap customers and non-customers.

SIFMA has similar comments on the Commission's proposal relating to ledger accounts as it did on other aspects of the Commission's proposal: the Commission should permit flexibility and not define ledger account in a way that would be inconsistent with the CFTC's approach. In addition, as noted above, we believe that the Commission should make the use of LEIs mandatory, but allow firms flexibility to use internal codes to identify counterparties that they can map to LEIs.[33]

➢ ***Recommendation:*** *The Commission should allow flexibility in how a "ledger account" is understood and operationalized, and not mandate a detailed specified format, to enable SBSDs and MSBSPs to have flexibility in how they keep and maintain required records relating to security-based swaps. Furthermore, the Commission should not define or interpret a "ledger account" in a way that would be inconsistent with the CFTC's concept of a "ledger account."*

2. Daily Margin Calculation

The Commission has proposed Rule 18a–3 under the Exchange Act, which would establish margin requirements with respect to noncleared security-based swaps applicable to nonbank SBSDs and nonbank MSBSPs.[34] The Commission is proposing to require that nonbank SBSDs and nonbank MSBSPs make and keep current a record of the daily calculations that would be required under proposed Rule 18a–3 by amending Rule 17a–3 and including a parallel provision in paragraph (a) of proposed Rule 18a–5 applicable to nonbank SBSDs and nonbank MSBSPs.

➢ ***Recommendation:*** *SIFMA supports the Commission's proposed recordkeeping requirements relating to the daily margin calculation, but we request that the Commission consider the concerns that we raised regarding the Commission's margin*

[33] *See* note 25, *supra*.

[34] *See* SEC Capital and Margin Proposal at 70274-88.

proposal in the SIFMA Comment Letter on SEC Capital and Margin Proposal and the SIFMA Comment Letter on Margin for Uncleared Swaps.

D. Accountholder, Associated Persons, and Business Conduct

1. Accountholder Information

The proposal relating to accountholder information is modeled on paragraph (a)(9) of Rule 17a–3, which requires broker-dealers to make and keep current certain information with respect to each securities accountholder. The Commission is proposing to amend paragraph (a)(9) to require certain information with respect to security-based swap accountholders, and to include similar requirements in paragraphs (a) and (b) of proposed Rule 18a–5. Specifically, the proposal would require broker-dealers, SBSDs, and MSBSPs to make and keep current, in the case of a security-based swap account: (1) A record of the unique counterparty identifier of the accountholder; (2) the name and address of accountholder; and (3) the signature of each person authorized to transact business in the security-based swap account.

SIFMA generally supports the Commission's proposal to require that broker-dealers, SBSDs, and MSBSPs obtain certain information regarding their security-based swap accountholders. In particular, SIFMA supports the requirement to require a record of the unique counterparty identifier of each accountholder. As noted above, we believe that the Commission should make the use of LEIs mandatory, but also allow firms flexibility to use identify counterparties with internal codes that they can map to LEIs.

With respect to the requirement to obtain a signature of each person authorized to transact business in the security-based swap account, we note that this requirement originated in a time when securities transactions were largely documented in paper. With the increasing use of electronic communications and electronic trading platforms, it is not common practice in the swaps market to obtain actual signatures of persons authorized to transact business on behalf of a counterparty in a swaps account. Instead, broker-dealers, SBSDs, and MSBSPs should be permitted to satisfy this requirement by establishing policies and procedures relating to counterparty trade authorization.

- ***Recommendation:*** *The Commission should make the use of LEIs mandatory, although it should permit firms to use different counterparty identifiers for internal firm purposes as long as they are able to translate their internal counterparty identifiers into the standard LEI convention.*[35] *Furthermore, the Commission should permit broker-dealers, SBSDs, and MSBSPs to satisfy the requirement to obtain signatures of persons authorized to trade on behalf of counterparties by establishing policies and procedures relating to counterparty trade authorization.*

[35] *See* note 25, *supra*.

2. Associated Persons

The proposal relating to associated person information is modeled on paragraph (a)(12) of Rule 17a–3, which requires broker-dealers to make and keep current records of a wide range of information about associated persons of the broker-dealer. Because Rule 17a-3(a)(12) already applies to broker-dealer SBSDs and broker-dealer MSBSPs, the Commission is not proposing to amend paragraph (a)(12) to account for security-based swaps. The Commission, however, is proposing to include parallel provisions in paragraphs (a) and (b) of proposed Rule 18a–5 Consequently, stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs would be required to make and keep current a questionnaire or application for employment for each associated person, which must include the associated person's identifying information, business affiliations for the past ten years, relevant disciplinary history, relevant criminal record, and place of business, among other things. Bank SBSDs and bank MSBSPs would be subject to the rule only with respect to associated persons whose activities relate to the conduct of their business as an SBSD or MSBSP.

For this purpose, the term "associated person" means: "(i) any partner, officer, director, or branch manager of such security-based swap dealer or major security-based swap participant (or any person occupying a similar status or performing similar functions); (ii) any person directly or indirectly controlling, controlled by, or under common control with such security based swap dealer or major security-based swap participant; or (iii) any employee of such security-based swap dealer or major security-based swap participant."[36] As a result of this broad definition, under the Commission's proposal, stand-alone SBSDs and stand-alone MSBSPs, and to a lesser extent bank SBSDs and bank MSBSPs, would be required to make and keep current records of a wide range of information about a broad group of personnel.

However, in its proposed rules regarding registration of SBSDs and MSBSPs, the Commission had proposed to require each SBSD and MSBSP to obtain information regarding associated persons solely for the purpose of supporting an SBSD's or MSBSP's required certification that none of its associated persons that effect, or are involved in effecting, security-based swaps on the SBSD's or MSBSP's behalf is subject to a statutory disqualification.[37] Specifically, paragraph (b) of proposed Rule 15Fb6–1 under the Exchange Act would require each SBSD and MSBSP to obtain a questionnaire or application for employment executed by each of its associated persons that "effect or are involved in effecting" security-based swaps on

---

[36] Section 3(a)(70) of the Exchange Act, as added by Section 761(a)(6) of the Dodd-Frank Act. This definition does not include persons whose functions are solely clerical or ministerial.

[37] Section 15F(b)(6), as added by Section 764(a) of the Dodd-Frank Act, provides: "Except to the extent otherwise specifically provided by rule, regulation, or order of the Commission, it shall be unlawful for a security-based swap dealer or a major security-based swap participant to permit any person associated with a security-based swap dealer or a major security-based swap participant who is subject to a statutory disqualification <u>to effect or be involved in effecting</u> security-based swaps on behalf of the security-based swap dealer or major security-based swap participant, if the security-based swap dealer or major security-based swap participant knew, or in the exercise of reasonable care should have known, of the statutory disqualification" (emphasis added).

its behalf.[38] Such questionnaire or application is intended by the Commission to serve as a basis for a background check of the associated person to determine whether the associated person is statutorily disqualified.

Although the SEC Registration Proposal limits the scope of associated persons from which an SBSD or MSBSP would be required to obtain information, the SEC Recordkeeping Proposal dramatically extends the scope of this requirement to all associated persons. The Commission does so without providing a policy rationale for departing from the Commission's registration proposal on this point or provide an analysis of the costs and benefits of the new approach, which will clearly impose significant additional costs on non-broker-dealer SBSDs and MSBSPs.[39]

While recognizing the need to ensure that associated persons are not subject to statutory disqualifications, consistent with our comments above, SIFMA recommends that the Commission harmonize its proposal with the approach taken by the CFTC in its final rules governing SD and MSP registration. The CFTC provides firms flexibility in complying with the statutory disqualification prohibition relating to associated persons of SDs and MSPs, including allowing for the National Futures Association or other service provider to vet potential associated persons for statutory disqualifications.[40]

At a minimum, however, SIFMA recommends that the Commission modify the recordkeeping proposal to make it consistent with the SEC Registration Proposal and, therefore, require an SBSD or MSBSP to obtain information only from associated persons who "effect or are involved in effecting" security-based swaps on its behalf. In addition, as we argued in our previous comments to the Commission in connection with the SEC Registration Proposal, the Commission should remove or, in the alternative, narrow the scope of, and provide exceptions

---

[38] The Commission defines associated persons "involved in effecting" security-based swaps to include, but not be limited to: "persons involved in drafting and negotiating master agreements and confirmations, persons recommending security-based swap transactions to counterparties, persons on a trading desk actively involved in effecting security-based swap transactions, persons pricing security-based swap positions and managing collateral for the SBS Entity, and persons assuring that the SBS Entity's security-based swap business operates in compliance with applicable regulations. In short, the term would encompass persons engaged in functions necessary to facilitate the SBS Entity's security-based swap business." *See* SEC Registration Proposal at 65795 n.56.

[39] *See* SIFMA Comment Letter on SEC Registration Proposal at 7 (arguing that the Commission significantly underestimated the burden the proposal's associated person investigation requirement would impose on prospective SBSDs and MSBSPs and questioning the Commission's estimate of how many associated persons would be subject to the required investigation). This burden would be significantly increased if the requirement applied to all associated persons through the backdoor of the recordkeeping rules.

[40] *See* CFTC, Registration of Swap Dealers and Major Swap Participants, 77 Fed. Reg. 2613, 2615-16 (Jan. 19, 2012), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2012-01-19/pdf/2012-792.pdf.

from, the associated person investigation requirement to make it clearer which associated persons are covered by the requirement.[41]

Moreover, SIFMA is concerned about the vagueness of the proposed limitation on the scope of the requirement with respect to bank SBSDs and bank MSBSPs, which are only required to keep records of every associated person whose "activities relate to the conduct of the business" of the SBSD or MSBSP. It is unclear what activities this is intended to capture. SIFMA recommends that the Commission limit the requirement to associated persons who effect or are involved in effecting security-based swaps on its behalf, narrowly defined, as recommended above.

Below we discuss application of this requirement to foreign SBSDs and foreign MSBSPs, which raises a number of difficult issues as a result of foreign privacy, secrecy, and blocking laws.[42]

- ***Recommendation:*** *The Commission should harmonize its proposal with the CFTC's approach to addressing the statutory disqualification prohibition for associated persons of SDs and MSPs. At a minimum, however, the Commission should modify the recordkeeping proposal to make it consistent with the SEC Registration Proposal and, therefore, only require an SBSD or MSBSP to obtain information from associated persons that effect or are involved in effecting security-based swaps on its behalf. The Commission also should remove or, in the alternative, narrow the scope of and provide exceptions from the associated person investigation requirement. Furthermore, the Commission should limit the requirement for a bank SBSD or bank MSBSP to obtain information from every associated person whose "activities relate to the conduct of the business of the SBSD or MSBSP" to those associated persons who effect or are involved in effecting security-based swaps on its behalf.*

3. External Business Conduct Standards

To promote compliance with previously proposed external business conduct standards, the Commission is proposing to amend Rule 17a–3 and to include parallel provisions in paragraphs (a) and (b) of proposed Rule 18a–5 to require SBSDs and MSBSPs to make and keep current a record that demonstrates their compliance with proposed external business conduct rules, as applicable. The proposal would require SBSDs and MSBSPs to keep supporting documents evidencing their compliance with the business conduct standards; the Commission states that a mere attestation of compliance would not be sufficient.

While SIFMA generally supports this aspect of the proposal, we request that the Commission confirm that the requirement for SBSDs and MSBSPs to keep "supporting documents evidencing their compliance with the business conduct standards," as applicable, is consistent with the requirement in proposed Rule 15Fk-1(b)(5) of the SEC Business Conduct

[41] *See* SIFMA Comment Letter on SEC Registration Proposal at 7-9.

[42] *See* Sections VI.D and VI.F.2, *infra*.

Proposal that the chief compliance officer of an SBSD or MSBSP establish, maintain and review policies and procedures reasonably designed to ensure compliance with the provisions of the Exchange Act and the rules and regulations thereunder relating to the SBSD's or MSBSP's business as an SBSD or MSBSP.[43] If the Commission intends to impose additional requirements with respect to compliance with its proposed business conduct standards, the Commission should clearly state what those new proposed requirements are, explain how they relate to what was previously proposed (*e.g.*, how they are different), and provide a sufficient justification for the proposed new requirements, including performing an adequate cost-benefit analysis.

In addition, the Commission requests comment on whether it should require broker-dealer SBSDs, stand-alone SBSDs, and bank SBSDs to make and keep a record that demonstrates they have complied with the business conduct standards required under proposed Rule 15Fh-6 under the Exchange Act (regarding political contributions by certain SBSDs).[44] To begin with, as we commented previously, the Dodd-Frank Act did not mandate any restrictions on political contributions by SBSDs, and so it is not clear to us that the Commission needs to impose such a requirement on a discretionary basis.[45] In this connection, we note that the regulations promulgated by the Municipal Securities Rulemaking Board on political contributions made in connection with municipal securities business will already cover most SBSDs doing business with municipal entities, and so there may not be much marginal benefit to imposing additional restrictions on SBSDs generally.[46] For similar reasons, we do not think the Commission should adopt additional recordkeeping rules relating to the proposed pay to play rules. Finally, we believe that such recordkeeping rules would be unnecessary because the Commission already is proposing to require SBSDs to establish, maintain, and review policies and procedures reasonably designed to ensure compliance with the provisions of the Exchange Act and the rules and regulations thereunder relating to the SBSD's or MSBSP's business as an SBSD or MSBSP.[47] Therefore, it is not necessary for the Commission to adopt prescriptive recordkeeping rules relating to pay to play provisions, such as described in its request for comment, to achieve its regulatory objectives.

- ***Recommendation:*** *The Commission should confirm that the SEC Recordkeeping Proposal is not proposing to create additional recordkeeping obligations with respect to business conduct standards set forth in the SEC Business Conduct Proposal, particularly with respect to the requirements relating to compliance with such requirements. Furthermore, the Commission should not adopt additional recordkeeping rules relating to the pay to play provisions proposed in the SEC Business Conduct Proposal.*

[43] *See* SEC Business Conduct Proposal. The reference in the SEC Business Conduct Proposal to a "documented system for applying those policies and procedures" occurs only in proposed Rule 15Fh-3(h)(3)(i) as something of a safe harbor from being deemed to have failed to diligently supervise. *See also* SIFMA Comment Letter on SEC Business Conduct Proposal.

[44] *See* SEC Recordkeeping Proposal at 25209.

[45] See SIFMA Comment Letter on SEC Business Conduct Proposal at 21. *See also id*. at 22-23.

[46] See SIFMA Comment Letter on SEC Business Conduct Proposal at 21-22.

[47] *See* note 43, *supra*.

E. Capital, Liquidity, and Customer Protection

1. Trial Balances and Computation of Net Capital

Paragraph (a)(11) of Rule 17a–3 requires broker-dealers to make and keep current a record of the proof of money balances of all ledger accounts in the form of trial balances and certain records relating to the computation of aggregate indebtedness and net capital under Rule 15c3–1 under the Exchange Act. The Commission is not proposing to amend paragraph (a)(11) to account for security-based swaps because the impact of security-based swaps on those computations is reflected in the amendments to the capital rules that have been proposed by the Commission to apply to broker-dealer SBSDs and stand-alone SBSDs. The Commission is proposing to include a parallel requirement in paragraph (a)(9) of proposed Rule 18a–5 applicable to stand-alone SBSDs and stand-alone MSBSPs, but not a parallel requirement for bank SBSDs or bank MSBSPs.

While we recognize the importance of including recordkeeping and reporting requirements with respect to trial balances and computation of net capital, we strongly urge the Commission to modify its proposed net capital requirements for SBSDs and MSBSPs to address comments SIFMA has raised regarding the proposal.[48] In particular, we are concerned that the proposed requirement to tie an SBSD's minimum level of net capital to 8% of the level of margin required to be collected by it with respect to security-based swaps would require the maintenance of resources far in excess of the actual risks presented by an SBSD's exposures.[49] As we have explained at length elsewhere, we recommend that the Commission adopt two alternatives to the proposed 8% margin factor that would more effectively be tailored to the risk presented by an SBSD's activities: (a) for stand-alone SBSDs that use internal models and ANC broker-dealers, a ratio based on a percentage of the entity's market and credit risk charges to capital and (b) for stand-alone and broker-dealer SBSDs that do not use internal models, a ratio based on a credit quality adjusted version of the proposed 8% margin factor.[50] If the Commission determines to adopt a margin factor that is additive to net capital, we strongly urge the Commission to discuss with interested constituencies the potential impact of any such margin factor before adopting it. SIFMA would be pleased to work with Commission staff to facilitate such a consultation.[51]

---

[48] *See* SIFMA Comment Letter on SEC Capital and Margin Proposal; *see also* SIFMA Comment Letter on Margin for Uncleared Swaps. The Executive Summaries contained in these letters are provided in Appendices A and B.

[49] *See* SIFMA Comment Letter on SEC Capital and Margin Proposal at 2-8 (discussing the reasons why the proposed 8% margin factor is not appropriately risk-based).

[50] *See* SIFMA Comment Letter on SEC Capital and Margin Proposal at 8-13.

[51] In addition, we would like to reiterate our previous comments regarding (i) the third-party custodian deduction and (ii) the legacy account deduction. In our comments, we suggested alternatives to these proposals that were intended to be more risk sensitive and less disruptive to the security-based swap market.

➢ ***Recommendation:*** *The Commission should modify the proposed net capital requirements for SBSDs and MSBSPs as described above.*

2. Liquidity Stress Tests

The Commission has proposed that certain broker-dealers, including broker-dealer SBSDs, and certain stand-alone SBSDs be subject to liquidity stress test requirements.[52] The Commission is proposing to amend Rule 17a–3 to add a requirement that ANC broker-dealers, including ANC broker-dealer SBSDs, make and keep current a report of the results of the monthly liquidity stress test, a record of the assumptions underlying the liquidity stress test, and the liquidity funding plan required under the proposed amendments to Rule 15c3–1. The Commission is proposing to include a parallel requirement in paragraph (a) of proposed Rule 18a–5 applicable to stand-alone SBSDs and stand-alone MSBSPs, but not a parallel requirement for bank SBSDs and bank MSBSPs.

While we recognize the importance of including recordkeeping and reporting requirements with respect to liquidity stress tests, we strongly urge the Commission to modify its proposed liquidity stress test requirements as follows:

- ***Liquid asset standards***. The Commission's liquidity rulemaking for broker-dealers and SBSDs should rely on the High Quality Liquid Asset ("**HQLA**") standard adopted by the Federal Reserve in the Liquidity Coverage Ratio ("**LCR**") regime.

- ***Intraday liquidity***. The Commission's liquidity rulemaking for broker-dealers and SBSDs should permit firms to use liquidity resources on an intraday basis so long as they comply with end-of-day standards.

With respect to the legacy account deduction, we recommend that the Commission should modify the legacy account deduction by instead adopting either a credit risk charge or a credit concentration charge, with an exception permitting SBSDs to elect to exclude from accounts subject to the charge any currently uncleared positions in a type of security-based swap for which a clearing agency has made an application to the Commission to accept for clearing. See SIFMA Comment Letter on SEC Capital and Margin Proposal at 24-27.

With respect to the third-party custodian deduction, to address the SBSD's credit risk to the custodian, the Commission could require that, under the arrangement the custody account is maintained with a "bank" (as defined in Section 3(a)(6) of the Exchange Act), U.S. broker-dealer, or non-U.S. bank or broker-dealer that has total regulatory or net capital in excess of $1 billion (such bank or broker-dealer, the "custodian"). Such custodian should be permitted to include an affiliate of the SBSD. Furthermore, the Commission should address any concerns it has regarding custodial arrangements directly through rules regarding the terms and conditions of such arrangements, for bank and nonbank SBSDs alike. See SIFMA Comment Letter on SEC Capital and Margin Proposal at 24-27.

The Commission should adopt one of the alternatives we have recommended and make corresponding changes, as applicable, to the SEC Recordkeeping proposal.

[52] *See* SEC Capital and Margin Proposal at 70252-54.

- ***Holdco/subsidiary alignment***. Under appropriate circumstances, the Commission should recognize HQLAs held by a broker-dealer/SBSD's parent company as supporting the subsidiary entity's liquidity. Conditions to this requirement could include:

  (1) Parent company is subject to LCR on a consolidated basis;

  (2) Parent company has submitted a resolution plan to the Federal Reserve and FDIC;

  (3) The resolution plan anticipates the broker-dealer/SBSD receiving liquidity support in the event of material financial distress at the Parent company; and

  (4) The Federal Reserve/FDIC have not objected to the Parent company's resolution plan.[53]

We would be pleased to discuss this proposal with Commission staff.

➢ ***Recommendation**: The Commission should modify the proposed stress test requirements for SBSDs consistent with the recommendations above.*

3. Possession or Control

Rule 15c3–3 under the Exchange Act requires a broker-dealer that carries customer securities or cash (a "carrying broker-dealer") to maintain physical possession or control over customers' fully paid and excess margin securities. The Commission has proposed Rule 18a–4 under the Exchange Act to establish security-based swap customer protection requirements that are modeled on the requirements in Rule 15c3–3. Paragraph (b)(1) of proposed Rule 18a–4 would require an SBSD to promptly obtain and thereafter maintain physical possession or control of all excess securities collateral carried for the accounts of security-based swap customers.

The Commission is proposing to require that all SBSDs make and keep current a record of compliance with the possession or control requirement under proposed Rule 18a–4 by amending Rule 17a–3 to add this new requirement and including parallel requirements in paragraphs (a) and (b) of proposed Rule 18a–5. Consequently, this new recordkeeping requirement would apply to broker-dealer SBSDs, stand-alone SBSDs, and bank SBSDs. The records required under this proposal would need to document that each business day the firm took the steps required under paragraph (b) of proposed Rule 18a–3.

While we recognize the importance of including recordkeeping and reporting requirements with respect to possession or control requirements, we strongly urge the

[53] Suggested revisions to proposed Rule 18a-1 under the Exchange Act are set forth in Appendix C. *See* SIFMA, "SEC Liquidity Presentation" (Jan. 10, 2014), *available at:* http://www.sec.gov/comments/s7-08-12/s70812-55.pdf. *See also* SIFMA Comment Letter on SEC Capital and Margin Proposal at 30-32.

Commission to modify the possession or control requirements in proposed Rule 18a-4 to address certain technical questions and issues that we think need to be addressed for the proposed requirements to be made consistent with Rule 15c3-3 and to accommodate the funding and hedging practices of dealers in OTC derivatives.[54]

➢ ***Recommendation:*** *The Commission should modify its proposal to address certain technical questions and issues that need to be addressed for the proposed requirements to be made consistent with Rule 15c3-3 and to accommodate the funding and hedging practices of dealers in OTC derivatives, as outlined in the SIFMA Comment Letter on SEC Capital and Margin Proposal.*

4. Reserve Computation

Rule 15c3–3 requires a carrying broker-dealer to maintain a reserve of funds or qualified securities in an account at a bank that is at least equal in value to the net cash owed to customers. The Commission has proposed a parallel requirement in proposed Rule 18a–4. The Commission is proposing to require that all types of SBSDs make and keep current a record of their reserve computations under proposed Rule 18a–4 by amending Rule 17a–3 to add the requirement and to include parallel requirements in paragraphs (a) and (b) of proposed Rule 18a–5.

While we recognize the importance of including recordkeeping and reporting requirements with respect to the reserve computation, we strongly urge the Commission to modify the proposed customer reserve account requirements to address certain technical questions and issues that we think need to be addressed for the proposed requirements to be made consistent with Rule 15c3-3 and to accommodate the funding and hedging practices of dealers in OTC derivatives.[55]

➢ ***Recommendation:*** *The Commission should modify its proposal to address certain technical questions and issues that need to be addressed for the proposed requirements to be made consistent with Rule 15c3-3 and to accommodate the funding and hedging practices of dealers in OTC derivatives, as outlined in the SIFMA Comment Letter on SEC Capital and Margin Proposal.*

IV. Record Retention

A. Voice Records

The Commission is proposing to amend the preservation requirement in paragraph (b)(4) of Rule 17a–4 to include recordings of telephone calls required to be maintained pursuant to Section 15F(g)(1) of the Exchange Act (*i.e.*, in connection with security-based swap transactions). Under this proposed requirement, a broker-dealer SBSD or a broker-dealer MSBSP would be required to preserve for three years telephone calls that it chooses to record to the extent the calls are related to security-based swap transactions. The Commission is

---

[54] *See* SIFMA Comment Letter on SEC Capital and Margin Proposal at 47-50.

[55] *See Id*.

proposing to include parallel communication preservation requirements for stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs modeled on paragraph (b)(4) of Rule 17a–4. The requirements relating to bank SBSDs and bank MSBSPs would be limited to the registrant's business as an SBSD or MSBSP.

SIFMA supports the Commission's decision to make voice recordings voluntary and only to require the retention of voice recordings an SBSD or MSBSP voluntarily chooses to record.[56] We are concerned, however, by the Commission's three-year retention period requirement for voice recordings that are voluntarily made. The CFTC, which requires firms to create certain voice recordings, only requires firms to maintain such records for one year. Firms will frequently make voice recordings of swap transactions to comply with CFTC regulations. In many cases, it will be difficult, if not impossible, for dually registered firms to separate recordings relating to swaps from recordings relating to security-based swaps, given the inter-connectedness of the product sets. Thus, dually registered firms may be put in a position where they effectively have to maintain voice recordings for both swap and security-based swap activity for the Commission's longer three-year retention period, even though the Commission does not mandate voice recordings in the first place. We do not think it would be appropriate to impose the three-year requirement, when the primary reason for the recordings is compliance with the CFTC policy, as it would impose additional cost without a corresponding regulatory benefit. Therefore, we recommend that the Commission limit the record retention period for voice recordings to one year, consistent with the CFTC's approach.

- ***Recommendation:*** *The Commission should limit the record retention period for voluntarily recorded voice records to one year, consistent with the CFTC's approach.*

B. WORM Storage Challenges

The Commission is proposing to include in proposed Rule 18a-6 a record maintenance and preservation requirement, with respect to electronic storage media, for stand-alone SBDSs/MSBSPs and bank SBSDs/MSBSPs that is parallel to the requirements currently applicable to broker-dealers in Rule 17a-4(f) under the Exchange Act. Among other things, the electronic media storage must preserve the records exclusively in a non-rewritable, non-erasable format. This format is often referred to as "write once, read many," or "WORM."

SIFMA has approached the CFTC and Commission staff to request a wholesale review of the WORM storage requirements for electronic records. Given the many advances in technology and the increasing complexity of records, SIFMA believes that the WORM standard is no longer the most efficient or effective standard for retaining electronic records. The rapid evolution of complex content from social media, voice recordings, and ledgers, which often cannot be archived in discrete documentary form, have further highlighted challenges to retaining records in WORM format. SIFMA is advocating for a principles-based standard in lieu of the WORM technology-based standard. A principles-based standard would include security and audit requirements that would ensure the integrity and retrievability of records in a more efficient and effective manner, while still preserving WORM as an acceptable format. Our discussions with

---

[56] *See* SEC Recordkeeping Proposal at 25266.

the CFTC and the Commission are ongoing, but we urge the Commission not to expand the WORM requirements to SBSDs at this time.

For these reasons, and reasons we have expressed elsewhere in other contexts,[57] we do not support the use of WORM technology with respect to electronically stored SBSD or MSBSP records.

➢ ***Recommendation:*** *The Commission should not mandate the use of WORM storage systems for SBSDs and MSBSPs. Furthermore, the Commission should not mandate the use of WORM storage systems more generally, including for broker-dealers who may be dually-registered as SBSDs.*

V. Reporting

The Commission is proposing new FOCUS Report Form SBS ("**Form SBS**") that would be used by all types of SBSDs and MSBSPs to report financial and operational information and, in the case of broker-dealer SBSDs and broker-dealer MSBSPs, replace their use of Part II, Part IIA, Part IIB, or Part II CSE of the Financial and Operational Combined Uniform Single Report ("**FOCUS Report**"). Under the proposal, different reporting rules would apply to broker-dealer SBSDs/MSBSPs, stand-alone SBSDs/MSBSPs, and bank SBSDs/MSBSP, given the differences in their business operations and the Commission's authority over them. The reporting program is modeled on the reporting program for broker-dealers in Rule 17a–5 under the Exchange Act. Rule 17a–5 has two main elements: (i) a requirement that broker-dealers file periodic unaudited reports containing information about their financial and operational condition on a FOCUS Report; and (ii) a requirement that broker-dealers annually file financial statements and certain reports and a report covering the financial statements and reports prepared by an independent public accountant registered with the Public Company Accounting Oversight Board ("**PCAOB**") in accordance with PCAOB standards.

SIFMA recognizes the importance that reporting requirements play in promoting transparency of the financial and operational condition of a firm to the Commission, the firm's designated examining authority, and (in the case of a portion of the annual reports) to the public. SIFMA also supports the Commission's decision to tailor the reporting requirements to different types of registrants. Nevertheless, we have a number of serious concerns with proposed Form SBS, some of which are as follows:

---

[57] Because SIFMA believes that the WORM requirement imposes additional costs and inefficiencies in the recordkeeping process, we are seeking to eliminate this requirement for broker-dealers as well. *See* SEC Interpretation: Electronic Storage of Broker-Dealer Records, Release No. 34-44238 (May 1, 2001), 66 Fed. Reg. 22916 (May 7, 2001), *available at:* http://www.sec.gov/rules/interp/34-47806.htm. *See also* SIA comment letter to the SEC re. Amendment to Rules under the Investment Company and Investment Adviser Acts (Apr. 19, 2001), *available at:* https://www.sifma.org/issues/item.aspx?id=1209; SIA comment letter on a proposal relating to modernizing the SEC's electronic storage rule (Feb. 21, 2003), *available at:* http://www.sifma.org/issues/item.aspx?id=1014; and SIFMA comment letter to the SEC on electronic records retention (Dec. 19, 2007), *available at:* http://www.sifma.org/issues/item.aspx?id=208.

- ***Proposed Form SBS is not tailored to the unique characteristics of security-based swaps***. We are concerned that proposed Form SBS, without further modification, would not adequately reflect the differences between security-based swaps and most securities. As we discussed above, the ongoing contractual relationship between parties distinguishes a security-based swap from most securities and is reflected in the different ways in which security-based swaps and most securities are treated for recordkeeping purposes.[58] Also, as discussed above, many terms and concepts that are more appropriate for debt and equity securities are not really applicable to security-based swaps – for example, terms like "longs and shorts." Thus, in many places, proposed Form SBS is not sufficiently tailored to security-based swap activity as opposed to the traditional securities activity of broker-dealers.

- ***Proposed Form SBS contains requests for information that are unclear or incomplete***. In part because proposed Form SBS is not adequately tailored to reflect the unique characteristics of security-based swaps, it is unclear, in a number of places, what information proposed Form SBS is trying to elicit from firms. The request for information also is incomplete in several places. Examples of places where proposed Form SBS is unclear or incomplete are included in Appendix D.

- ***Parts 4 and 5 of proposed Form SBS contain schedules that are treated as part of proposed Form SBS rather than as supplemental to the form.*** As with the schedules to the Focus Report for broker-dealers, SIFMA requests that the schedules in Parts 4 and 5 of proposed Form SBS not be treated as part of proposed Form SBS, but rather that they be treated as supplementary schedules.

- ***Proposed Form SBS does not adequately address the concerns of U.S. and foreign bank SBSDs and bank MSBSPs.*** Examples of how proposed Form SBS does not adequately address the concerns of U.S. and foreign bank SBSDs and bank MSBSPs are included in Appendix E.

- ***Proposed Form SBS reflects aspects of the SEC Capital and Margin Proposal that should be modified***. We are concerned that proposed Form SBS reflects a decision on the part of the Commission to adopt certain of the proposals contained in the SEC Capital and Margin Proposal, most notably the proposed 8% margin factor. As we have previously commented, we have serious concerns regarding certain aspects of the SEC Capital and Margin Proposal, which we think will impose costs that are disproportionate to the risks of security-based swap dealing activity.[59] In particular, as noted above, we are concerned that the proposed requirement to tie an SBSD's minimum level of net capital to 8% of the level of margin required to be collected by

[58] *See* Section II.A., *supra*.

[59] As noted above, Appendices A and B of this letter contain the executive summaries of the SIFMA Comment Letter on SEC Capital and Margin Proposal and the SIFMA Comment Letter on Margin for Uncleared Swaps, respectively. We encourage the Commission to reconsider the fuller discussion of these points in the referenced comment letters.

> it with respect to security-based swaps would require the maintenance of resources far in excess of the actual risks presented by an SBSD's exposures.[60]

Rather than attempting to rewrite, or provide detailed annotations on, proposed Form SBS, we believe it would be more fruitful for the Commission to enter into a constructive dialogue with interested constituencies to discuss the various parts of proposed Form SBS in more detail, with the goal of developing a reporting regime that both is workable for SBSDs and MSBSPs and achieves the Commission's regulatory objectives. SIFMA would be pleased to work with Commission staff to facilitate such a consultation.

- ***Recommendation:*** *Given some of the problems identified above, the Commission should enter into a constructive dialogue with interested constituencies with the goal of developing a reporting regime that both is workable for SBSDs and MSBSPs and achieves the Commission's regulatory objectives. At a minimum, the Commission should revise proposed Form SBS to reflect the differences between security-based swap activity and traditional securities activity and address the other concerns raised above.*

VI. Cross-Border Considerations

The Commission did not address the application of its proposed recordkeeping and reporting requirements in the cross-border context in the SEC Recordkeeping Proposal or in the final cross-border rules the Commission adopted in June of this year.[61] In the Commission's cross-border proposal, such requirements were preliminarily considered "entity-level requirements" because the Commission believed that such requirements provided the Commission with vital information in connection with its oversight of registrants.[62] However, the Commission solicited comment regarding the cross-border application of the recordkeeping and reporting requirements, which had not yet been proposed at the time of the SEC Cross-Border Proposal.

As discussed below, SIFMA has a number of concerns regarding the application of the recordkeeping and reporting requirements to foreign SBSDs, foreign MSBSPs, and foreign branches of U.S. banks.

---

[60] *See* SIFMA Comment Letter on SEC Capital and Margin Proposal, particularly at 2-8.

[61] *See* Application of the "Security-based Swap Dealer" and "Major Security-based Swap Participant" Definitions to Cross-Border Security-Based Swap Activities; Republication, Release No. 34-72472 (June 25, 2014), 79 Fed. Reg. 47278 (Aug. 12, 2014, as corrected) ("**SEC Final Cross-Border Rules**"), *available at*: http://www.gpo.gov/fdsys/pkg/FR-2014-08-12/pdf/R1-2014-15337.pdf.

[62] *See* SEC Cross-Border Proposal at 31013.

A. Classification and Application of Recordkeeping Requirements

The Commission has proposed to classify recordkeeping requirements, including requirements relating daily trading records and confirmations, as "entity-level requirements."[63] This is in contrast to the CFTC's approach, which classifies daily trading records and confirmations as transaction-level requirements.[64] As with uncleared swap margin, SIFMA believes that daily trading record and confirmation requirements should apply on a transaction-by-transaction basis rather than apply to an SBSD's security-based swap dealing more generally. Since both the application and, presumably, the enforcement of these requirements will be addressed at the transaction level, we believe that daily trading record and confirmation requirements are more appropriately categorized as transaction-level requirements.

Such a classification would enable the Commission to better tailor application of its recordkeeping requirements to foreign SBSDs and MSBSPs. Specifically, we believe that the Commission generally should not apply recordkeeping rules that are classified as transaction-level requirements to transactions by registered foreign SBSD (or registered U.S. SBSDs engaging in security-based swap dealing through foreign branches) with non-U.S. persons or foreign branches of U.S. banks. Such an approach would help promote the principles of comity, cooperation, and the harmonization of international security-based swap regulation, as well as consistency with the CFTC Cross-Border Release.

- ***Recommendation:*** *The Commission should classify requirements relating to daily trading records and confirmations as transaction-level requirements rather than entity-level requirements. Furthermore, the Commission should not apply such transaction-level requirements to transactions of foreign SBSDs (or registered U.S. SBSDs that engage in security-based swap dealing through foreign branches) with non-U.S. persons or foreign branches of U.S. banks.*

B. Application of Recordkeeping and Reporting Rules to Foreign Branches of U.S. Banks

As noted above, SIFMA recommends that the Commission permit a foreign SBSD or foreign MSBSP to satisfy its recordkeeping and reporting requirements by complying with recordkeeping and reporting rules established by its foreign regulator, provided such rules are comparable to Commission rules.[65] The opportunity for substituted compliance should be

[63] The Commission classified mandatory clearing, mandatory trade execution, and mandatory reporting as transaction-level requirements. These requirements are not the subject of this release or the present discussion.

[64] *See* CFTC, Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292 (July 26, 2013) ("**CFTC Cross-Border Release**"), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2013-07-26/pdf/2013-17958.pdf. The CFTC Cross-Border Release treats requirements relating to daily trading records, trade confirmations, swap trading relationship documentation, and portfolio reconciliation and compression, among others, as "transaction-level requirements."

[65] *See* Section I.C, *supra*.

extended to Foreign Branches (*i.e.*, registered bank SBSDs that engage in dealing activity through foreign branches) in transactions with non-U.S. persons or other Foreign Branches, with respect to the recordkeeping requirements that were classified above as "transaction-level requirements." The Commission already has proposed substituted compliance with respect to Foreign Branches for regulatory reporting, public dissemination, and trade execution.[66] The SEC Cross-Border Proposal does not, however, extend substituted compliance to Foreign Branches with respect to recordkeeping or any other requirements.[67]

To increase the equality of treatment of Foreign Branches and foreign SBSDs, Foreign Branches should be able to rely on substituted compliance determinations for the recordkeeping requirements that are classified as transaction-level requirements in respect of transactions with non-U.S. persons or Foreign Branches. The proposed disparate treatment of Foreign Branches and foreign SBSDs puts Foreign Branches at a competitive disadvantage, even though Foreign Branches are, in most cases, subject to extensive supervision and oversight in their host country, and substituted compliance would only be permitted where such comprehensive regulation exists. Consequently, to mitigate the competitive inequalities that result from disparate treatment of entities operating outside the United States, we believe that the final cross-border rule should allow Foreign Branches to benefit from the availability of substituted compliance for requirements relating to daily trading records, confirmations, and other transaction-level recordkeeping requirements.

- ***Recommendation:*** *Foreign Branches should be permitted to rely on substituted compliance with respect to requirements relating to daily trading records, confirmations, and other recordkeeping requirements that are classified as transaction-level requirements in transactions with non-U.S. persons or other Foreign Branches.*

C. Allocation of Duties

The SEC Cross-Border Proposal allows an SBSD to allocate Title VII duties to an agent, provided that the SBSD ultimately remains responsible for compliance with the applicable requirements. We support this provision and believe that it reflects the realities of the security-based swap market, in which agents often play a significant role. Furthermore, we appreciate that this allocation is permitted but optional, which we believe provides the flexibility necessary for the broad range of business relationships that exist in the security-based swap markets.

- ***Recommendation:*** *We support the Commission's decision to permit an SBSD to allocate duties to an agent.*[68]

---

[66] *See* SEC Cross-Border Proposal at 31058-101.

[67] Under the SEC Cross-Border Proposal, only foreign SBSD are able to rely on substituted compliance, although Foreign Branches are provided certain relief with respect to transaction-level requirements relating to mandatory clearing, trade execution, and reporting.

[68] For example, when a foreign SBSD uses a U.S. broker-dealer to act as an agent in security-based swap transactions, such as in an arrangement similar to a Rule 15a-6(a)(3) "chaperoning arrangement," it could allocate its recordkeeping obligations to the U.S. broker-dealer.

D. Foreign Privacy, Secrecy, and Blocking Laws

We believe that additional time is needed for the Commission and market participants to address concerns arising from client confidentiality requirements under the local law of certain non-U.S. jurisdictions, some of which may even apply to transactions with U.S. persons. In addition, conducting criminal background checks on associated persons and disclosing their employment records may, among other things, be subject to fairly strict data privacy laws in certain countries that will prevent firms from sending this information outside of the country (such as to a U.S. regulator). This is a complicated issue that requires consultation with local regulators in each relevant jurisdiction. More than a dozen jurisdictions have been identified where local law prohibits the disclosure of client names to non-local regulators that do not currently have an information-sharing treaty or agreement in place with the local regulator, some of which cannot be satisfied by counterparty consent. The proposed recordkeeping rules may raise problems in such jurisdictions because local law may prohibit local entities from disclosing certain information regarding certain clients.

As this delicate issue requires more time for the Commission to consider and to develop possible alternative solutions, we believe that registered foreign SBSDs and foreign MSBSPs should be permitted to mask information regarding clients, associated persons, or such other persons as local laws require in any disclosures to the Commission, as part of an examination or for any other purpose, provided that the failure to do so would violate foreign legal requirements. The Commission should work with foreign regulators to address these problems. To the extent that these problems are not solved before foreign SBSD and MSBSP are required to register, market participants may need to ask for additional relief from specific requirements.

- ***Recommendation:*** *The Commission should take into account the issue of foreign jurisdictions' privacy, secrecy, and blocking laws.*

E. Other Cross-Border Issues

1. Accounting Standards for Foreign SBSDs and Foreign MSBSPs

As discussed in Section I.C above, there will be a number of foreign financial institutions required to register as SBSDs that are subject to prudential regulatory oversight and audited under the laws of their home jurisdiction. As proposed, the recordkeeping and reporting rules would require Foreign SBSDs to submit monthly reporting to the Commission under proposed Form SBS as well as annual financial reporting in accordance with U.S. GAAP. The requirements proposed by the Commission for stand-alone SBSDs are predicated on the assumption that the majority of such entities would be unregulated.[69]

Foreign SBSDs that are prudentially regulated in their home jurisdiction are already subject to extensive oversight and reporting obligations. Such Foreign SBSDs undertake financial and regulatory reporting. Generally such reporting would not be in accordance with U.S. GAAP standards, but rather with IFRS. This reporting is also typically submitted to home-

[69] *See* SEC Recordkeeping Proposal at 25290.

country prudential regulators on a quarterly basis. To require such Foreign SBSDs to prepare separate additional reports would lead to substantive costs which would not be commensurate with the benefits the Commission is seeking to obtain. In advance of making a substituted compliance determination for Foreign SBSDs, we believe the Commission should allow any required reporting by Foreign SBSDs to be undertaken in accordance with IFRS and on a quarterly basis for the following reasons:

- IFRS is a standard already recognized by the Commission: The Commission allows the use of IFRS for existing reporting frameworks,[70] and has been a strong supporter of the convergence of IFRS and U.S. GAAP standards through the efforts of the International Accounting Standards Board ("**IASB**") and the Financial Accounting Standards Board ("**FASB**"). Accepting reporting based on the use of IFRS will provide the Commission with comparably robust information which will allow for an analysis of financial condition of Foreign SBSD's utilizing the standard. SIFMA urges the Commission to act in accordance with the mandate of Section 752(a) of the Dodd-Frank Act to strive towards consistent international standards in accepting and acknowledging IFRS for Foreign SBSDs.

- Duplication of reporting standards and requirements: Foreign SBSDs face potential reporting obligations under two separate regimes and standards, *i.e.*, their home-country prudential regulators' standards and the Commission's proposed standards. As mentioned above, Foreign SBSDs that are prudentially regulated in their home jurisdiction generally provide reporting on a quarterly basis, whereas the Commission's proposal would materially increase the frequency of reporting required. One method of reducing the unnecessary compliance burden on such firms would be to allow reporting on a quarterly basis, and thus be in line with existing reporting frameworks, as well as the approach permitted for SBSDs which are subject to U.S. prudential regulation.

➢ ***Recommendation:*** *In advance of making substituted compliance determinations, the Commission should allow Foreign SBSDs to report information on a quarterly basis (in line with U.S. prudentially regulated SBSDs) in accordance with IFRS rather than U.S. GAAP.*

2. Obtaining Information from Associated Persons

In addition to the comments made above, we also believe that the scope of the requirement to obtain information regarding associated persons of an SBSD or MSBSP should not apply, in the case of foreign SBSDs, foreign MSBSPs, and Foreign Branches, to associated persons who effect or are involved in effecting transactions with non-U.S. persons or Foreign

[70] The SEC permits foreign private issuers to provide financial statements to the SEC in accordance with IFRS and no obligation to reconcile to U.S. GAAP. *See* SEC, Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP, Release No. 33-8879 (Dec. 21, 2007), 73 Fed. Reg. 986 (Jan. 4, 2008), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2008-01-04/pdf/E7-25250.pdf.

Branches.[71] As noted above, the purpose of this requirement is to support an SBSD's or MSBSP's required certification that none of its associated persons effect, or are involved in effecting, security-based swaps on the SBSD's or MSBSP's behalf is subject to a statutory disqualification. Just as the Commission has proposed to limit the application of the external business conduct standards outside the United States, we do not think it is necessary or appropriate to apply the statutory disqualification provision to associated persons of foreign SBSDs or MSBSPs that are only involved in effecting transactions in connection with such entities' non-US person counterparties. Therefore, we believe the Commission should similarly limit the scope of information foreign SBSDs, foreign MSBPs, and Foreign Branches are required to obtain from their associated persons. In addition, we note that many of the associated persons of foreign SBSDs and foreign MSBSPs will not be U.S. citizens and, therefore, will not have some of the information required to be obtained under the rule (*e.g.*, social security numbers).

- ***Recommendation:*** *The Commission should not require foreign SBSDs, foreign MSBSPs, or Foreign Branches to obtain information regarding associated persons who effect or are involved in the effecting transactions solely with respect to their non-US person counterparties.*

VII. Phased Implementation of Recordkeeping and Reporting Requirements

An appropriate phase-in period for recordkeeping and reporting requirements is necessary to provide market participants with adequate time to build systems and technologies to record and report security-based swap activity. In most cases, complying with the proposal will require firms either to modify existing systems or to build entirely new systems. Given the complexity of the proposed rules and their interconnection with other Commission proposals, it will require much time to develop and test systems to ensure compliance with Commission regulations.

In addition, we urge the Commission not to impose implementation deadlines that conflict with the "code freeze" which typically occurs at year-end. Specifically, we suggest that the implementation dates should not fall in December or January (or, for Japanese firms, at the end of March). Financial institutions generally prohibit technological changes to their systems between early December and mid-January in an annual "code freeze." This practice is consistent with principles of prudential bank management and long-standing best practice across the industry, and was established in conjunction with the bank supervisory process. In addition, financial institutions are generally going through year-end book-closing processes in December or January (or, in Japan, at the end of March). Implementing any new procedures that will require systems changes is extremely difficult during the "code freeze" which typically occurs at year-end.

[71] We note that the Commission did not address whether a transaction by a non-U.S. person with another non-U.S. person "conducted within the United States" would have been included in such non-U.S. person's SBSD *de minimis* threshold or otherwise trigger application of Title VII requirements. Given the significant issues raised by commenters on this proposed requirement, the Commission stated the final resolution of this issue could benefit from further consideration and public comment. *See* SEC Final Cross-Border Rules at 47279-80.

- ***Recommendation:*** *The Commission should phase in the recordkeeping and reporting requirements the later of (i) 12 months after the adoption of the SBS Recordkeeping Proposal or (ii) 12 months after the adoption of the SEC Capital and Margin Proposal. Furthermore, we urge the Commission not to impose implementation deadlines that conflict with the "code freeze" which typically occurs at year-end.*

* * *

SIFMA appreciates the opportunity to comment on the Commission's proposed recordkeeping, reporting, notification, and security count requirements for SBSDs and MSBSPs and welcomes any questions the Commission may have regarding these comments.

Respectfully submitted,

Mary Kay Scucci, PhD, CPA
Managing Director
SIFMA

cc: Mary Jo White, Chairman
Luis A. Aguilar, Commissioner
Daniel J. Gallagher, Commissioner
Kara M. Stein, Commissioner
Michael S. Piwowar, Commissioner
Stephen Luparello, Director
Division of Trading and Markets
Michael A. Macchiaroli, Associate Director
Division of Trading and Markets
Thomas Smith, Deputy Director
Division of Swap Dealer and Intermediary Oversight, CFTC

Appendix A

EXECUTIVE SUMMARY[72]

SIFMA greatly appreciates the Commission's thoughtful effort to reconcile the many difficult and, in some cases, conflicting objectives that must be addressed in fashioning capital, margin and segregation requirements for nonbank SBSDs and MSBSPs. These objectives include the mandate in Section 15F(e) of the Exchange Act for the Commission's capital and margin requirements to "help ensure the safety and soundness" of nonbank SBSDs and MSBSPs and "be appropriate for the risk associated with" uncleared security-based swaps ("**SBS**"). Section 15F(e) also requires the Commission, together with the Commodity Futures Trading Commission (the "**CFTC**") and the Prudential Regulators,[73] to the maximum extent practicable, to establish and maintain comparable capital and margin requirements for bank and nonbank swap dealers ("**SDs**"), SBSDs, major swap participants ("**MSPs**") and MSBSPs. Section 752 of Dodd-Frank similarly requires the Commission to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to SBS. Finally, Section 3(f) of the Exchange Act generally requires the Commission to consider whether its rules "will promote efficiency, competition, and capital formation," and Section 23(a)(2) prohibits the Commission from adopting any rule that "would impose a burden on competition not necessary or appropriate in furtherance of the purposes" of the Exchange Act.

SIFMA recognizes that, in implementing capital, margin and segregation requirements for nonbank SBSDs, the Commission has largely drawn from its existing broker-dealer financial responsibility rules and sought to adapt those rules for SBSDs. Nevertheless, we are concerned that this approach, without further modification, does not adequately address or conform to the statutory principles described above. We strongly believe that, in applying those principles, the Commission should take into account the broader context of regulatory reform, including the significant reduction in risks that will occur once dealers and major participants in the SBS markets are required to register and comply with basic capital requirements, standardized SBS become subject to mandatory clearing and, for uncleared SBS, variation margin is required to be exchanged. Accordingly, the modifications that we recommend the Commission make to the Proposal are intended to be evaluated within that broader context.

The Proposal Would Impose Costs That Are Disproportionate to the Risks of SBS Dealing Activity. Contrary to the statutory requirements that the Commission's capital and margin requirements "be appropriate for the risk associated with" uncleared SBS and "promote efficiency," the Proposal would impose duplicative and excessive capital and margin requirements.

---

[72] This executive summary is taken from the SIFMA Comment Letter on SEC Capital and Margin Proposal at ii-ix.

[73] Under Dodd-Frank, the "Prudential Regulators" are the Board of Governors of the Federal Reserve System ("**FRB**"), the Federal Deposit Insurance Corporation ("**FDIC**"), the Federal Housing Finance Agency ("**FHFA**"), the Farm Credit Administration ("**FCA**") and the Office of the Comptroller of the Currency ("**OCC**").

In particular, we are concerned that the proposed requirement to tie a SBSD's minimum level of net capital to 8% of the level of margin required to be collected by it with respect to SBS would require the maintenance of resources far in excess of the actual risks presented by a SBSD's exposures. Similarly, the proposed requirements to apply deductions to net capital based on the level of margin required for SBS would also be excessive, as well as inconsistent with the proposed capital regimes for SDs and banks SBSDs (*e.g.*, by requiring 100% deductions for collateral held by third-party custodians and legacy account positions). The six SIFMA member firms who operate alternative net capital ("**ANC**") broker-dealers have preliminarily projected that, in light of the severity of these requirements, the amount of capital that would be required for the single business line of SBS dealing under the Proposal would exceed $87 billion, the amount of capital currently devoted to all of those firms' securities businesses combined, including investment banking, prime brokerage, market making and retail brokerage.[74]

We also believe that entity-level liquidity stress test requirements are likely to be destabilizing by trapping assets within SBSD subsidiaries and preventing centralized liquidity risk management. Given the limits on available liquid assets, it is more systemically sound for liquidity to be managed in an integrated, group-wide manner, so that a subsidiary with excess liquidity can provide resources to one that is under stress. There is no empirical evidence, nor do we believe, that the risks arising from the SBS dealing business are greater than the aggregate risks arising from all of these other businesses. Furthermore, we believe that Dodd-Frank's reforms, most notably the significant expansion of central clearing and daily exchange of variation margin for uncleared SBS, will significantly decrease the risk in the SBS dealing business

Additionally, SIFMA is concerned that mandatory initial margin requirements would replace potential exposure with actual exposure, reduce overall market liquidity, exacerbate pro-cyclical shocks and, if extended universally, place margin in the hands of entities not subject to prudential supervision. While we appreciate the Commission's efforts to mitigate these adverse impacts by proposing to limit initial margin requirements to the collection of initial margin by SBSDs from financial end users, even such limited initial margin requirements will have negative consequences. In this regard, SIFMA member firms have estimated that the liquidity demands associated with mandatory initial margin requirements are likely to range between approximately $1.1 trillion (if dealers are not required to collect from each other) to $3 trillion (if dealers must collect from each other) to $4.1 trillion (if dealers must post to non-dealers).[75]

[74] The firms estimated the amount capital currently devoted to their securities businesses by determining the amount of capital, after deductions for non-allowable assets and capital charges, that is necessary for them to have net capital in excess of the early warning level specified in Rule 17a-11.

[75] The ultimate amount would depend on the extent to which firms use models instead of standardized haircuts and the extent of any initial margin thresholds. A more detailed depiction of estimated initial margin levels is contained as Figure 1 in Appendix 2 to this letter. To create the estimates in Figure 1, we used data submitted by several SIFMA member firms in response to the Quantitative Impact Study ("**QIS**") conducted in connection with the international consultation on margin requirements for uncleared derivatives released in July 2012. Since SIFMA prepared these estimates, the results of the QIS were released as part of a second consultation. We are still studying those results. However, we note that the QIS results presented generally assume that all firms use approved internal models. Our estimates, in

Moreover, in stressed conditions, we estimate that initial margin amounts collected by firms that use internal models could increase by more than 400%. These mandatory initial margin requirements cannot be reconciled with the Commission's statutory mandate under Dodd-Frank and the Exchange Act, nor has the Commission offered a sufficient basis to justify their adoption consistent with that mandate. Indeed, in SIFMA's view, their adoption likely would substantially limit the availability of essential credit and magnify the adverse effects of financial shocks on the broader economy.

***The Proposal Would Make Nonbank SBSDs Uncompetitive*.** It is essential, as both a statutory and a policy matter, for the Commission to take into account that bank and nonbank SBSDs are engaged in the same fundamental business – entering into SBS transactions with the same customers and in the same markets. Accordingly, while we recognize that there are relevant differences between bank and nonbank dealer business models (*e.g.*, relating to types of funding and access to backstop liquidity), it would be inconsistent with Dodd-Frank, and with preserving the competitiveness of nonbank SBSDs, to adopt capital and margin requirements that are not comparable to those of the Prudential Regulators to the maximum extent practicable.

Consistency between the Commission's and the CFTC's capital and margin requirements is also necessary for nonbank SBSDs to be competitive with bank SBSDs. Most SBSDs will also be registered as SDs. For nonbank SBSDs, this will mean compliance, at the same time, with both CFTC and Commission capital and margin requirements. Bank SBSDs, in contrast, will be subject to only to a single set of capital and margin requirements. As a result, subjecting dually registered nonbank SBSD-SDs to two sets of inconsistent capital and margin requirements would impair their ability to compete effectively, without offering any incremental safety and soundness benefits.

In addition, nonbank SBSDs compete for business with foreign SBSDs. Foreign SBSDs generally must comply with Basel-compliant capital requirements similar to those applied by the Prudential Regulators. They also will, in most cases, be subject to margin requirements that are consistent with emerging international standards. As noted above, Dodd-Frank requires the Commission to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of SBS. We appreciate the steps the Commission has taken to satisfy this mandate through its participation as part of the Working Group on Margining Requirements of the Basel Committee on Banking Supervision ("**BCBS**") and the International Organization of Securities Commissions ("**IOSCO**" and, together with BCBS, "**BCBS/IOSCO**"). Because BCBS/IOSCO has not yet finalized its recommendations for international margin standards, however, it is not possible at this time to evaluate the extent and likely impact of any inconsistencies between the Proposal and international standards. Accordingly, we urge the Commission, once the BCBS/IOSCO recommendations are final, to re-propose its margin rules for further public comment to address any modifications that might be necessary to conform to those recommendations or to seek input on any inconsistencies between them.

---

contrast, focus on a mix of model-based and haircut-based initial margin amounts. In addition, the QIS results do not take into account the increased initial margin associated with a movement from non-stressed to stressed market conditions.

<u>The Proposal's Inconsistencies with Other Regulators' Regimes Would Increase Costs and Risks</u>. To the extent that the Commission's requirements for dually registered SD-SBSDs apply in addition to, or in a manner inconsistent with, CFTC requirements, such requirements would exacerbate the burdens imposed by those existing requirements and tend to promote inefficiencies by discouraging dual registration. Discouraging dual registration is particularly problematic because conducting the swap and SBS dealing business in two different legal entities will reduce opportunities for netting, thereby increasing credit risk between the dealer and its customers and increasing the amount of margin required to be posted by, and the associated liquidity demands on, customers.

We see no justification, from a cost-benefit perspective, to applying inconsistent capital and margin regimes to a SBSD that is also registered as an SD, except to the minimum extent necessary to accommodate the applicable statutory regime created by Congress. Doing so would serve no purpose other than to require significant investment in the infrastructure necessary to monitor compliance with those regimes simultaneously without materially enhancing investor protection or safety and soundness.[76]

We further note that similar considerations apply in respect of other registration categories. Many SBSDs will conduct an integrated equity derivatives business, dealing in SBS and OTC options, and so accordingly will be registered as OTC derivatives dealers. For these reasons, we strongly urge the Commission to take every step possible to coordinate with the CFTC in the adoption of consistent capital and margin requirements.[77]

<u>A More Risk-Sensitive Approach Would Better Achieve Dodd-Frank's Objectives</u>**.** SIFMA has suggested below modifications to the Proposal that are intended to achieve Dodd-Frank's objectives while also addressing these considerations. In particular, we strongly urge the Commission to (i) adopt a more risk-sensitive minimum capital requirement, (ii) eliminate its proposed 100% capital deductions for collateral held by third-party custodians and undermargined legacy accounts, (iii) harmonize its liquidity stress test requirements with the applicable FRB and Basel requirements and (iv) focus on establishing a robust, two-way variation margin regime, rather than a mandatory initial margin regime.

In each case we believe that the suggested modification is both necessary and appropriate to make the relevant requirement more risk-sensitive or to prevent unintended risks and costs, to SBSDs or the financial system more generally. Moreover, we believe that the capital and margin regime, as modified to reflect our suggestions, would still ensure that nonbank SBSDs hold adequate capital (including for illiquid assets and unsecured exposures), prevent the buildup of unsecured exposures with respect to SBS, and generally reduce leverage in the financial system.

---

[76] We observe that differences in the regimes applicable to bank and nonbank SBSDs raise similar issues for firms that conduct SBS activities through both bank and nonbank subsidiaries.

[77] References in this letter to stand-alone SBSDs that are approved to use internal models are also intended to apply to OTC derivatives dealers that are dually registered as SBSDs.

A summary of our specific recommendations for a more risk-sensitive approach is set forth below.

CAPITAL REQUIREMENTS

- ***Minimum Capital Requirements***. We support the Proposal's fixed dollar minimum capital requirements. However, for the adjustable minimum capital requirement, we suggest two alternative ratios to the proposed 8% margin factor that we believe will be better tailored to the actual overall risk presented by a SBSD's activities: (a) for stand-alone SBSDs that use internal models and ANC broker-dealers, a ratio based on a percentage of the entity's market and credit risk charges to capital and (b) for stand-alone and broker-dealer SBSDs that do not use internal models, a ratio based on a credit quality adjusted version of the proposed 8% margin factor.

- ***Market Risk Charges.***

    - *Adoption of Banking Agencies' Market Risk Capital Rule Revisions*. We support the incorporation of Basel 2.5 market risk standards into capital requirements for ANC broker-dealers, OTC derivatives dealers and nonbank SBSDs that use internal models, with a conforming adjustment to reflect that Basel 2.5 add-ons should not apply to assets for which the Commission already requires a firm to take a 100% haircut.

    - *VaR Model Standards and Application Process*. We request that the Commission adopt an expedited model review and approval process for models that have been approved and are subject to periodic assessment by the FRB or a qualifying foreign regulator.

    - *Standardized Market Risk Haircuts*. We suggest several modifications to the proposed standardized market risk haircuts for SBSDs that do not have approval to use internal models:

        - For cleared swaps and SBS (regardless of asset class), the capital charge should be based on the clearing organization's initial margin requirement, similar to the Commission's current treatment of futures in Appendix B of Rule 15c3-1.

        - For credit default swaps ("**CDS**"), we believe that the disparity between the proposed haircuts and capital charges derived from internal models is sufficiently wide to merit further review by the Commission of empirical data regarding the historical market volatility and losses given default associated with CDS positions.

        - For interest rate swaps, the capital charge should be calculated using solely the U.S. government securities grid, without the proposed 1% minimum haircut.

        - For transactions in highly liquid currencies, the capital charge should be based on the current haircuts for similar maturity commercial paper, bankers acceptances and certificates of deposit or U.S. government securities. The capital rules also should recognize offsets between foreign exchange transactions and swaps, SBS and securities forward transactions.

- ***Credit Risk Charges*.** We recommend that, in the case of an ANC broker-dealer or a stand-alone nonbank SBSD approved to use internal models, the Commission should not limit the use of a credit risk charge in lieu of a 100% deduction for uncollateralized receivables to SBS with a commercial end user.

- ***Capital Charge In Lieu of Margin*.**

    - *Third Party Custodian Deduction*. We strongly urge the Commission to eliminate its proposed 100% deduction for collateral held by a third-party custodian. Instead, the Commission should address any concerns it has regarding custodial arrangements directly through rules regarding the terms and conditions of such arrangements, for bank and nonbank SBSDs alike.

    - *Legacy Account Deduction*. We strongly urge the Commission to modify the proposed 100% deduction for undermargined legacy accounts by instead adopting either a credit risk charge or a credit concentration charge, with an exception permitting SBSDs to elect to exclude from accounts subject to the charge any currently uncleared positions in a type of SBS for which a clearing agency has made an application to the Commission to accept the SBS for clearing.

    - *Cleared SBS Deduction*. We request that the Commission eliminate the proposed 100% deduction for a shortfall between clearing agency minimum margin requirements and proprietary capital charges, and instead address any concerns regarding clearing agency minimum margin requirements directly through its regulation of clearing agencies.

- ***Liquidity Stress Test Requirements***. While we support enhancing liquidity requirements for financial institutions, we strongly urge the Commission to modify its proposed stress test requirements to align them with applicable Basel and FRB requirements, including by adopting an exception for firms subject to consolidated stress test requirements.

- ***OTC Derivatives Dealers*.** We request that the Commission modify its OTC derivatives dealer framework through conditional exemptions that would allow an OTC derivatives dealer to dually register as a stand-alone SBSD.

- ***SBS Brokerage Activities*.** A broker-dealer SBSD that is approved to use internal models should not be subject to the higher minimum capital requirements applicable to an ANC broker-dealer if it limits the scope of its brokerage activities to brokerage activity incidental to clearing SBS and accepting and sending customer orders for execution on a SBS execution facility.

MARGIN REQUIREMENTS

- ***Initial Margin Requirements*.** As noted above, mandatory initial margin requirements would replace potential exposure with actual exposure, reduce overall market liquidity, exacerbate pro-cyclical shocks and, if extended universally, place margin in the hands of entities not subject to prudential supervision. Accordingly, we strongly urge the Commission (as well as the CFTC and the Prudential Regulators) to focus on establishing a robust, two-way variation margin regime, while continuing to evaluate, in consultation with interested constituencies, including international regulators, effective methodologies to further mitigate systemic risk without causing the adverse impacts that would result from initial margin collection requirements

- ***Exceptions to the Margin Collection Requirement***. We request that the Commission make the following modifications to the exceptions to the margin collection requirement:

    - *Commercial End Users*. We request that the Commission make the definition of commercial end user for the margin exception consistent with the definition for the mandatory clearing exception, and the margin proposals of other U.S. and international regulators.

    - *Sovereign Entities*. We request that the Commission ensure that its treatment of sovereign entities is consistent with international standards.

    - *Affiliates*. We request that the Commission apply margin requirements to inter-affiliate transactions only when one of the affiliates is unregulated.

    - *Structured Finance or Securitization SPVs*. Where alternative security arrangements are in place, we request that SBS with a structured finance or securitization SPV be excluded from margin requirements. Furthermore, a SBSD's security interest in accordance with the SPV's governing documents should be considered a substitute for the collection of collateral and no capital charge for foregone margin should be required.

- ***Eligible Collateral*.** We support the Commission's proposed requirements regarding the scope of eligible collateral, except that we request that it clarify that the requirement that the SBSD maintain possession and control of the collateral should apply only to "excess securities collateral" as defined in its proposed segregation rules.

SEGREGATION REQUIREMENTS

- ***Omnibus Segregation Requirements*.** We generally support the Commission's proposed omnibus segregation requirements, but have identified a number of technical issues and questions that we believe merit further consultation by the Commission with interested constituencies.

- ***Individual Segregation Requirements.*** We request that the Commission clarify certain aspects of the individual segregation requirements, including who should receive the notice regarding the counterparty's right to elect individual segregation, the time at which a segregation election takes effect and the scope of transactions to which it applies.

- ***Segregation Requirements for Bank SBSDs***. For a SBSD that has a Prudential Regulator, we request that the Commission adopt an exception from segregation requirements, except those pertaining to the customer's right to elect individual segregation.

PHASED IMPLEMENTATION

- We request that the Commission provide a 24-month phase-in period for variation margin requirements, with a 12-month phase-in period for uncleared SBS between SBSDs.

- We also request that the Commission's proposed capital rules (other than the application of Basel 2.5) not take effect until the later of two years from the effective date of the Proposal's margin requirements or the effective date for Basel III's minimum capital requirements.

Appendix B

EXECUTIVE SUMMARY[78]

Implicit in the BCBS-IOSCO Framework is the recognition of the importance of inter- and intra-national consistency in margin requirements for non-centrally cleared derivatives ("**OTC margin requirements**"). As the Agencies consider national implementation of the BCBS-IOSCO Framework, their principal objective should be to ensure such consistency. As we explain more fully in the discussion section of this letter, to achieve that objective, and more generally to reduce systemic risk, we recommend that the Agencies take the following steps:

- **Mitigation of adverse procyclical effects**. To avoid resulting destabilizing calls for collateral during periods of extreme market stress, the Agencies should clarify that a market participant is not required, absent a direction from its prudential supervisor, to recalibrate the baseline stress scenarios and market shocks incorporated in its quantitative portfolio models based on dynamic changes in market volatilities and correlations.

- **Model approval**. To promote consistency, efficiency and transparency, the Agencies should: (a) recognize quantitative portfolio models that have been approved by home country supervisors (for firms registered in multiple jurisdictions) and consolidated supervisors (for firms subject to consolidated supervision by another regulator), in each case subject to a comparability determination; (b) permit non-registrants to use models administered by their registrant counterparties; and (c) accommodate the use of standardized models, including by non-registrants.

- **Initial margin timing requirements**. To minimize disruptive margin disputes, the Agencies should initially adopt a weekly initial margin schedule and then decrease the interval and increase the frequency of initial margin collection as portfolio reconciliation disputes are resolved more quickly and the use of standardized models becomes more widespread.

- **Consistent definitions for covered entities**. To promote international harmonization, the Agencies should (a) conform their definition of "financial entity" to the "financial counterparty" definition applicable under European rules and (b) exclude sovereign entities under a common definition of this category.

- **Structured finance/securitization SPVs**. In recognition of the appropriate alternative collateral arrangements already in place for swaps/security-based swaps with structured finance and securitization special purpose vehicles ("**SPVs**"), the Agencies should adopt an exception for non-centrally cleared swaps and security-based swaps with such entities.

- **Inter-affiliate swaps and security-based swaps**. To promote effective group-wide risk management, the Agencies should adopt an exception for non-centrally cleared swaps and security-based swaps between affiliates.

---

[78] This executive summary is taken from the SIFMA Comment Letter on Margin for Uncleared Swaps at 2-4.

- **Limited "emerging market" exception**. To promote competitive parity in emerging markets while still ensuring appropriate mitigation of risk to the U.S., the Agencies should adopt an "emerging market" exception with a notional volume limitation analogous to the CFTC's exception from transaction-level requirements for foreign branches of U.S. banks.

- **Portfolio margining**. To prevent unwarranted competitive disparities between different categories of registrant, the Agencies should accommodate portfolio margining of OTC derivatives to the fullest extent contemplated by the BCBS-IOSCO Framework.

- **Eligible collateral**. The Agencies should promote international harmonization with respect to the definitions of different categories of eligible collateral assets and provide guidance on the use of industry-developed definitions for the categories of collateral assets.

- **Phased implementation**. In recognition of the dependency of implementation efforts on specific rules that have not yet been adopted (*e.g.*, definitions for covered entities, covered products, and eligible collateral), OTC margin requirements should not come into effect until two years after final rules have been adopted in the U.S., the European Union and Japan.

Appendix C

Suggested Edits to Proposed Rule 18a-1[79]

[Corresponding edits would apply to Rule 15c3-1(f)]

Additions are underlined; deletions are marked with strikethrough.

Proposed Rule 18a-1

(f) Liquidity requirements.

(1) Liquidity stress test. A security-based swap dealer that computes net capital under paragraph (a)(2) of this Rule 18a-1 must perform a liquidity stress test at least monthly, the results of which must be provided within ten business days to senior management that has responsibility to oversee risk management at the security-based swap dealer. The assumptions underlying the liquidity stress test must be reviewed at least quarterly by senior management that has responsibility to oversee risk management at the security-based swap dealer and at least annually by senior management of the security-based swap dealer. The liquidity stress test must include, at a minimum, the following assumed conditions lasting for 30 consecutive days:

> (A) A stress event includes a decline in creditworthiness of the broker or dealer severe enough to trigger contractual credit-related commitment provisions of counterparty agreements;
>
> (B) The loss of all existing unsecured funding at the earlier of its maturity or put date and an inability to acquire a material amount of new unsecured funding from third parties or non-affiliates~~, including intercompany advances and unfunded committed lines of credit~~;
>
> (C) The potential for a material net loss of secured funding for less liquid assets;
>
> (D) The loss of the ability to procure repurchase agreement financing for less liquid assets;
>
> (E) The illiquidity of collateral required by and on deposit at clearing agencies or other entities which is not deducted from net worth or which is not funded by customer assets;
>
> (F) A material increase in collateral required to be maintained at registered clearing agencies of which it is a member; and
>
> (G) The potential for a material loss of liquidity caused by market participants exercising contractual rights and/or refusing to enter into transactions with respect to the various businesses, positions, and commitments of the security-based swap dealer, including those related to customer businesses of the security-based swap dealer.

---

[79] The suggested edits to proposed Rule 18a-1 are contained in SIFMA, "SEC Liquidity Presentation" (Jan. 10, 2014), *available at:* http://www.sec.gov/comments/s7-08-12/s70812-55.pdf.

(2) Stress test of consolidated entity. The security-based swap dealer must justify and document any differences in the assumptions used in the liquidity stress test of the security-based swap dealer from those used in the liquidity stress test of the consolidated entity of which the security-based swap dealer is a part.

(3) Liquidity reserves. ~~The~~ Subject to the provisions of paragraph (f)(4) of this Rule 18a-1, the security-based swap dealer must maintain at ~~all times~~ the end of each business day liquidity reserves based on the results of the liquidity stress test. The liquidity reserves used to satisfy the liquidity stress test must be:

> (A) (i) Cash, obligations of the United States, or obligations fully guaranteed as to principal and interest by the United States; and
>
> ~~(B~~ii) Unencumbered and free of any liens at all times; or
>
> (B) Any assets that qualify as "high-quality liquid assets" in 12 C.F.R. § __.20.

Securities in the liquidity reserve can be used to meet delivery requirements as long as cash or other acceptable securities of equal or greater value are moved into the liquidity pool contemporaneously.

(4) Consolidated liquidity compliance program. A security-based swap dealer that is a consolidated subsidiary of a bank holding company that has submitted a resolution plan to the Board of Governors of the Federal Reserve System (the "Board") and the Federal Deposit Insurance Corporation (the "Corporation") during the most recent completed annual cycle, pursuant to 12 C.F.R. § 243, may apply to the Commission for approval to adopt a consolidated liquidity compliance program in lieu of maintaining the liquidity reserves that would otherwise be required by paragraph (f)(3) of this Rule 18a-1. A security-based swap dealer that has received approval from the Commission, in writing, to adopt a consolidated liquidity compliance program may maintain all or a portion of its liquidity reserves with its top-tier bank holding company [or an affiliate], as determined by the security-based swap dealer. A consolidated liquidity compliance program must ensure that the bank holding company, on a consolidated basis, complies with applicable liquidity requirements imposed by the Board and must require the bank holding company to monitor the liquidity needs of, and provide liquidity support to, the security-based swap dealer subsidiary, as necessary.

When evaluating requests under this paragraph (f)(4), the Commission shall consider:

> (A) The extent to which the resolution plan anticipates the security-based swap dealer receiving liquidity support in the event of material financial distress at the bank holding company; and
>
> (B) Whether the Board or the Corporation has objected to any relevant provision of the bank holding company's resolution plan for the most recent completed annual cycle and, if so, whether the bank holding company has resolved any such objections.

(5) Contingency funding plan. (A) The security-based swap dealer must have a written contingency funding plan that addresses the security-based swap dealer's policies and the roles and responsibilities of relevant personnel for meeting the liquidity needs of the security-based swap dealer and communications with the public and other market participants during a liquidity stress event.

(B) A security-based swap dealer that has received approval from the Commission to adopt a consolidated liquidity compliance program under paragraph (f)(4) may rely on the contingency funding plan adopted by its top-tier bank holding company rather than adopt a separate contingency funding plan under this paragraph (f)(5).

Appendix D

The following is a non-exhaustive list of places where proposed Form SBS is unclear or incomplete:

- In Part 1 of proposed Form SBS:
  - There is no reference to foreign SBSDs or MSBSPs or OTC Derivative Dealers that are dually registered as an SBSD or MSBSP.
  - It is unclear how the lines relating to "Failed to deliver," "Securities borrowed," and "Omnibus accounts" relate to security-based swaps. Are they intended to refer to securities transactions in connection with the settlement of security-based swaps, to securities that are used as collateral for security-based swaps, or to something else?
  - Receivables are broken out differently on the asset side than payables are broken out on the liability side, which results in a mismatch of entries.
  - It is unclear what "Other derivatives payables" refers to on line 23.
- In Part 2 of proposed Form SBS:
  - The referenced notes (*i.e.*, Notes B, C, and D) are not on the form;
  - The Commission does not define borrows, loans or fails on lines 7, 8, and 9, which would be helpful to ensure accurate calculation – does this refer to collateral only?
  - The security count reference on line 7 is inconsistent with proposed Rule 18a-9, which does not require a bank SBSD to conduct this count.
  - In the reserve computation section on lines 21 and 22, the reference to line 21, should be to line 20.
- In Part 4 of proposed Form SBS, which would apply to nonbank SBSDs and nonbank MSBSPs, and consists of four schedules that elicit detailed information about a firm's security-based swap and swap positions, counterparties, and exposures:
  - The Commission should clarify what "Other derivatives and options" in line 15 refers to. Is this intended to capture listed and unlisted options, or something else?
  - There is a request for information regarding "current net exposure" and "total exposure," but both requests contain columns that request information regarding "current net exposure" and "total exposure." It is unclear what information the Commission is trying to elicit from firms.

- In Part 5 of proposed Form SBS:
    - The reference to longs and shorts should be defined – is the reference to stock record, exposure, or balance sheet?

Appendix E

The following are examples of how proposed Form SBS does not adequately address the concerns of U.S. and foreign bank SBSDs and bank MSBSPs.

- Noting that banks must file financial statements and supporting schedules known as "call reports" with their prudential regulator, the Commission states that it believes that the most common form of call report for a bank that would register as an SBSD or MSBSP is Form FFIEC 031. However, banks submit a variety of call reports depending on the type of firm. For example, U.S. branches and agencies of foreign banks file Form FFIEC 002. Because the information contained on Form FFIEC 002 is not identical to Form FFIEC 031, the Commission is incorrect in assuming that banks will necessarily be able to complete Part 2 of proposed Form SBS based on "call reports." Foreign bank SBSDs and bank MSBSPs would need to generate new information to fill out Part 2 of proposed Form SBS.

- Banks are required to file call reports with their prudential regulator 30 days after the end of a quarter.[80] The Commission should modify the time period for bank SBSDs and bank MSBSPs to file proposed Form SBS to conform to the time such entities have to file their call reports.

[80] *See* Instructions for Call Report FFIEC 002 (Preparation of Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks) at Gen-1, *available at:* http://www.ffiec.gov/PDF/FFIEC_forms/FFIEC002_201403_i.pdf; Instructions for Call Reports FFIEC 031 and 041 (Preparation of Consolidated Reports of Condition and Income) at 7 (6-13), *available at:* http://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_FFIEC041_201406_i.pdf.

Appendix D-3

SIFMA Unofficial Discussion Notes on Reporting Proposal

Recordkeeping for SBSD
SEC Meeting
Thursday, April 30, 2015 | 11:00-2:00 p.m. EST

U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C.
Participant Dial In: 1-877-317-6777 (U.S.)

Agenda

1. **Introductions and Opening Remarks**– *Mary Kay Scucci, SIFMA*

2. **Purpose of Meeting**– *Mike Macchiaroli and Timothy Fox, SEC*

3. **Open Discussion**

   a. Standalone Swap Dealer Example– *Ralph Mattone, Nomura*

   b. Appendix of SIFMA Comment Letter (September 5, 2014) in response to Release No. 34-71958 SEC *Recordkeeping and Reporting Requirements for SBSD* Rule Proposal– *William Tirrell, Bank of America*

   c. FOCUS Report. Pg. 448-510 of SEC Release No. 34-71958 SEC *Recordkeeping and Reporting Requirements for SBSD* Rule Proposal – *Thomas Favia, Goldman Sachs*

General Ledger

GL Account #	GL Account Desc	3/31/2015
10000000	Cash	46,000
15000000	Failed to Deliver	3,000
16000000	Securities Borrow ed	2,084
17000000	Clearing Organizations	255,607
18000000	**Derivatives Contracts**	**330,035**
18100000	Other	821,122
19000000	Reverse Repos	1,331,721
19100000	Securities Ow ned at Market Value	3,614,944
19200000	Dividends and Interest Receivable	2,708
19300000	**Other Assets (Includes Cash Collateral)**	**494,340**
Assets		**6,901,561**

GL Account #	GL Account Desc	3/31/2015
20000000	Bank Loans Payable	46,000
25000000	Repurchase Agreements	494,343
26000000	Failed to Receive	2,084
27000000	Securities Loaned	255,607
28000000	**Derivative Contracts**	**329,774**
28200000	Securities Sold Not Yet Purchased at MV	821,122
29000000	Accrued Expenses and other liabilities	1,334,979
29200000	**Other Liabilities (Includes Cash Collateral)**	**3,614,944**
29200000	Equity	2,708
Liabilities and Stock Holders Equity		**6,901,561**

Sub Ledger

18000000	Derivatives Contracts	
a	Interest Rate	8,923,332
b	Currency & Foreign Exchange	266,212
c	Equity	221,586
		9,411,130
d	Other (Netting/Collateral)	(9,081,095)
		330,035

28000000	Derivative Contracts	
a	Interest Rate	7,553,000
b	Currency & Foreign Exchange	282,000
c	Equity	223,000
		8,058,000
d	Other (Netting/Collateral)	(7,728,226)
		329,774

Credit Risk Charge

Obligor #	Obligor Name	LPV	SPV	Netting Flag	Internal Rating	Positive NPV	Collateral	Exposure	Charge	Concentration	Capital Charge	Concentration
116088	Counterparty A			Y	1				20%	5%		-
116583	Counterparty B			Y	7				50%	20%		-
125189	Counterparty C			Y	5				50%	20%		-
126500	Counterparty D			N	5				50%	20%		-
127518	Counterparty E			Y	7				50%	20%		-
188556	Counterparty F			Y	7				50%	20%		-
367040	Counterparty G			Y	10				50%	20%		-
407925	Counterparty H	8,011	(593)	Y	15	7,418	550	6,868	100%	50%	549	-
223486	Counterparty I			N	15				100%	50%		-
6319796	Counterparty J			N	NR				100%	50%		-
Grand Total		**9,411,130**	**(8,058,000)**			**9,566**	**8,709**	**1,392**			**60,823**	**-**

Affiliate charge is 100% of Positive PV (after the application of collateral)

All others is 8% of Positive PV (after the application of collateral) multiplied by the following based on Counterparty Credit Rating:

- 20% for 2 highest Rating Categories
- 50% for the 3rd and 4th rating categories
- 100% for everyone else

If the Net Present Value of all derivative for any one counterparty (after application of collateral) exceeds 25% of TNC the excess Present value is subject to the following concentration charges:

- 5% for 2 highest Rating Categories
- 20% for the 3rd and 4th rating categories
- 50% for everyone else

Trade Details

GL Account Number	GL_description	Security	Ledger	Derivative_Description	Counterparty	Counterpar_description	Obligor	Obligor Name	LPV	SPV
18000000	SWAP NPV	8432752	NGFP	InterestRateSwap	6018261	Counterparty H	407925	Counterparty H	3,709	0
18000000	SWAP NPV	8432752	NGFP	Single Name CDS	6018261	Counterparty H	407925	Counterparty H	4,302	0
18000000	SWAP NPV	8432754	NGFP	InterestRateSwap	6018261	Counterparty H	407925	Counterparty H	-	(593)
									8,011	**(593)**

Additional Fields Available

- Notional
- Trade Date
- Maturity Date
- Reset Date
- Underlying Asset

Collateral Details

Collateral Agreement ID	As Of Date	Principal	Counterparty	RDM Code	Cpty Threshold	Net Exposure	Min Transfer Amount	Variation Cash Collateral	Variation Non Cash Collateral	Obligor	Settled Collateral - USEQ
Counterparty H	3/31/2015	NGFP	Counterparty H	6018261	7,000	7,418	250	300	250	407925	550
											550

Appendix A

EXECUTIVE SUMMARY[72]

SIFMA greatly appreciates the Commission's thoughtful effort to reconcile the many difficult and, in some cases, conflicting objectives that must be addressed in fashioning capital, margin and segregation requirements for nonbank SBSDs and MSBSPs. These objectives include the mandate in Section 15F(e) of the Exchange Act for the Commission's capital and margin requirements to "help ensure the safety and soundness" of nonbank SBSDs and MSBSPs and "be appropriate for the risk associated with" uncleared security-based swaps ("**SBS**"). Section 15F(e) also requires the Commission, together with the Commodity Futures Trading Commission (the "**CFTC**") and the Prudential Regulators,[73] to the maximum extent practicable, to establish and maintain comparable capital and margin requirements for bank and nonbank swap dealers ("**SDs**"), SBSDs, major swap participants ("**MSPs**") and MSBSPs. Section 752 of Dodd-Frank similarly requires the Commission to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to SBS. Finally, Section 3(f) of the Exchange Act generally requires the Commission to consider whether its rules "will promote efficiency, competition, and capital formation," and Section 23(a)(2) prohibits the Commission from adopting any rule that "would impose a burden on competition not necessary or appropriate in furtherance of the purposes" of the Exchange Act.

SIFMA recognizes that, in implementing capital, margin and segregation requirements for nonbank SBSDs, the Commission has largely drawn from its existing broker-dealer financial responsibility rules and sought to adapt those rules for SBSDs. Nevertheless, we are concerned that this approach, without further modification, does not adequately address or conform to the statutory principles described above. We strongly believe that, in applying those principles, the Commission should take into account the broader context of regulatory reform, including the significant reduction in risks that will occur once dealers and major participants in the SBS markets are required to register and comply with basic capital requirements, standardized SBS become subject to mandatory clearing and, for uncleared SBS, variation margin is required to be exchanged. Accordingly, the modifications that we recommend the Commission make to the Proposal are intended to be evaluated within that broader context.

The Proposal Would Impose Costs That Are Disproportionate to the Risks of SBS Dealing Activity. Contrary to the statutory requirements that the Commission's capital and margin requirements "be appropriate for the risk associated with" uncleared SBS and "promote efficiency," the Proposal would impose duplicative and excessive capital and margin requirements.

---

[72] This executive summary is taken from the SIFMA Comment Letter on SEC Capital and Margin Proposal at ii-ix.

[73] Under Dodd-Frank, the "Prudential Regulators" are the Board of Governors of the Federal Reserve System ("**FRB**"), the Federal Deposit Insurance Corporation ("**FDIC**"), the Federal Housing Finance Agency ("**FHFA**"), the Farm Credit Administration ("**FCA**") and the Office of the Comptroller of the Currency ("**OCC**").

In particular, we are concerned that the proposed requirement to tie a SBSD's minimum level of net capital to 8% of the level of margin required to be collected by it with respect to SBS would require the maintenance of resources far in excess of the actual risks presented by a SBSD's exposures. Similarly, the proposed requirements to apply deductions to net capital based on the level of margin required for SBS would also be excessive, as well as inconsistent with the proposed capital regimes for SDs and banks SBSDs (*e.g.*, by requiring 100% deductions for collateral held by third-party custodians and legacy account positions). The six SIFMA member firms who operate alternative net capital ("**ANC**") broker-dealers have preliminarily projected that, in light of the severity of these requirements, the amount of capital that would be required for the single business line of SBS dealing under the Proposal would exceed $87 billion, the amount of capital currently devoted to all of those firms' securities businesses combined, including investment banking, prime brokerage, market making and retail brokerage.[74]

We also believe that entity-level liquidity stress test requirements are likely to be destabilizing by trapping assets within SBSD subsidiaries and preventing centralized liquidity risk management. Given the limits on available liquid assets, it is more systemically sound for liquidity to be managed in an integrated, group-wide manner, so that a subsidiary with excess liquidity can provide resources to one that is under stress. There is no empirical evidence, nor do we believe, that the risks arising from the SBS dealing business are greater than the aggregate risks arising from all of these other businesses. Furthermore, we believe that Dodd-Frank's reforms, most notably the significant expansion of central clearing and daily exchange of variation margin for uncleared SBS, will significantly decrease the risk in the SBS dealing business

Additionally, SIFMA is concerned that mandatory initial margin requirements would replace potential exposure with actual exposure, reduce overall market liquidity, exacerbate pro-cyclical shocks and, if extended universally, place margin in the hands of entities not subject to prudential supervision. While we appreciate the Commission's efforts to mitigate these adverse impacts by proposing to limit initial margin requirements to the collection of initial margin by SBSDs from financial end users, even such limited initial margin requirements will have negative consequences. In this regard, SIFMA member firms have estimated that the liquidity demands associated with mandatory initial margin requirements are likely to range between approximately $1.1 trillion (if dealers are not required to collect from each other) to $3 trillion (if dealers must collect from each other) to $4.1 trillion (if dealers must post to non-dealers).[75]

---

[74] The firms estimated the amount capital currently devoted to their securities businesses by determining the amount of capital, after deductions for non-allowable assets and capital charges, that is necessary for them to have net capital in excess of the early warning level specified in Rule 17a-11.

[75] The ultimate amount would depend on the extent to which firms use models instead of standardized haircuts and the extent of any initial margin thresholds. A more detailed depiction of estimated initial margin levels is contained as Figure 1 in Appendix 2 to this letter. To create the estimates in Figure 1, we used data submitted by several SIFMA member firms in response to the Quantitative Impact Study ("**QIS**") conducted in connection with the international consultation on margin requirements for uncleared derivatives released in July 2012. Since SIFMA prepared these estimates, the results of the QIS were released as part of a second consultation. We are still studying those results. However, we note that the QIS results presented generally assume that all firms use approved internal models. Our estimates, in

Moreover, in stressed conditions, we estimate that initial margin amounts collected by firms that use internal models could increase by more than 400%. These mandatory initial margin requirements cannot be reconciled with the Commission's statutory mandate under Dodd-Frank and the Exchange Act, nor has the Commission offered a sufficient basis to justify their adoption consistent with that mandate. Indeed, in SIFMA's view, their adoption likely would substantially limit the availability of essential credit and magnify the adverse effects of financial shocks on the broader economy.

***The Proposal Would Make Nonbank SBSDs Uncompetitive*.** It is essential, as both a statutory and a policy matter, for the Commission to take into account that bank and nonbank SBSDs are engaged in the same fundamental business – entering into SBS transactions with the same customers and in the same markets. Accordingly, while we recognize that there are relevant differences between bank and nonbank dealer business models (*e.g.*, relating to types of funding and access to backstop liquidity), it would be inconsistent with Dodd-Frank, and with preserving the competitiveness of nonbank SBSDs, to adopt capital and margin requirements that are not comparable to those of the Prudential Regulators to the maximum extent practicable.

Consistency between the Commission's and the CFTC's capital and margin requirements is also necessary for nonbank SBSDs to be competitive with bank SBSDs. Most SBSDs will also be registered as SDs. For nonbank SBSDs, this will mean compliance, at the same time, with both CFTC and Commission capital and margin requirements. Bank SBSDs, in contrast, will be subject to only to a single set of capital and margin requirements. As a result, subjecting dually registered nonbank SBSD-SDs to two sets of inconsistent capital and margin requirements would impair their ability to compete effectively, without offering any incremental safety and soundness benefits.

In addition, nonbank SBSDs compete for business with foreign SBSDs. Foreign SBSDs generally must comply with Basel-compliant capital requirements similar to those applied by the Prudential Regulators. They also will, in most cases, be subject to margin requirements that are consistent with emerging international standards. As noted above, Dodd-Frank requires the Commission to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of SBS. We appreciate the steps the Commission has taken to satisfy this mandate through its participation as part of the Working Group on Margining Requirements of the Basel Committee on Banking Supervision ("**BCBS**") and the International Organization of Securities Commissions ("**IOSCO**" and, together with BCBS, "**BCBS/IOSCO**"). Because BCBS/IOSCO has not yet finalized its recommendations for international margin standards, however, it is not possible at this time to evaluate the extent and likely impact of any inconsistencies between the Proposal and international standards. Accordingly, we urge the Commission, once the BCBS/IOSCO recommendations are final, to re-propose its margin rules for further public comment to address any modifications that might be necessary to conform to those recommendations or to seek input on any inconsistencies between them.

---

contrast, focus on a mix of model-based and haircut-based initial margin amounts. In addition, the QIS results do not take into account the increased initial margin associated with a movement from non-stressed to stressed market conditions.

<u>The Proposal's Inconsistencies with Other Regulators' Regimes Would Increase Costs and Risks</u>. To the extent that the Commission's requirements for dually registered SD-SBSDs apply in addition to, or in a manner inconsistent with, CFTC requirements, such requirements would exacerbate the burdens imposed by those existing requirements and tend to promote inefficiencies by discouraging dual registration. Discouraging dual registration is particularly problematic because conducting the swap and SBS dealing business in two different legal entities will reduce opportunities for netting, thereby increasing credit risk between the dealer and its customers and increasing the amount of margin required to be posted by, and the associated liquidity demands on, customers.

We see no justification, from a cost-benefit perspective, to applying inconsistent capital and margin regimes to a SBSD that is also registered as an SD, except to the minimum extent necessary to accommodate the applicable statutory regime created by Congress. Doing so would serve no purpose other than to require significant investment in the infrastructure necessary to monitor compliance with those regimes simultaneously without materially enhancing investor protection or safety and soundness.[76]

We further note that similar considerations apply in respect of other registration categories. Many SBSDs will conduct an integrated equity derivatives business, dealing in SBS and OTC options, and so accordingly will be registered as OTC derivatives dealers. For these reasons, we strongly urge the Commission to take every step possible to coordinate with the CFTC in the adoption of consistent capital and margin requirements.[77]

***<u>A More Risk-Sensitive Approach Would Better Achieve Dodd-Frank's Objectives</u>*.** SIFMA has suggested below modifications to the Proposal that are intended to achieve Dodd-Frank's objectives while also addressing these considerations. In particular, we strongly urge the Commission to (i) adopt a more risk-sensitive minimum capital requirement, (ii) eliminate its proposed 100% capital deductions for collateral held by third-party custodians and undermargined legacy accounts, (iii) harmonize its liquidity stress test requirements with the applicable FRB and Basel requirements and (iv) focus on establishing a robust, two-way variation margin regime, rather than a mandatory initial margin regime.

In each case we believe that the suggested modification is both necessary and appropriate to make the relevant requirement more risk-sensitive or to prevent unintended risks and costs, to SBSDs or the financial system more generally. Moreover, we believe that the capital and margin regime, as modified to reflect our suggestions, would still ensure that nonbank SBSDs hold adequate capital (including for illiquid assets and unsecured exposures), prevent the buildup of unsecured exposures with respect to SBS, and generally reduce leverage in the financial system.

[76] We observe that differences in the regimes applicable to bank and nonbank SBSDs raise similar issues for firms that conduct SBS activities through both bank and nonbank subsidiaries.

[77] References in this letter to stand-alone SBSDs that are approved to use internal models are also intended to apply to OTC derivatives dealers that are dually registered as SBSDs.

A summary of our specific recommendations for a more risk-sensitive approach is set forth below.

CAPITAL REQUIREMENTS

- ***Minimum Capital Requirements***. We support the Proposal's fixed dollar minimum capital requirements. However, for the adjustable minimum capital requirement, we suggest two alternative ratios to the proposed 8% margin factor that we believe will be better tailored to the actual overall risk presented by a SBSD's activities: (a) for stand-alone SBSDs that use internal models and ANC broker-dealers, a ratio based on a percentage of the entity's market and credit risk charges to capital and (b) for stand-alone and broker-dealer SBSDs that do not use internal models, a ratio based on a credit quality adjusted version of the proposed 8% margin factor.

- ***Market Risk Charges.***

  - *Adoption of Banking Agencies' Market Risk Capital Rule Revisions*. We support the incorporation of Basel 2.5 market risk standards into capital requirements for ANC broker-dealers, OTC derivatives dealers and nonbank SBSDs that use internal models, with a conforming adjustment to reflect that Basel 2.5 add-ons should not apply to assets for which the Commission already requires a firm to take a 100% haircut.

  - *VaR Model Standards and Application Process*. We request that the Commission adopt an expedited model review and approval process for models that have been approved and are subject to periodic assessment by the FRB or a qualifying foreign regulator.

  - *Standardized Market Risk Haircuts*. We suggest several modifications to the proposed standardized market risk haircuts for SBSDs that do not have approval to use internal models:

    - For cleared swaps and SBS (regardless of asset class), the capital charge should be based on the clearing organization's initial margin requirement, similar to the Commission's current treatment of futures in Appendix B of Rule 15c3-1.

    - For credit default swaps ("**CDS**"), we believe that the disparity between the proposed haircuts and capital charges derived from internal models is sufficiently wide to merit further review by the Commission of empirical data regarding the historical market volatility and losses given default associated with CDS positions.

    - For interest rate swaps, the capital charge should be calculated using solely the U.S. government securities grid, without the proposed 1% minimum haircut.

  - For transactions in highly liquid currencies, the capital charge should be based on the current haircuts for similar maturity commercial paper, bankers acceptances and certificates of deposit or U.S. government securities. The capital rules also should recognize offsets between foreign exchange transactions and swaps, SBS and securities forward transactions.

- ***Credit Risk Charges*.** We recommend that, in the case of an ANC broker-dealer or a stand-alone nonbank SBSD approved to use internal models, the Commission should not limit the use of a credit risk charge in lieu of a 100% deduction for uncollateralized receivables to SBS with a commercial end user.

- ***Capital Charge In Lieu of Margin*.**

  - *Third Party Custodian Deduction*. We strongly urge the Commission to eliminate its proposed 100% deduction for collateral held by a third-party custodian. Instead, the Commission should address any concerns it has regarding custodial arrangements directly through rules regarding the terms and conditions of such arrangements, for bank and nonbank SBSDs alike.

  - *Legacy Account Deduction*. We strongly urge the Commission to modify the proposed 100% deduction for undermargined legacy accounts by instead adopting either a credit risk charge or a credit concentration charge, with an exception permitting SBSDs to elect to exclude from accounts subject to the charge any currently uncleared positions in a type of SBS for which a clearing agency has made an application to the Commission to accept the SBS for clearing.

  - *Cleared SBS Deduction*. We request that the Commission eliminate the proposed 100% deduction for a shortfall between clearing agency minimum margin requirements and proprietary capital charges, and instead address any concerns regarding clearing agency minimum margin requirements directly through its regulation of clearing agencies.

- ***Liquidity Stress Test Requirements***. While we support enhancing liquidity requirements for financial institutions, we strongly urge the Commission to modify its proposed stress test requirements to align them with applicable Basel and FRB requirements, including by adopting an exception for firms subject to consolidated stress test requirements.

- ***OTC Derivatives Dealers*.** We request that the Commission modify its OTC derivatives dealer framework through conditional exemptions that would allow an OTC derivatives dealer to dually register as a stand-alone SBSD.

- ***SBS Brokerage Activities*.** A broker-dealer SBSD that is approved to use internal models should not be subject to the higher minimum capital requirements applicable to an ANC broker-dealer if it limits the scope of its brokerage activities to brokerage activity incidental to clearing SBS and accepting and sending customer orders for execution on a SBS execution facility.

MARGIN REQUIREMENTS

- ***Initial Margin Requirements*.** As noted above, mandatory initial margin requirements would replace potential exposure with actual exposure, reduce overall market liquidity, exacerbate pro-cyclical shocks and, if extended universally, place margin in the hands of entities not subject to prudential supervision. Accordingly, we strongly urge the Commission (as well as the CFTC and the Prudential Regulators) to focus on establishing a robust, two-way variation margin regime, while continuing to evaluate, in consultation with interested constituencies, including international regulators, effective methodologies to further mitigate systemic risk without causing the adverse impacts that would result from initial margin collection requirements

- ***Exceptions to the Margin Collection Requirement***. We request that the Commission make the following modifications to the exceptions to the margin collection requirement:

    - *Commercial End Users*. We request that the Commission make the definition of commercial end user for the margin exception consistent with the definition for the mandatory clearing exception, and the margin proposals of other U.S. and international regulators.

    - *Sovereign Entities*. We request that the Commission ensure that its treatment of sovereign entities is consistent with international standards.

    - *Affiliates*. We request that the Commission apply margin requirements to inter-affiliate transactions only when one of the affiliates is unregulated.

    - *Structured Finance or Securitization SPVs*. Where alternative security arrangements are in place, we request that SBS with a structured finance or securitization SPV be excluded from margin requirements. Furthermore, a SBSD’s security interest in accordance with the SPV's governing documents should be considered a substitute for the collection of collateral and no capital charge for foregone margin should be required.

- ***Eligible Collateral*.** We support the Commission’s proposed requirements regarding the scope of eligible collateral, except that we request that it clarify that the requirement that the SBSD maintain possession and control of the collateral should apply only to “excess securities collateral” as defined in its proposed segregation rules.

SEGREGATION REQUIREMENTS

- ***Omnibus Segregation Requirements*.** We generally support the Commission’s proposed omnibus segregation requirements, but have identified a number of technical issues and questions that we believe merit further consultation by the Commission with interested constituencies.

- ***Individual Segregation Requirements.*** We request that the Commission clarify certain aspects of the individual segregation requirements, including who should receive the notice regarding the counterparty's right to elect individual segregation, the time at which a segregation election takes effect and the scope of transactions to which it applies.

- ***Segregation Requirements for Bank SBSDs***. For a SBSD that has a Prudential Regulator, we request that the Commission adopt an exception from segregation requirements, except those pertaining to the customer's right to elect individual segregation.

PHASED IMPLEMENTATION

- We request that the Commission provide a 24-month phase-in period for variation margin requirements, with a 12-month phase-in period for uncleared SBS between SBSDs.

- We also request that the Commission's proposed capital rules (other than the application of Basel 2.5) not take effect until the later of two years from the effective date of the Proposal's margin requirements or the effective date for Basel III's minimum capital requirements.

Appendix B

EXECUTIVE SUMMARY[78]

Implicit in the BCBS-IOSCO Framework is the recognition of the importance of inter- and intra-national consistency in margin requirements for non-centrally cleared derivatives ("**OTC margin requirements**"). As the Agencies consider national implementation of the BCBS-IOSCO Framework, their principal objective should be to ensure such consistency. As we explain more fully in the discussion section of this letter, to achieve that objective, and more generally to reduce systemic risk, we recommend that the Agencies take the following steps:

- **Mitigation of adverse procyclical effects**. To avoid resulting destabilizing calls for collateral during periods of extreme market stress, the Agencies should clarify that a market participant is not required, absent a direction from its prudential supervisor, to recalibrate the baseline stress scenarios and market shocks incorporated in its quantitative portfolio models based on dynamic changes in market volatilities and correlations.

- **Model approval**. To promote consistency, efficiency and transparency, the Agencies should: (a) recognize quantitative portfolio models that have been approved by home country supervisors (for firms registered in multiple jurisdictions) and consolidated supervisors (for firms subject to consolidated supervision by another regulator), in each case subject to a comparability determination; (b) permit non-registrants to use models administered by their registrant counterparties; and (c) accommodate the use of standardized models, including by non-registrants.

- **Initial margin timing requirements**. To minimize disruptive margin disputes, the Agencies should initially adopt a weekly initial margin schedule and then decrease the interval and increase the frequency of initial margin collection as portfolio reconciliation disputes are resolved more quickly and the use of standardized models becomes more widespread.

- **Consistent definitions for covered entities**. To promote international harmonization, the Agencies should (a) conform their definition of "financial entity" to the "financial counterparty" definition applicable under European rules and (b) exclude sovereign entities under a common definition of this category.

- **Structured finance/securitization SPVs**. In recognition of the appropriate alternative collateral arrangements already in place for swaps/security-based swaps with structured finance and securitization special purpose vehicles ("**SPVs**"), the Agencies should adopt an exception for non-centrally cleared swaps and security-based swaps with such entities.

- **Inter-affiliate swaps and security-based swaps**. To promote effective group-wide risk management, the Agencies should adopt an exception for non-centrally cleared swaps and security-based swaps between affiliates.

---

[78] This executive summary is taken from the SIFMA Comment Letter on Margin for Uncleared Swaps at 2-4.

- **Limited "emerging market" exception**. To promote competitive parity in emerging markets while still ensuring appropriate mitigation of risk to the U.S., the Agencies should adopt an "emerging market" exception with a notional volume limitation analogous to the CFTC's exception from transaction-level requirements for foreign branches of U.S. banks.

- **Portfolio margining**. To prevent unwarranted competitive disparities between different categories of registrant, the Agencies should accommodate portfolio margining of OTC derivatives to the fullest extent contemplated by the BCBS-IOSCO Framework.

- **Eligible collateral**. The Agencies should promote international harmonization with respect to the definitions of different categories of eligible collateral assets and provide guidance on the use of industry-developed definitions for the categories of collateral assets.

- **Phased implementation**. In recognition of the dependency of implementation efforts on specific rules that have not yet been adopted (*e.g.*, definitions for covered entities, covered products, and eligible collateral), OTC margin requirements should not come into effect until two years after final rules have been adopted in the U.S., the European Union and Japan.

Appendix C

Suggested Edits to Proposed Rule 18a-1[79]

[Corresponding edits would apply to Rule 15c3-1(f)]

Additions are underlined; deletions are marked with strikethrough.

Proposed Rule 18a-1

(f) Liquidity requirements.

(1) Liquidity stress test. A security-based swap dealer that computes net capital under paragraph (a)(2) of this Rule 18a-1 must perform a liquidity stress test at least monthly, the results of which must be provided within ten business days to senior management that has responsibility to oversee risk management at the security-based swap dealer. The assumptions underlying the liquidity stress test must be reviewed at least quarterly by senior management that has responsibility to oversee risk management at the security-based swap dealer and at least annually by senior management of the security-based swap dealer. The liquidity stress test must include, at a minimum, the following assumed conditions lasting for 30 consecutive days:

> (A) A stress event includes a decline in creditworthiness of the broker or dealer severe enough to trigger contractual credit-related commitment provisions of counterparty agreements;
>
> (B) The loss of all existing unsecured funding at the earlier of its maturity or put date and an inability to acquire a material amount of new unsecured funding from third parties or non-affiliates~~, including intercompany advances and unfunded committed lines of credit~~;
>
> (C) The potential for a material net loss of secured funding for less liquid assets;
>
> (D) The loss of the ability to procure repurchase agreement financing for less liquid assets;
>
> (E) The illiquidity of collateral required by and on deposit at clearing agencies or other entities which is not deducted from net worth or which is not funded by customer assets;
>
> (F) A material increase in collateral required to be maintained at registered clearing agencies of which it is a member; and
>
> (G) The potential for a material loss of liquidity caused by market participants exercising contractual rights and/or refusing to enter into transactions with respect to the various businesses, positions, and commitments of the security-based swap dealer, including those related to customer businesses of the security-based swap dealer.

---

[79] The suggested edits to proposed Rule 18a-1 are contained in SIFMA, "SEC Liquidity Presentation" (Jan. 10, 2014), *available at:* http://www.sec.gov/comments/s7-08-12/s70812-55.pdf.

(2) Stress test of consolidated entity. The security-based swap dealer must justify and document any differences in the assumptions used in the liquidity stress test of the security-based swap dealer from those used in the liquidity stress test of the consolidated entity of which the security-based swap dealer is a part.

(3) Liquidity reserves. ~~The~~ Subject to the provisions of paragraph (f)(4) of this Rule 18a-1, the security-based swap dealer must maintain at ~~all times~~ the end of each business day liquidity reserves based on the results of the liquidity stress test. The liquidity reserves used to satisfy the liquidity stress test must be:

> (A) (i) Cash, obligations of the United States, or obligations fully guaranteed as to principal and interest by the United States; and
>
> ~~(B~~ii) Unencumbered and free of any liens at all times; or
>
> (B) Any assets that qualify as "high-quality liquid assets" in 12 C.F.R. § __.20.

Securities in the liquidity reserve can be used to meet delivery requirements as long as cash or other acceptable securities of equal or greater value are moved into the liquidity pool contemporaneously.

(4) Consolidated liquidity compliance program. A security-based swap dealer that is a consolidated subsidiary of a bank holding company that has submitted a resolution plan to the Board of Governors of the Federal Reserve System (the "Board") and the Federal Deposit Insurance Corporation (the "Corporation") during the most recent completed annual cycle, pursuant to 12 C.F.R. § 243, may apply to the Commission for approval to adopt a consolidated liquidity compliance program in lieu of maintaining the liquidity reserves that would otherwise be required by paragraph (f)(3) of this Rule 18a-1. A security-based swap dealer that has received approval from the Commission, in writing, to adopt a consolidated liquidity compliance program may maintain all or a portion of its liquidity reserves with its top-tier bank holding company [or an affiliate], as determined by the security-based swap dealer. A consolidated liquidity compliance program must ensure that the bank holding company, on a consolidated basis, complies with applicable liquidity requirements imposed by the Board and must require the bank holding company to monitor the liquidity needs of, and provide liquidity support to, the security-based swap dealer subsidiary, as necessary.

When evaluating requests under this paragraph (f)(4), the Commission shall consider:

> (A) The extent to which the resolution plan anticipates the security-based swap dealer receiving liquidity support in the event of material financial distress at the bank holding company; and
>
> (B) Whether the Board or the Corporation has objected to any relevant provision of the bank holding company's resolution plan for the most recent completed annual cycle and, if so, whether the bank holding company has resolved any such objections.

(5) Contingency funding plan. (A) The security-based swap dealer must have a written contingency funding plan that addresses the security-based swap dealer's policies and the roles and responsibilities of relevant personnel for meeting the liquidity needs of the security-based swap dealer and communications with the public and other market participants during a liquidity stress event.

(B) A security-based swap dealer that has received approval from the Commission to adopt a consolidated liquidity compliance program under paragraph (f)(4) may rely on the contingency funding plan adopted by its top-tier bank holding company rather than adopt a separate contingency funding plan under this paragraph (f)(5).

Appendix D

The following is a non-exhaustive list of places where proposed Form SBS is unclear or incomplete:

- In Part 1 of proposed Form SBS:
  - There is no reference to foreign SBSDs or MSBSPs or OTC Derivative Dealers that are dually registered as an SBSD or MSBSP.
  - It is unclear how the lines relating to "Failed to deliver," "Securities borrowed," and "Omnibus accounts" relate to security-based swaps. Are they intended to refer to securities transactions in connection with the settlement of security-based swaps, to securities that are used as collateral for security-based swaps, or to something else?
  - Receivables are broken out differently on the asset side than payables are broken out on the liability side, which results in a mismatch of entries.
  - It is unclear what "Other derivatives payables" refers to on line 23.
- In Part 2 of proposed Form SBS:
  - The referenced notes (*i.e.*, Notes B, C, and D) are not on the form;
  - The Commission does not define borrows, loans or fails on lines 7, 8, and 9, which would be helpful to ensure accurate calculation – does this refer to collateral only?
  - The security count reference on line 7 is inconsistent with proposed Rule 18a-9, which does not require a bank SBSD to conduct this count.
  - In the reserve computation section on lines 21 and 22, the reference to line 21, should be to line 20.
- In Part 4 of proposed Form SBS, which would apply to nonbank SBSDs and nonbank MSBSPs, and consists of four schedules that elicit detailed information about a firm's security-based swap and swap positions, counterparties, and exposures:
  - The Commission should clarify what "Other derivatives and options" in line 15 refers to. Is this intended to capture listed and unlisted options, or something else?
  - There is a request for information regarding "current net exposure" and "total exposure," but both requests contain columns that request information regarding "current net exposure" and "total exposure." It is unclear what information the Commission is trying to elicit from firms.

- In Part 5 of proposed Form SBS:
  - The reference to longs and shorts should be defined – is the reference to stock record, exposure, or balance sheet?

Appendix E

The following are examples of how proposed Form SBS does not adequately address the concerns of U.S. and foreign bank SBSDs and bank MSBSPs.

- Noting that banks must file financial statements and supporting schedules known as "call reports" with their prudential regulator, the Commission states that it believes that the most common form of call report for a bank that would register as an SBSD or MSBSP is Form FFIEC 031. However, banks submit a variety of call reports depending on the type of firm. For example, U.S. branches and agencies of foreign banks file Form FFIEC 002. Because the information contained on Form FFIEC 002 is not identical to Form FFIEC 031, the Commission is incorrect in assuming that banks will necessarily be able to complete Part 2 of proposed Form SBS based on "call reports." Foreign bank SBSDs and bank MSBSPs would need to generate new information to fill out Part 2 of proposed Form SBS.

- Banks are required to file call reports with their prudential regulator 30 days after the end of a quarter.[80] The Commission should modify the time period for bank SBSDs and bank MSBSPs to file proposed Form SBS to conform to the time such entities have to file their call reports.

---

[80] *See* Instructions for Call Report FFIEC 002 (Preparation of Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks) at Gen-1, *available at:* http://www.ffiec.gov/PDF/FFIEC_forms/FFIEC002_201403_i.pdf; Instructions for Call Reports FFIEC 031 and 041 (Preparation of Consolidated Reports of Condition and Income) at 7 (6-13), *available at:* http://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_FFIEC041_201406_i.pdf.

FOCUS Report FORM SBS Part 1

STATEMENT OF FINANCIAL CONDITION

Items on this page to be reported by a: Stand-Alone SBSD
Broker-Dealer SBSD
Stand-Alone MSBSP
Broker-Dealer MSBSP

ASSETS

Assets	Allowable	Non-Allowable	Total
1. Cash	$ ____ [200]		$ ____ [750]
2. Cash segregated in compliance with federal and other regulations	$ ____ [210]		$ ____ [760]
3. Receivables from brokers/dealers and clearing organizations			
A. Failed to deliver			
1. Includible in the formula for reserve requirement under Rule 15c3-3a	$ ____ [220]		
2. Includible in the formula for the deposit requirement under Rule 18a-4a	$ ____ [999]		
3. Other	$ ____ [230]		$ ____ [770]
B. Securities borrowed			
1. Includible in the formula for reserve requirement under Rule 15c3-3a	$ ____ [240]		
2. Includible in the formula for the deposit requirement under Rule 18a-4a	$ ____ [999]		
3. Other	$ ____ [250]		$ ____ [780]
C. Omnibus accounts			
1. Includible in the formula for reserve requirement under Rule 15c3-3a	$ ____ [260]		
2. Includible in the formula for the deposit requirement under Rule 18a-4a	$ ____ [999]		
3. Other	$ ____ [270]		$ ____ [790]
D. Clearing organizations			
1. Includible in the formula for reserve requirement under Rule 15c3-3a	$ ____ [280]		
2. Includible in the formula for the deposit requirement under Rule 18a-4a	$ ____ [999]		
3. Other	$ ____ [290]		$ ____ [800]
E. Other	$ ____ [300]	$ ____ [550]	$ ____ [810]
4. Receivables from customers			
A. Securities accounts			
1. Cash and fully secured accounts	$ ____ [310]		
2. Partly secured accounts	$ ____ [320]	$ ____ [560]	
3. Unsecured accounts		$ ____ [570]	
B. Commodity accounts	$ ____ [330]	$ ____ [580]	
C. Allowance for doubtful accounts	$ (____) [335]	$ (____) [590]	$ ____ [820]
5. Receivables from non-customers			
A. Cash and fully secured accounts	$ ____ [340]		
B. Partly secured and unsecured accounts	$ ____ [350]	$ ____ [600]	$ ____ [830]
6. Securities purchased under agreements to resell	$ ____ [360]	$ ____ [605]	$ ____ [840]
7. Trade date receivable	$ ____ [292]		$ ____ [802]
8. Total securities, including security-based swaps, and spot commodities and swaps owned at market value	$ ____ [849]		$ ____ [850]
Includes encumbered securities of: $ ____ [120]			
9. Securities owned not readily marketable			
A. At cost $ ____ [130]	$ ____ [440]	$ ____ [610]	$ ____ [860]
10. Other investments not readily marketable			
A. At cost $ ____ [140]			
B. At estimated fair value	$ ____ [450]	$ ____ [620]	$ ____ [870]

Name of Firm: ____________________

As of: ____________________

FOCUS Report FORM SBS Part 1	STATEMENT OF FINANCIAL CONDITION
	Items on this page to be reported by a: Stand-Alone SBSD Broker-Dealer SBSD Stand-Alone MSBSP Broker-Dealer MSBSP

Assets		Allowable	Non-Allowable	Total
11. Securities borrowed under subordination agreements and partners' individual and capital securities accounts, at market value				
A. Exempted securities	$ ____ [150]			
B. Other	$ ____ [160]	$ ____ [460]	$ ____ [630]	$ ____ [880]
12. Secured demand notes – market value of collateral				
A. Exempted securities	$ ____ [170]			
B. Other	$ ____ [180]	$ ____ [470]	$ ____ [640]	$ ____ [890]
13. Memberships in exchanges				
A. Owned, at market value	$ ____ [190]			
B. Owned at cost			$ ____ [650]	
C. Contributed for use of company, at market value			$ ____ [660]	$ ____ [900]
14. Investment in and receivables from affiliates, subsidiaries and associated partnerships		$ ____ [480]	$ ____ [670]	$ ____ [910]
15. Property, furniture, equipment, leasehold improvements and rights under lease agreements At cost (net of accumulated depreciation and amortization)		$ ____ [490]	$ ____ [680]	$ ____ [920]
16. Other assets				
A. Dividends and interest receivable		$ ____ [500]	$ ____ [690]	
B. Free shipments		$ ____ [510]	$ ____ [700]	
C. Loans and advances		$ ____ [520]	$ ____ [710]	
D. Miscellaneous		$ ____ [530]	$ ____ [720]	
E. Collateral accepted under ASC 860		$ ____ [536]		
F. SPE Assets		$ ____ [537]		$ ____ [930]
17. **TOTAL ASSETS**		$ ____ [540]	$ ____ [740]	$ ____ [940]

Note: MSBSPs should only complete the Allowable and Total columns.

Name of Firm: ______________________

As of: ______________________

FOCUS Report
FORM SBS
Part 1

STATEMENT OF FINANCIAL CONDITION

Items on this page to be reported by a: Stand-Alone SBSD
Broker-Dealer SBSD
Stand-Alone MSBSP
Broker-Dealer MSBSP

LIABILITIES AND OWNERSHIP EQUITY

Liabilities		A.I. Liabilities	Non-A.I. Liabilities	Total
18. Bank loans payable				
A. Includible in the formula for reserve requirements under Rule 15c3-3a		$ ______ [1030]	$ ______ [1240]	$ ______ [1460]
B. Includible in the formula for the deposit requirement under Rule 18a-4a		$ ______ [9999]	$ ______ [9999]	$ ______ [9999]
C. Other		$ ______ [1040]	$ ______ [1250]	$ ______ [1470]
19. Securities sold under repurchase agreements			$ ______ [1260]	$ ______ [1480]
20. Payable to brokers/dealers and clearing organizations				
A. Failed to receive				
1. Includible in the formula for reserve requirements under Rule 15c3-3a		$ ______ [1050]	$ ______ [1270]	$ ______ [1490]
2. Includible in the formula for the deposit requirement under Rule 18a-4a		$ ______ [9999]	$ ______ [9999]	$ ______ [9999]
3. Other		$ ______ [1060]	$ ______ [1280]	$ ______ [1500]
B. Securities loaned				
1. Includible in the formula for reserve requirements under Rule 15c3-3a		$ ______ [1070]		$ ______ [1510]
2. Includible in the formula for the deposit requirement under Rule 18a-4a		$ ______ [9999]		$ ______ [9999]
3. Other		$ ______ [1080]	$ ______ [1290]	$ ______ [1520]
C. Omnibus accounts				
1. Includible in the formula for reserve requirements under Rule 15c3-3a		$ ______ [1090]		$ ______ [1530]
2. Includible in the formula for the deposit requirement under Rule 18a-4a		$ ______ [9999]		$ ______ [9999]
3. Other		$ ______ [1095]	$ ______ [1300]	$ ______ [1540]
D. Clearing organizations				
1. Includible in the formula for reserve requirements under Rule 15c3-3a		$ ______ [1100]		$ ______ [1550]
2. Includible in the formula for the deposit requirement under Rule 18a-4a		$ ______ [9999]		$ ______ [9999]
3. Other		$ ______ [1105]	$ ______ [1310]	$ ______ [1560]
E. Other		$ ______ [1110]	$ ______ [1320]	$ ______ [1570]
21. Payable to customers				
A. Securities accounts – including free credits of	$ ______ [950]	$ ______ [1120]		$ ______ [1580]
B. Commodities accounts		$ ______ [1130]	$ ______ [1330]	$ ______ [1590]
C. Security-based swap accounts – including free credits of	$ ______ [999]	$ ______ [9999]		$ ______ [9999]
D. Swap accounts		$ ______ [9999]	$ ______ [9999]	$ ______ [9999]
22. Payable to non-customers				
A. Securities accounts		$ ______ [1140]	$ ______ [1340]	$ ______ [1600]
B. Commodities accounts		$ ______ [1150]	$ ______ [1350]	$ ______ [1610]
C. Security-based swap accounts		$ ______ [9999]	$ ______ [9999]	$ ______ [9999]
D. Swap accounts		$ ______ [9999]	$ ______ [9999]	$ ______ [9999]
23. Other derivatives payables		$ ______ [9999]	$ ______ [9999]	$ ______ [1561]
24. Trade date payable		$ ______ [9999]	$ ______ [9999]	$ ______ [1562]
25. Securities sold but not yet purchased at market value – including arbitrage of	$ ______ [960]		$ ______ [1360]	$ ______ [1620]
26. Accounts payable and accrued liabilities and expenses				
A. Drafts payable		$ ______ [1160]		$ ______ [1630]
B. Accounts payable		$ ______ [1170]		$ ______ [1640]
C. Income taxes payable		$ ______ [1180]		$ ______ [1650]
D. Deferred income taxes			$ ______ [1370]	$ ______ [1660]
E. Accrued expenses and other liabilities		$ ______ [1190]		$ ______ [1670]
F. Other		$ ______ [1200]	$ ______ [1380]	$ ______ [1680]
G. Obligation to return securities		$ ______ [9999]	$ ______ [9999]	$ ______ [1686]
H. SPE liabilities		$ ______ [9999]	$ ______ [9999]	$ ______ [1687]

Name of Firm: ______________________

As of: ______________________

FOCUS Report FORM SBS Part 1	STATEMENT OF FINANCIAL CONDITION
	Items on this page to be reported by a: Stand-Alone SBSD Broker-Dealer SBSD Stand-Alone MSBSP Broker-Dealer MSBSP

Item	Sub-amount		Column 1		Column 2		Column 3	
27. Notes and mortgages payable								
A. Unsecured			$ ______	1210			$ ______	1690
B. Secured			$ ______	1211	$ ______	1390	$ ______	1700
28. Liabilities subordinated to claims of creditors								
A. Cash borrowings					$ ______	1400	$ ______	1710
1. From outsiders	$ ______	970						
2. Includes equity subordination (Rule 15c3-1(d) or Rule 18a-1(h)) of	$ ______	980						
B. Securities borrowings, at market value					$ ______	1410	$ ______	1720
1. From outsiders	$ ______	990						
C. Pursuant to secured demand note collateral agreements					$ ______	1420	$ ______	1730
1. From outsiders	$ ______	1000						
2. Includes equity subordination (Rule 15c3-1(d) or Rule 18a-1(h)) of	$ ______	1010						
D. Exchange memberships contributed for use of company, at market value					$ ______	1430	$ ______	1740
E. Accounts and other borrowings not qualified for net capital purposes			$ ______	1220	$ ______	1440	$ ______	1750
29. **TOTAL LIABILITIES**			$ ______	1230	$ ______	1450	$ ______	1760

<u>Ownership Equity</u>

Item	Column 1		Column 2		Column 3	
30. Sole proprietorship					$ ______	1770
31. Partnership and limited liability company – including limited partners	$ ______	1020			$ ______	1780
32. Corporation						
A. Preferred stock			$ ______	1791		
B. Common stock			$ ______	1792		
C. Additional paid-in capital			$ ______	1793		
D. Retained earnings			$ ______	1794		
E. Total					$ ______	1795
F. Less capital stock in treasury					$ (______)	1796
33. **TOTAL OWNERSHIP EQUITY** (sum of Line Items 1770, 1780, 1795, and 1796)					$ ______	1800
34. **TOTAL LIABILITIES AND OWNERSHIP EQUITY** (sum of Line Items 1760 and 1810)					$ ______	1810

Name of Firm: ______________________

As of: ______________________

FOCUS Report FORM SBS Part 1	COMPUTATION OF NET CAPITAL (FILER AUTHORIZED TO USE MODELS)
	Items on this page to be reported by a: Stand-Alone SBSD (Authorized to use models) Broker-Dealer SBSD (Authorized to use models) Broker-Dealer MSBSP (Authorized to use models)

Computation of Net Capital

1. Total ownership equity from Item 1800 .... $ ________ [3480]
2. Deduct ownership equity not allowable for net capital .... $(________) [3490]
3. Total ownership equity qualified for net capital .... $ ________ [3500]
4. Add:
   - A. Liabilities subordinated to claims of creditors allowable in computation of net capital .... $ ________ [3520]
   - B. Other (deductions) or allowable credits (list) .... $ ________ [3525]
5. Total capital and allowable subordinated liabilities .... $ ________ [3530]
6. Deductions and/or charges
   - A. Total nonallowable assets from Statement of Financial Condition .... $ ________ [3540]
     1. Additional charges for customers' and non-customers' security accounts .... $ ________ [3550]
     2. Additional charges for customers' and non-customers' commodity accounts .... $ ________ [3560]
     3. Additional charges for customers' and non-customers' security-based swap accounts .... $ ________ [9999]
     4. Additional charges for customers' and non-customers' swap accounts .... $ ________ [9999]
   - B. Aged fail-to-deliver .... $ ________ [3570]
     1. Number of items .... ________ [3450]
   - C. Aged short security differences – less
     reserve of .... ________ [3460] $ ________ [3580]
     number of items .... ________ [3470]
   - D. Secured demand note deficiency .... $ ________ [3590]
   - E. Commodity futures contracts and spot commodities – proprietary capital charges .... $ ________ [3600]
   - F. Other deductions and/or charges .... $ ________ [3610]
   - G. Deductions for accounts carried under Rules 15c3-1(a)(6) and (c)(2)(x) .... $ ________ [3615]
   - H. Total deductions and/or charges (sum of Lines 6A-6G) .... $(________) [3620]
7. Other additions and/or allowable credits (list) .... $ ________ [3630]
8. Tentative net capital .... $ ________ [3640]
9. Contractual securities commitments .... $ ________ [3660]
10. Market risk exposure
    - A. Total value at risk (sum of Lines 10A1-10A5) .... $ ________ [3634]
      Value at risk components
      1. Fixed income VaR .... $ ________ [3636]
      2. Currency VaR .... $ ________ [3637]
      3. Commodities VaR .... $ ________ [3638]
      4. Equities VaR .... $ ________ [3639]
      5. Credit derivatives VaR .... $ ________ [3641]
    - B. Diversification benefit .... $ ________ [3642]
    - C. Total diversified VaR (Line 10A minus Line 10B) .... $ ________ [3643]
    - D. Multiplication factor .... $ ________ [3645]
    - E. Subtotal (Line 10C multiplied by Line 10D) .... $ ________ [3655]

Name of Firm: ____________________

As of: ____________________

COMPUTATION OF NET CAPITAL (FILER AUTHORIZED TO USE MODELS)

Items on this page to be reported by a: Stand-Alone SBSD (Authorized to use models)
Broker-Dealer SBSD (Authorized to use models)
Broker-Dealer MSBSP (Authorized to use models)

Item				
11. Deduction for specific risk, unless included in Line 10 above			$	3646
12. Risk deduction using scenario analysis			$	3647
A. Fixed income	$	3648		
B. Currency	$	3649		
C. Commodities	$	3651		
D. Equities	$	3652		
E. Credit derivatives	$	3653		
13. Residual marketable securities (see Rule 15c3-1(c)(2)(vi) or 18a-1(c)(1)(vii), as applicable)			$	3665
14. Total market risk exposure (add Lines 10E, 11, 12 and 13)			$	3677
15. Credit risk exposure for commercial end user counterparties (see Appendix E to Rule 15c3-1 or Rule 18a-1(e)(2), as applicable)				
A. Counterparty exposure charge (add Lines 15A1 and 15A2)			$	3676
1. Net replacement value default, bankruptcy	$	9999		
2. Credit equivalent amount exposure to the counterparty multiplied by the credit-risk weight of the counterparty multiplied by 8%	$	9999		
B. Concentration charge			$	3659
1. Credit risk weight ≤20%	$	3656		
2. Credit risk weight >20% and ≤50%	$	3657		
3. Credit risk weight >50%	$	3658		
C. Portfolio concentration charge			$	3678
16. Total credit risk exposure (add Lines 15A, 15B and 15C)			$	3688
17. Net capital (subtract Lines 9, 14 and 16 from Line 8)			$	3750

Name of Firm: ____________________

As of: ____________________

FOCUS Report FORM SBS Part 1	COMPUTATION OF NET CAPITAL (FILER NOT AUTHORIZED TO USE MODELS)
	Items on this page to be reported by a: Stand-Alone SBSD (Not authorized to use models) Broker-Dealer SBSD (Not authorized to use models) Broker-Dealer MSBSP (Not authorized to use models)

Computation of Net Capital

1. Total ownership equity from Item 1800 .... $ ________ [3480]
2. Deduct ownership equity not allowable for net capital .... $ (________) [3490]
3. Total ownership equity qualified for net capital .... $ ________ [3500]
4. Add:
   A. Liabilities subordinated to claims of creditors allowable in computation of net capital.......... $ ________ [3520]
   B. Other (deductions) or allowable credits (list) .... $ ________ [3525]
5. Total capital and allowable subordinated liabilities .... $ ________ [3530]
6. Deductions and/or charges
   A. Total nonallowable assets from Statement of Financial Condition.......... $ ________ [3540]
      1. Additional charges for customers' and non-customers' security accounts.......... $ ________ [3550]
      2. Additional charges for customers' and non-customers' commodity accounts.......... $ ________ [3560]
      3. Additional charges for customers' and non-customers' security-based swap accounts .... $ ________ [9999]
      4. Additional charges for customers' and non-customers' swap accounts.......... $ ________ [9999]
   B. Aged fail-to-deliver .... $ ________ [3570]
      1. Number of items .... ________ [3450]
   C. Aged short security differences-less reserve of .... $________ [3460] $ ________ [3580]
      1. Number of items .... ________ [3470]
   D. Secured demand note deficiency .... $________ [3590]
   E. Commodity futures contracts and spot commodities – proprietary capital charges.......... $ ________ [3600]
   F. Other deductions and/or charges.......... $ ________ [3610]
   G. Deductions for accounts carried under Rule 15c3-1(a)(6) and (c)(2)(x) .... $ ________ [3615]
   H. Total deductions and/or charges $ (________) [3620]
7. Other additions and/or allowable credits .... $ ________ [3630]
8. Tentative net capital (net capital before haircuts) .... $ ________ [3640]
9. Haircuts on securities other than security-based swaps
   A. Contractual securities commitments.......... $ ________ [3660]
   B. Subordinated securities borrowings.......... $ ________ [3670]
   C. Trading and investment securities
      1. Bankers' acceptances, certificates of deposit, commercial paper, and money market instruments .... $ ________ [3680]
      2. U.S. and Canadian government obligations.......... $ ________ [3690]
      3. State and municipal government obligations.......... $ ________ [3700]
      4. Corporate obligations.......... $ ________ [3710]
      5. Stocks and warrants .... $ ________ [3720]
      6. Options.......... $ ________ [3730]
      7. Arbitrage .... $ ________ [3732]
      8. Other securities.......... $ ________ [3734]
   D. Undue concentration.......... $ ________ [3650]
   E. Other (List: ________________________________).......... $ ________ [3736]
10. Haircuts on security-based swaps.......... $ ________ [9999]
11. Haircuts on swaps .... $ ________ [9999]
12. Total haircuts .... $ ________ [3740]
13. Net capital (Line 8 minus Line 12).......... $ ________ [3750]

Name of Firm: ________________________

As of: ________________________

FOCUS Report FORM SBS Part 1	COMPUTATION OF MINIMUM REGULATORY CAPITAL REQUIREMENTS (BROKER-DEALER)
	Items on this page to be reported by a: Broker-Dealer SBSD Broker-Dealer MSBSP

Calculation of Excess Tentative Net Capital (If Applicable)

1. Tentative net capital .... $ ______ [3640]

2. Minimum tentative net capital requirement .... $ ______ [9999]

3. Excess tentative net capital (difference between Lines 1 and 2) .... $ ______ [9999]

4. Tentative net capital in excess of 120% of minimum tentative net capital requirement reported on Line 2 .... $ ______ [9999]

Calculation of Minimum Net Capital Requirement

4. Ratio minimum net capital requirement

   A. $6^{2}/_{3}$% of total aggregate indebtedness (Line Item 3840) .... $ ______ [3756]

   B. 2% of aggregate debit items as shown in the Formula for Reserve Requirements pursuant to Rule 15c3-3 .... $ ______ [3870]

      i. Minimum CFTC net capital requirement .... $ ______ [7490]

   C. 8% of risk margin amount .... $ ______ [9999]

   D. Minimum ratio requirement (sum of Lines 4A, 4B, and/or 4C, as applicable) .... $ ______ [9999]

5. Fixed-dollar minimum net capital requirement .... $ ______ [3880]

6. Minimum net capital requirement (greater of Lines 4D and 5) .... $ ______ [3760]

7. Excess net capital (Item 3750 minus Item 3760) .... $ ______ [3910]

8. Net capital and tentative net capital in relation to early warning thresholds

   A. Net capital in excess of 120% of minimum net capital requirement reported on Line 6 .... $ ______ [9999]

   B. Net capital in excess of 5% of combined aggregate debit items as shown in the Formula for Reserve Requirements pursuant to Rule 15c3-3 .... $ ______ [9999]

Computation of Aggregate Indebtedness

9. Total liabilities from Statement of Financial Condition (Item 1760) .... $ ______ [3790]

10. Add:

   A. Drafts for immediate credit .... $ ______ [3800]

   B. Market value of securities borrowed for which no equivalent value is paid or credited .... $ ______ [3810]

   C. Other unrecorded amounts (list) .... $ ______ [3820]

   D. Total additions (sum of Line Items 3800, 3810, and 3820) .... $ ______ [3830]

11. Deduct: Adjustment based on deposits in Special Reserve Bank Accounts (see Rule 15c3-1(c)(1)(vii)) .... $ ______ [3838]

12. Total aggregate indebtedness (sum of Line Items 3790 and 3830) .... $ ______ [3840]

13. Percentage of aggregate indebtedness to net capital (Item 3840 divided by Item 3750) .... % ______ [3850]

14. Percentage of aggregate indebtedness to net capital *after* anticipated capital withdrawals (Item 3840 divided by Item 3750 less Item 4880) .... % ______ [3853]

Calculation of Other Ratios

15. Percentage of net capital to aggregate debits (Item 3750 divided by Item 4470) .... % ______ [3851]

16. Percentage of net capital, *after* anticipated capital withdrawals, to aggregate debits (Item 3750 less Item 4880, divided by Item 4470) .... $ ______ [3854]

17. Percentage of debt to debt-to-equity total, computed in accordance with Rule 15c3-1(d) .... % ______ [3860]

18. Options deductions/net capital ratio (1000% test) total deductions exclusive of liquidating equity under Rule 15c3-1(a)(6) and (c)(2)(x) divided by net capital .... $ ______ [3852]

Name of Firm: ______________________

As of: ______________________

FOCUS Report FORM SBS Part 1	COMPUTATION OF MINIMUM REGULATORY CAPITAL REQUIREMENTS (NON-BROKER-DEALER)
	Items on this page to be reported by a: Stand-Alone SBSD

Calculation of Excess Tentative Net Capital (If Applicable)

1. Tentative net capital	$ ____	3640
2. Fixed-dollar minimum tentative net capital requirement	$ ____	9999
3. Excess tentative net capital (difference between Lines 1 and 2)	$ ____	9999
4. Tentative net capital in excess of 120% of minimum tentative net capital requirements reported on Line 2	$ ____	9999

Calculation of Minimum Net Capital Requirement

5. Ratio minimum net capital requirement – 8% of risk margin amount	$ ____	9999
6. Fixed-dollar minimum net capital requirement	$ ____	3880
7. Minimum net capital requirement (greater of Lines 4 and 5)	$ ____	3760
8. Excess net capital (Item 3750 minus Item 3760)	$ ____	3910
9. Net capital in excess of 120% of minimum net capital requirement reported on Line 6 (Line Item 3750 – [Line Item 3760 x 120%])	$ ____	9999

Name of Firm: ____

As of: ____

FOCUS Report FORM SBS Part 1	COMPUTATION OF TANGIBLE NET WORTH	
	Items on this page to be reported by a:	Stand-Alone MSBSP Broker-Dealer MSBSP

1. Total ownership equity (from Item 1800) .... $ __________ [1800]

2. Goodwill and other intangible assets .... $ __________ [9999]

3. Tangible net worth (Line 1 minus Line 2) .... $ __________ [9999]

Name of Firm: __________

As of: __________

FOCUS Report FORM SBS Part 1	STATEMENT OF INCOME (LOSS)
	Items on this page to be reported by a: Stand-Alone SBSD Broker-Dealer SBSD Stand-Alone MSBSP Broker-Dealer MSBSP

REVENUE				FOCUS Report Reference Line
1. Fees, Commissions, or Premiums from Derivatives, Securities and Other Instruments				
A. Equities, ETFs and closed end funds		$ ______	13935	A: 3935
B. Exchange listed equity securities executed OTC		$ ______	13937	C/II: 3937
C. U.S. government and agencies		$ ______	11001	
D. Foreign sovereign debt		$ ______	11002	
E. Corporate debt		$ ______	11003	
F. Mortgage-backed and other asset-backed securities		$ ______	11004	
G. Municipals		$ ______	11005	
H. Listed options		$ ______	13938	A: 3938
I. OTC options		$ ______	11006	
J. All other securities commissions		$ ______	13939	A: 3939
K. Commodity transactions		$ ______	13991	C: 3991, II/IIA: 3990
L. Foreign exchange		$ ______	11007	
M. Security-based swaps		$ ______	99999	
N. Mixed swaps		$ ______	99999	
O. Swaps		$ ______	99999	
P. Aggregate amount if less than the greater of $5,000 or 5% of total revenue (Item 14030) (do not complete Lines 1A-1O)		$ ______	11008	
1. Is any portion of Line 1P related to municipal securities?	Yes ☐ No ☐ 11009			
Total Commissions (sum of Lines 1A-1O):		$ ______	13940	A: 3940
2. Revenue from Sale of Investment Company Shares		$ ______	13970	A: 3970
3. Revenue from Sale of Insurance Based Products				
A. Variable contracts		$ ______	11020	
B. Non-securities insurance based products		$ ______	11021	
C. Aggregate amount if less than the greater of $5,000 or 5% of total revenue (Item 14030) (do not complete Lines 3A-3B)		$ ______	11022	
Total Revenue from Sale of Insurance Based Products (sum of Lines 3A-3B):		$ ______	11029	
4. Gains or Losses on Derivative Trading Desks				
A. Interest rate/fixed income products		$ ______	13921	C: 3921
B. Currency		$ ______	13922	C: 3922
C. Equity products		$ ______	13923	C: 3923
D. Commodity products		$ ______	13924	C: 3924
E. Other		$ ______	13925	C: 3925
Total Gains or Losses on Derivative Trading (sum of Lines 4A-4E):		$ ______	13926	C: 3926
5. Gains or Losses on Principal Trades (Do not report amounts already reported on Lines 4A-4E)				
A. Equities, ETFs and closed end funds. Includes dividends:	Yes ☐ No ☐ 11030	$ ______	13903	C: 3903
B. U.S. government and agencies. Includes interest:	Yes ☐ No ☐ 11031	$ ______	11032	C: 3901
C. Foreign sovereign debt. Includes interest:	Yes ☐ No ☐ 11033	$ ______	11034	C: 3901
D. Corporate debt. Includes interest:	Yes ☐ No ☐ 11035	$ ______	11036	C: 3901
E. Mortgage-backed and other asset-backed securities. Includes interest:	Yes ☐ No ☐ 11037	$ ______	11038	C: 3901
F. Municipal securities. Includes interest:	Yes ☐ No ☐ 11039	$ ______	13901	C: 3901
G. Listed options		$ ______	11040	
H. OTC options		$ ______	11041	
I. Commodity transactions		$ ______	13904	C: 3904

Name of Firm: ______________________

As of: ______________________

FOCUS Report FORM SBS Part 1	STATEMENT OF INCOME (LOSS)
	Items on this page to be reported by a: Stand-Alone SBSD Broker-Dealer SBSD Stand-Alone MSBSP Broker-Dealer MSBSP

J. Foreign exchange .... $ ________ [13902] C: 3902

K. Futures .... $ ________ [11044]

L. Security-based swaps (sum of Lines 5L1-5L4) .... $ ________ [11042]

1. Debt security-based swaps (other than credit default swaps) .... $ ________ [99999]
2. Equity security-based swaps .... $ ________ [99999]
3. Credit default security-based swaps .... $ ________ [99999]
4. Other security-based swaps .... $ ________ [99999]

M. Mixed swaps .... $ ________ [99999]

N. Swaps (sum of Lines 5N1-5N7) .... $ ________ [11043]

1. Interest rate swaps .... $ ________ [99999]
2. Foreign exchange swaps .... $ ________ [99999]
3. Commodity swaps .... $ ________ [99999]
4. Debt index swaps (other than credit default swaps) .... $ ________ [99999]
5. Equity index swaps .... $ ________ [99999]
6. Credit default swaps .... $ ________ [99999]
7. Other swaps .... $ ________ [99999]

O. Other .... $ ________ [13951] C: 3951

P. Aggregate amount if less than the greater of $5,000 or 5% of total revenue (Item 14030) (do not complete Lines 5A-5O) .... $ ________ [11045]

1. Is any portion of Line 5P related to municipal securities? .... Yes ☐ No ☐ [11046]

Total Gains or Losses on Principal Trades (sum of Lines 5A-5O): $ ________ [13950] A: 3950

6. Capital Gains (Losses) on Firm Investment Accounts .... $ ________ [13952] A: 3952

A. Includes dividends and/or interest .... Yes ☐ No ☐ [11053]

B. Realized capital gains (losses) .... $ ________ [4235] C: 4235

C. Unrealized capital gains (losses) .... $ ________ [4236] C: 4236

7. Interest / Rebate / Dividend Income

A. Securities borrowings .... $ ________ [11060]

B. Reverse repurchase transactions .... $ ________ [11061]

C. Margin interest .... $ ________ [13960] C/II: 3960

D. Revenue earned from customer bank sweep (FDIC insured products) programs .... $ ________ [11062]

E. Revenue earned from customer fund sweeps into '40 Act investments .... $ ________ [11063]

F. Interest and/or dividends on securities held in firm inventory (not otherwise reported) .... $ ________ [11064]

G. Other interest .... $ ________ [13953] C: 3953

H. Aggregate amount if less than the greater of $5,000 or 5% of total revenue (Item 14030) (do not complete Lines 7A-7G) .... $ ________ [11065]

Total Interest / Rebate / Dividend Income (sum of Lines 7A-7G): $ ________ [11069]

8. Revenue from Underwritings and Selling Group Participation

A. Municipal offerings .... $ ________ [11070]

B. Registered offerings

1. Offerings other than self or affiliate (excludes municipal offerings) .... $ ________ [11071]
2. Offerings, self or affiliate (excludes municipal offerings) .... $ ________ [11072]

Total Revenue from Registered Offerings (sum of Lines 8A-8B2): $ ________ [11079]

C. Unregistered offerings (excludes municipal offerings) (sections below refer to Operational Page – see instructions)
Did the broker or dealer filing this report participate in the sale of any unregistered offering during the reporting period for which it received no compensation? .... Yes ☐ No ☐ [11080]

1. Unregistered offerings, other than self or affiliate offerings – Section 1 .... $ ________ [11081]
2. Unregistered offerings, self or affiliate offerings – Section 2 .... $ ________ [11082]

Total Revenue from Unregistered Offerings (sum of Line Items 11081 and 11082): $ ________ [11089]

Name of Firm: ____________________

As of: ____________________

FOCUS Report FORM SBS Part 1	STATEMENT OF INCOME (LOSS)
	Items on this page to be reported by a: Stand-Alone SBSD Broker-Dealer SBSD Stand-Alone MSBSP Broker-Dealer MSBSP

Item		Box	Ref
Total Revenue from Underwritings and Selling Group Participation (sum of Line Items 11070, 11079, and 11089):	$ ______	13955	A: 3955
9. Miscellaneous Fees Earned			
A. Fees earned from affiliated entities	$ ______	11090	
B. Investment banking fees; M&A advisory	$ ______	11091	
C. Account supervision and investment advisory services	$ ______	13975	A: 3975
D. Administrative fees	$ ______	11092	A: 3975
E. Revenue from research services	$ ______	13980	C/II: 3980
F. Rebates from exchanges, ECNs, and ATSs	$ ______	11093	
G. 12b-1 fees	$ ______	11094	
H. Mutual fund revenue other than concessions or 12b-1 fees	$ ______	11095	
I. Execution services	$ ______	11096	
J. Clearing services	$ ______	11097	
K. Fees earned on customer bank sweep (FDIC insured products) programs	$ ______	11098	
L. Fees earned from sweep programs into '40 Act investments	$ ______	11099	
M. Networking fees from '40 Act companies	$ ______	11100	
N. Other fees	$ ______	11101	
O. Aggregate amount if less than the greater of $5,000 or 5% of total revenue (Item 14030) (do not complete Lines 9A-9N)	$ ______	11102	
Total Fees Earned (sum of Lines 9A-9N):	$ ______	11109	
10. Other Revenue			
A. Total revenue from sale of certificates of deposit (CDs) issued by an affiliate	$ ______	11126	
B. Other revenue	$ ______	13995	A: 3995

If Line Item 13995 is greater than both 10% of Item 14030 and $5,000, provide a description of the 3 largest components of Other Revenue, along with the associated revenue for each.

Description	Box	Amount	Box
B-1. Description of: 1st largest component of Other Revenue	11120	$ ______	11121
B-2. Description of: 2nd largest component of Other Revenue	11122	$ ______	11123
B-3. Description of: 3rd largest component of Other Revenue	11124	$ ______	11125

Item		Box	Ref
Total Revenue (sum of Line Items 11230, 11231, 11232, 11233, 11234, 11235, & 11236):	$ ______	14030	A: 4030
EXPENSES			
11. Compensation Expenses			
A. Registered representatives' compensation	$ ______	14110	C/II: 4110
B. Compensation paid to all other revenue producing personnel (including temporary personnel)	$ ______	14040	C/II: 4040
C. Compensation paid to non-revenue producing personnel (including temporary personnel)	$ ______	11200	
D. Bonuses	$ ______	11201	
E. Other compensation expenses	$ ______	11202	
F. Aggregate amount if less than the greater of $5,000 or 5% of total expenses (Item 14200) (do not complete Lines 11A-11E)	$ ______	11203	
Total Compensation Expenses (sum of Lines 11A-11E):	$ ______	11209	
12. Commission, Clearance and Custodial Expenses			
A. Floor brokerage and fees paid	$ ______	14055	C/II: 4055
B. Amounts paid to exchanges, ECNs, and ATSs	$ ______	14145	C/II: 4145
C. Clearance fees paid to broker-dealers	$ ______	11210	
D. Clearance fees paid to non-broker-dealers	$ ______	14135	C/II: 4135
E. Commission paid to broker-dealers	$ ______	14140	IIA: 4140
F. 12b-1 fees	$ ______	11211	
G. Custodial fees	$ ______	11212	

Name of Firm: ______________________

As of: ______________________

FOCUS Report FORM SBS Part 1	STATEMENT OF INCOME (LOSS)
	Items on this page to be reported by a: Stand-Alone SBSD Broker-Dealer SBSD Stand-Alone MSBSP Broker-Dealer MSBSP

Item		Line	Cross-reference
H. Aggregate amount if less than the greater of $5,000 or 5% of total expenses (Item 14200) (do not complete Lines 12A-12G)	$ ____	11213	
Total Commission, Clearance and Custodial Fees (sum of Lines 12A-12G):	$ ____	11219	
13. Expenses Incurred on Behalf of Affiliates and Others			
A. Soft dollar expenses	$ ____	11220	
B. Rebates/recapture of commissions	$ ____	11221	
Total Expenses incurred on Behalf of Affiliates and Others (sum of Lines 13A-13B):	$ ____	11229	
14. Interest and Dividend Expenses			
A. Interest paid on bank loans	$ ____	11230	
B. Interest paid on debt instruments where firm is the obligor, including subordination agreements	$ ____	11231	
C. Interest paid on customer and security-based swap customer balances	$ ____	11232	
D. Interest paid on securities loaned transactions	$ ____	11233	
E. Interest paid on repurchase agreements	$ ____	11234	
F. Interest and/or dividends on short securities inventory	$ ____	11235	
G. Other interest expenses	$ ____	11236	
H. Aggregate amount if less than the greater of $5,000 or 5% of total expenses (Item 14200) (do not complete Lines 14A-14G)	$ ____	11237	
Total Interest and Dividend Expenses (sum of Lines 14A-14G):	$ ____	14075	A: 4075
15. Fees Paid to Third Party Service Providers			
A. To affiliates	$ ____	11240	
B. To non-affiliates	$ ____	11241	
Total Fees Paid to Third Party Service Providers (sum of Lines 15A-15B):	$ ____	11249	
16. General, Administrative, Regulatory and Miscellaneous Expenses			
A. Finders' fees	$ ____	11250	
B. Technology, data and communication costs	$ ____	14060	C/II: 4060, 4186
C. Research	$ ____	11251	
D. Promotional fees	$ ____	14150	C/II: 4150
E. Travel and entertainment	$ ____	11252	
F. Occupancy and equipment expenses	$ ____	14080	C/II: 4080
G. Non-recurring charges	$ ____	14190	C/II: 4190
H. Regulatory fees	$ ____	14195	A: 4195
I. Professional service fees	$ ____	11253	
J. Litigation, arbitration, settlement, restitution and rescission, and related outside counsel legal fees	$ ____	11254	
K. Losses in error accounts and bad debts	$ ____	14170	C/II: 4170
L. State and local income taxes	$ ____	11255	
M. Aggregate amount if less than the greater of $5,000 or 5% of total expenses (Item 14200) (do not complete Lines 16A-16L)	$ ____	11256	
Total General, Administrative, Regulatory and Miscellaneous Expenses (sum of Lines 16A-16L):	$ ____	11269	
17. Other Expenses			
A. Other expenses	$ ____	14100	A: 4100

If Line Item 14100 is greater than both 10% of Item 14200 and $5,000, provide a description of the 3 largest components of Other Expenses, along with the associated expense for each.

Description	Line	Amount	Line
A-1. Description of: 1st largest component of Other Expenses ____	11280	$ ____	11281
A-2. Description of: 2nd largest component of Other Expenses ____	11282	$ ____	11283
A-3. Description of: 3rd largest component of Other Expenses ____	11284	$ ____	11285

Item		Line	Cross-reference
Total Expenses (sum of Line Items 11209, 11219, 11229, 14075, 11249, 11269, and 14100):	$ ____	14200	A: 4200

Name of Firm: ____________________

As of: ____________________

FOCUS Report FORM SBS Part 1	STATEMENT OF INCOME (LOSS)
	Items on this page to be reported by a: Stand-Alone SBSD Broker-Dealer SBSD Stand-Alone MSBSP Broker-Dealer MSBSP

NET INCOME

18. Net Income

A. Income (loss) before Federal income taxes and items below		$ ____	14210	A: 4210
B. Provision for Federal income taxes		$ ____	14220	A: 4220
C. Equity in earnings (losses) of unconsolidated subsidiaries not included above		$ ____	14222	A: 4222
1. After Federal income taxes of	$ ____ 4238			C/II: 4238
D. Extraordinary gains (losses)		$ ____	14224	A: 4224
1. After Federal income taxes of	$ ____ 4239			C/II: 4239
E. Cumulative effect of changes in accounting principles		$ ____	14225	A: 4225
F. Net income (loss) after Federal income taxes and extraordinary items		$ ____	14230	A: 4230
Total Net Income (Line Item 14210 minus Line Items 14220, 14222, 14224, and 14225):		$ ____	11299	

Name of Firm: ____________________

As of: ____________________

CAPITAL WITHDRAWALS

Items on this page to be reported by a: Stand-Alone SBSD
Broker-Dealer SBSD
Broker-Dealer MSBSP

OWNERSHIP EQUITY AND SUBORDINATED LIABILITIES MATURING OR PROPOSED TO BE WITHDRAWN WITHIN THE NEXT SIX MONTHS AND ACCRUALS, WHICH HAVE NOT BEEN DEDUCTED IN THE COMPUTATION OF NET CAPITAL

Type of Proposed Withdrawal or Accrual (See below for code to enter)	Name of Lender or Contributor	Insider or Outsider? (In or Out)	Amount to be Withdrawn (cash amount and/or Net Capital Value of Securities)	(MM/DD/YY) Withdrawal or Maturity Date	Expect to Renew (Yes or No)
______ 4600	______ 4601	______ 4602	$ ______ 4603	______ 4604	______ 4605
______ 4610	______ 4611	______ 4612	$ ______ 4613	______ 4614	______ 4615
______ 4620	______ 4621	______ 4622	$ ______ 4623	______ 4624	______ 4625
______ 4630	______ 4631	______ 4632	$ ______ 4633	______ 4634	______ 4635
______ 4640	______ 4641	______ 4642	$ ______ 4643	______ 4644	______ 4645
______ 4650	______ 4651	______ 4652	$ ______ 4653	______ 4654	______ 4655
______ 4660	______ 4661	______ 4662	$ ______ 4663	______ 4664	______ 4665
______ 4670	______ 4671	______ 4672	$ ______ 4673	______ 4674	______ 4675
______ 4680	______ 4681	______ 4682	$ ______ 4683	______ 4684	______ 4685
______ 4690	______ 4691	______ 4692	$ ______ 4693	______ 4694	______ 4695
		Total:	$ ______ 4699*		

* To agree with the total on Recap (Line Item 4880)

Instructions: Detailed listing must include the total of items maturing during the six month period following the report date, regardless of whether or not the capital contribution is expected to be renewed. The schedule must also include proposed capital withdrawals scheduled within the six month period following the report date including the proposed redemption of stock and payments of liabilities secured by fixed assets (which are considered allowable assets in the capital computation, which could be required by the lender on demand or in less than six months.

CODE:	**DESCRIPTIONS:**
1.	Equity capital
2.	Subordinated liabilities
3.	Accruals
4.	Assets not readily convertible into cash

Name of Firm: ______________________

As of: ______________________

FOCUS Report FORM SBS Part 1	CAPITAL WITHDRAWALS RECAP
	Items on this page to be reported by a: Stand-Alone SBSD Broker-Dealer SBSD Broker-Dealer MSBSP

OWNERSHIP EQUITY AND SUBORDINATED LIABILITIES MATURING OR PROPOSED TO BE WITHDRAWN WITHIN THE NEXT SIX MONTHS AND ACCRUALS, WHICH HAVE NOT BEEN DEDUCTED IN THE COMPUTATION OF NET CAPITAL

Item		Amount	Code
1. Equity capital			
A. Partnership and limited liability company capital			
1. General partners	$	________	4700
2. Limited partners and limited liability company members	$	________	4710
3. Undistributed profits	$	________	4720
4. Other (describe below)	$	________	4730
5. Sole proprietorship	$	________	4735
B. Corporation capital			
1. Common stock	$	________	4740
2. Preferred stock	$	________	4750
3. Retained earnings (dividends and other)	$	________	4760
4. Other (describe below)	$	________	4770
2. Subordinated liabilities			
A. Secured demand notes	$	________	4780
B. Cash subordinates	$	________	4790
C. Debentures	$	________	4800
D. Other (describe below)	$	________	4810
3. Other accrued withdrawals			
A. Bonuses	$	________	4820
B. Voluntary contributions to pension or profit sharing plans	$	________	4860
C. Other (describe below)	$	________	4870
Total (sum of Lines 1-3):	$	________	4880

4. Description of Other

____

____

____

STATEMENT OF CHANGES IN OWNERSHIP EQUITY
(SOLE PROPRIETORSHIP, PARTNERSHIP OR CORPORATION)

Item				Amount	Code
1. Balance, beginning of period			$	________	4240
A. Net income (loss)			$	________	4250
B. Additions (includes non-conforming capital of	$ ________	4262)	$	________	4260
C. Deductions (includes non-conforming capital of	$ ________	4272)	$	________	4270
2. Balance, end of period (from Line Item 1800)			$	________	4290

STATEMENT OF CHANGES IN LIABILITIES
SUBORDINATED TO CLAIMS OF CREDITORS

Item		Amount	Code
3. Balance, beginning of period	$	________	4300
A. Increases	$	________	4310
B. Decreases	$	(________)	4320
4. Balance, end of period (from Item 3520)	$	________	4330

Name of Firm: ____________________

As of: ____________________

FOCUS Report FORM SBS Part 1	FINANCIAL AND OPERATIONAL DATA
	Items on this page to be reported by a: Stand-Alone SBSD Broker-Dealer SBSD Broker-Dealer MSBSP

	Valuation	Number
1. Month end total number of stock record breaks		
A. Breaks long unresolved for more than three business days	$ ______ [4890]	______ [4900]
B. Breaks short unresolved for more than seven business days after discovery	$ ______ [4910]	______ [4920]
2. Is the firm in compliance with Rule 17a-13 or 18a-9, as applicable, regarding periodic count and verification of securities positions and locations at least once in each calendar quarter? (Check one)	Yes ☐ [4930]	No ☐ [4940]
3. Personnel employed at end of reporting period		
A. Income producing personnel		______ [4950]
B. Non-income producing personnel (all other)		______ [4960]
C. Total (sum of Lines 3A-3B)		______ [4970]
4. Actual number of tickets executed during the reporting period		______ [4980]
5. Number of corrected customer confirmations mailed after settlement date		______ [4990]

	No. of Items	Ledger Amount	Market Value
6. Failed to deliver 5 business days or longer (21 business days or longer in the case of municipal securities)	______ [5360]	$ ______ [5361]	$ ______ [5362]
7. Failed to receive 5 business days or longer (21 business days or longer in the case of municipal securities)	______ [5363]	$ ______ [5364]	$ ______ [5365]
8. Security (including security-based swap) concentrations			
A. Proprietary positions for which there is an undue concentration			$ ______ [5370]
B. Customers' and security-based swap customers' accounts under Rules 15c3-3 or 18a-4, as applicable			$ ______ [5374]
9. Total of personal capital borrowings due within six months			$ ______ [5378]
10. Maximum haircuts on underwriting commitments during the reporting period			$ ______ [5380]
11. Planned capital expenditures for business expansion during next six months			$ ______ [5382]
12. Liabilities of other individuals or organizations guaranteed by respondent			$ ______ [5384]
13. Lease and rentals payable within one year			$ ______ [5386]
14. Aggregate lease and rental commitments payable for entire term of the lease			
A. Gross			$ ______ [5388]
B. Net			$ ______ [5390]

Name of Firm: ______________________

As of: ______________________

FOCUS Report FORM SBS Part 1	FINANCIAL AND OPERATIONAL DATA
	Items on this page to be reported by a: Stand-Alone SBSD Broker-Dealer SBSD Broker-Dealer MSBSP

Operational Deductions from Capital – Note A

		I No. of Items		II Debits (Short Value) (Omit 000's)		III Credits (Long Value) (Omit 000's)		IV Deductions in Computing Net Capital (Omit Pennies)	
1. Money suspense and balancing differences		____	5610	$____	5810	$____	6010	$____	6012
2. Security suspense and differences with related money balances	L	____	5620	$____	5820	$____	6020	$____	6022
	S	____	5625	$____	5825	$____	6025	$____	6027
3. Market value of short and long security suspense and differences without related money balances (other than reported in Line 4, below)		____	5630	$____	5830	$____	6030	$____	6032
4. Market value of security record breaks		____	5640	$____	5840	$____	6040	$____	6042
5. Unresolved reconciling differences with others									
A. Correspondents, SBSDs, and MSBSPs	L	____	5650	$____	5850	$____	6050	$____	6052
	S	____	5655	$____	5855	$____	6055	$____	6057
B. Depositories		____	5660	$____	5860	$____	6060	$____	6062
C. Clearing organizations	L	____	5670	$____	5870	$____	6070	$____	6072
	S	____	5675	$____	5875	$____	6075	$____	6077
D. Inter-company accounts		____	5680	$____	5880	$____	6080	$____	6082
E. Bank accounts and loans		____	5690	$____	5890	$____	6090	$____	6092
F. Other		____	5700	$____	5900	$____	6100	$____	6102
G. (Offsetting) Lines 5A through 5F		____	5720	$(____)	5920	$(____)	6120		
TOTAL (Lines 5A-5G)		____	5730	$____	5930	$____	6130	$____	6132
6. Commodity differences		____	5740	$____	5940	$____	6140	$____	6142
7. Open transfers and reorganization account items over 40 days not confirmed or verified		____	5760	$____	5960	$____	6160	$____	6162
8. TOTAL (Lines 1-7)		____	5770	$____	5970	$____	6170	$____	6172
9. Lines 1-6 resolved subsequent to report date		____	5775	$____	5975	$____	6175	$____	6177
10. Aged fails – to deliver		____	5780	$____	5980	$____	6180	$____	6182
– to receive		____	5785	$____	5985	$____	6185	$____	6187

NOTE A - This section must be completed as follows:

1. The filers must complete Column IV, Lines 1 through 8 and 10, reporting deductions from capital as of the report date whether resolved subsequently or not (see instructions relative to each line item).
2. Columns I, II and III of Lines 1 through 8 must be completed only if the total deduction on Column IV of Line 8 equals or exceeds 25% of excess net capital as of the prior month end reporting date. All columns of Line 10 require completion.
3. A response to Columns I through IV of Line 9 and the "Potential Operational Charges Not Deducted From Capital-Note B" schedule are required only if:
   A. The parameters cited in Note A-2 exist, and
   B. The total deduction, Line 8, Column IV, for the current month exceeds the total deductions for the prior month by 50% or more.
4. All columns and Lines 1 through 10 must be answered if required. If respondent has nothing to report, enter "0."

Other Operational Data (Items 1, 2 and 3 below require an answer)

Item 1. Have the accounts enumerated on Lines 5A through 5F above been reconciled with statements received from others within 35 days for Lines 5A through 5D and 65 days for Lines 5E and 5F prior to the report date and have all reconciling differences been appropriately comprehended in the computation of net capital at the report date? If this has not been done in all respects, answer No.
Yes ____ 5600
No ____ 5601

Item 2. Do the respondent's books reflect a concentrated position in commodities? If yes, report the totals ($000 omitted) in accordance with the specific instructions. If No, answer "0" for:

A. Firm trading and investment accounts $ ____ 5602

B. Customers' and non-customers' and other accounts $ ____ 5603

Item 3. Does respondent have any planned operational changes? (Answer Yes or No based on specific instructions.)
Yes ____ 5604
No ____ 5605

Name of Firm: ____________________

As of: ____________________

FOCUS Report FORM SBS Part 1	FINANCIAL AND OPERATIONAL DATA
	Items on this page to be reported by a: Stand-Alone SBSD Broker-Dealer SBSD Broker-Dealer MSBSP

Potential Operational Charges Not Deducted from Capital – Note B

	I No. of Items	II Debits (Short Value) (Report in Thousands)	III Credits (Long Value) (Report in Thousands)	IV Deductions in Computing Net Capital (Omit Pennies)
1. Money suspense and balancing differences	______ [6210]	$______ [6410]	$______ [6610]	$______ [6612]
2. Security suspense and differences with related money balances	L______ [6220]	$______ [6420]	$______ [6620]	$______ [6622]
	S______ [6225]	$______ [6425]	$______ [6625]	$______ [6627]
3. Market value of short and long security suspense and differences without related money (other than reported in Line 4, below)	______ [6230]	$______ [6430]	$______ [6630]	$______ [6632]
4. Market value of security record breaks	______ [6240]	$______ [6440]	$______ [6640]	$______ [6642]
5. Unresolved reconciling differences with others				
A. Correspondents, SBSDs, and MSBSPs	L______ [6250]	$______ [6450]	$______ [6650]	$______ [6652]
	S______ [6255]	$______ [6455]	$______ [6655]	$______ [6657]
B. Depositories	______ [6260]	$______ [6460]	$______ [6660]	$______ [6662]
C. Clearing organizations	L______ [6270]	$______ [6470]	$______ [6670]	$______ [6672]
	S______ [6275]	$______ [6475]	$______ [6675]	$______ [6677]
D. Inter-company accounts	______ [6280]	$______ [6480]	$______ [6680]	$______ [6682]
E. Bank accounts and loans	______ [6290]	$______ [6490]	$______ [6690]	$______ [6692]
F. Other	______ [6300]	$______ [6500]	$______ [6700]	$______ [6702]
G. (Offsetting) Lines 5A through 5F	______ [6310]	$(______) [6510]	$(______) [6710]	
TOTAL (Lines 5A-5G)	______ [6330]	$______ [6530]	$______ [6730]	$______ [6732]
6. Commodity differences	______ [6340]	$______ [6540]	$______ [6740]	$______ [6742]
7. TOTAL (Lines 1-6)	______ [6370]	$______ [6570]	$______ [6770]	$______ [6772]

NOTE B - This section must be completed as follows:

1. Lines 1 through 6 and Columns I through IV must be completed only if:
   A. The total deductions on Line 8, Column IV, of the "Operational Deductions From Capital-Note A" schedule equal or exceed 25% of excess net capital as of the prior month end reporting date; and
   B. The total deduction on Line 8, Column IV, , of the "Operational Deductions From Capital-Note A" schedule for the current month exceeds the total deductions for the prior month by 50% or more. If respondent has nothing to report, enter "0."
2. Include only suspense and difference items open at the report date which were NOT required to be deducted in the computation of net capital AND which were not resolved seven (7) business days subsequent to the report date.
3. Include in Column IV only additional deductions not comprehended in the computation of net capital at the report date.
4. Include on Lines 5A through 5F unfavorable differences offset by favorable differences at the report date if resolution of the favorable items resulted in additional deductions in the computation of net capital subsequent to the report date.
5. Exclude from Lines 5A through 5F new reconciling differences disclosed as a result of reconciling with the books of account statements received subsequent to the report date.
6. Lines 1 through 5 above correspond to similar lines in the "Operational Deductions From Capita-Note A" schedule and the same instructions should be followed except as stated in Notes B-1 through B-5 above.

Name of Firm: ______________________

As of: ______________________

FOCUS Report FORM SBS Part 1	COMPUTATION FOR DETERMINATION OF RESERVE REQUIREMENTS (See Rule 15c3-3, Exhibit A and Related Notes)
	Items on this page to be reported by a: Broker-Dealer SBSD (if subject to Rule 15c3-3) Broker-Dealer MSBSP (if subject to Rule 15c3-3)

CREDIT BALANCES

1. Free credit balances and other credit balances in customers' security accounts (see Note A) .... $ ________ [4340]
2. Monies borrowed collateralized by securities carried for the accounts of customers (see Note B) .... $ ________ [4350]
3. Monies payable against customers' securities loaned (see Note C) .... $ ________ [4360]
4. Customers' securities failed to receive (see Note D) .... $ ________ [4370]
5. Credit balances in firm accounts which are attributable to principal sales to customers .... $ ________ [4380]
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days .... $ ________ [4390]
7. **Market value of short security count differences over 30 calendar days old .... $ ________ [4400]
8. **Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days .... $ ________ [4410]
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days .... $ ________ [4420]
10. Other (List: ________________) .... $ ________ [4425]
11. TOTAL CREDITS (sum of Lines 1-10) .... $ ________ [4430]

DEBIT BALANCES

12. **Debit balances in customers' cash and margin accounts, excluding unsecured accounts and accounts doubtful of collection (see Note E) .... $ ________ [4440]
13. Securities borrowed to effectuate short sales by customers and securities borrowed to make delivery on customers' securities failed to deliver .... $ ________ [4450]
14. Failed to deliver of customers' securities not older than 30 calendar days .... $ ________ [4460]
15. Margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in customer accounts (see Note F) .... $ ________ [4465]
16. Margin required and on deposit with a clearing agency registered with the Commission under section 17A of the Exchange Act (15 U.S.C. 78q-1) or a derivatives clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) related to the following types of positions written, purchased or sold in customer accounts: (1) security futures products and (2) futures contracts (and options thereon) carried in a securities account pursuant to an SRO portfolio margining rule (see Note G) .... $ ________ [4467]
17. Other (List: ________________) .... $ ________ [4469]
18. **Aggregate debit items (sum of Lines 12-17) .... $ ________ [4470]
19. **Less 3% (for alternative method only – see Rule 15c3-1(a)(1)(ii)) (3% x Line Item 4470) .... $ ________ [4471]
20. **TOTAL 15c3-3 DEBITS (Line 18 less Line 19) .... $ ________ [4472]

RESERVE COMPUTATION

21. Excess of total debits over total credits (Line 20 less Line 11) .... $ ________ [4480]
22. Excess of total credits over total debits (Line 11 less Line 20) .... $ ________ [4490]
23. If computation is made monthly as permitted, enter 105% of excess of total credits over total debits .... $ ________ [4500]
24. Amount held on deposit in "Reserve Bank Account(s)," including $ ________ [4505] value of qualified securities, at end of reporting period .... $ ________ [4510]
25. Amount of deposit (or withdrawal) including $ ________ [4515] value of qualified securities .... $ ________ [4520]
26. New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including $ ________ [4525] value of qualified securities .... $ ________ [4530]
27. Date of deposit (MM/DD/YY) .... $ ________ [4540]

FREQUENCY OF COMPUTATION

28. Daily ________ [4332] Weekly ________ [4333] Monthly ________ [4334]

** In the event the net capital requirement is computed under the alternative method, this reserve formula must be prepared in accordance with the requirements of paragraph (a)(1)(ii) of Rule 15c3-1.

Name of Firm: ________________

As of: ________________

INFORMATION FOR POSSESSION OR CONTROL REQUIREMENTS UNDER RULE 15c3-3

Items on this page to be reported by a: Broker-Dealer SBSD (if subject to Rule 15c3-3)
Broker-Dealer MSBSP (if subject to Rule 15c3-3)

State the market valuation and number of items of:

1. Customers' fully paid securities and excess margin securities not in the respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frames specified under Rule 15c3-3. Notes A and B .... $ __________ [4586]

   A. Number of items .... __________ [4587]

2. Customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of the report date, excluding items arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3. Notes B, C and D .... $ __________ [4588]

   A. Number of items .... __________ [4589]

3. The system and procedures utilized in complying with the requirement to maintain physical possession or control of customers' fully paid and excess margin securities have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 15c3-3 .... Yes __________ [4584] No __________ [4585]

Notes:

A – Do not include in Line 1 customers' fully paid and excess margin securities required by Rule 15c3-3, to be in possession or control but for which no action was required by the respondent as of the report date or required action was taken by respondent within the time frames specified under Rule 15c3-3.

B – State separately in response to Lines 1 and 2 whether the securities reported in response thereto were subsequently reduced to possession or control by the respondent.

C – Be sure to include in Line 2 only items not arising from "temporary lags which result from normal business operations" as permitted under Rule 15c3-3.

D – Line 2 must be responded to only with a report which is filed as of the date selected for the broker's or dealer's annual audit of financial statements, whether or not such date is the end of a calendar quarter. The response to Line 2 should be filed within 60 calendar days after such date, rather than with the remainder of this report. This information may be required on a more frequent basis by the Commission or the designated examining authority in accordance with Rule 17a-5(a)(2)(iv).

Name of Firm: ______________________________

As of: ______________________________

FOCUS Report FORM SBS Part 1	COMPUTATION FOR DETERMINATION OF PAB REQUIREMENTS
	Items on this page to be reported by a: Broker-Dealer SBSD (if subject to Rule 15c3-3) Broker-Dealer MSBSP (if subject to Rule 15c3-3)

CREDIT BALANCES

1. Free credit balances and other credit balances in PAB security accounts (see Note A) .... $ ____________________ [2110]
2. Monies borrowed collateralized by securities carried for the accounts of PAB (see Note B).................... $ ____________________ [2120]
3. Monies payable against PAB securities loaned (see Note C) .... $ ____________________ [2130]
4. PAB securities failed to receive (see Note D) .... $ ____________________ [2140]
5. Credit balances in firm accounts which are attributable to principal sales to PAB.................................... $ ____________________ [2150]
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days.. $ ____________________ [2152]
7. **Market value of short security count differences over 30 calendar days old.. $ ____________________ [2154]
8. **Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days .... $ ____________________ [2156]
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days .... $ ____________________ [2158]
10. Other (List: ____) .... $ ____________________ [2160]
11. TOTAL PAB CREDITS (sum of Lines 1-10)... $ ______________________ [2170]

DEBIT BALANCES

12. Debit balances in PAB cash and margin accounts, excluding unsecured accounts and accounts doubtful of collection (see Note E).. $ ____________________ [2180]
13. Securities borrowed to effectuate short sales by PAB and securities borrowed to make delivery on PAB securities failed to deliver... $ ____________________ [2190]
14. Failed to deliver of PAB securities not older than 30 calendar days .... $ ____________________ [2200]
15. Margin required and on deposit with Options Clearing Corporation for all option contracts written or purchased in PAB accounts (see Note F).. $ ____________________ [2210]
16. Margin required and on deposit with a clearing agency registered with the Commission under section 17A of the Exchange Act (15 U.S.C. 78q-1) or a derivatives clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) related to the following types of positions written, purchased or sold in PAB accounts: (1) security futures products and (2) futures contracts (and options thereon) carried in a securities account pursuant to an SRO portfolio margining rule (see Note G) .... $ ____________________ [2215]
17. Other (List: ____)........................ $ ____________________ [2220]
18. TOTAL PAB DEBITS (sum of Lines 12-17)... $ ______________________ [2230]

RESERVE COMPUTATION

19. Excess of total PAB debits over total PAB credits (Line 18 less Line 11) .... $ ______________________ [2240]
20. Excess of total PAB credits over total PAB debits (Line 11 less Line 18) .... $ ______________________ [2250]
21. Excess debits in customer reserve formula computation .... $ ______________________ [2260]
22. PAB reserve requirement (Line 20 less Line 21) .... $ ______________________ [2270]
23. Amount held on deposit in Reserve Bank Account(s) including $ ____________ [2275] value of qualified securities, at end of reporting period .... $ ______________________ [2280]
24. Amount of deposit (or withdrawal) including $ ____________ [2285] value of qualified securities .... $ ______________________ [2290]
25. New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including $ ____________ [2295] value of qualified securities... $ ______________________ [2300]
26. Date of deposit (MM/DD/YY).. ______________________ [2310]

FREQUENCY OF COMPUTATION

27. Daily ___________________ [2315] Weekly ___________________ [2320] Monthly ___________________ [2330]

* See notes regarding PAB Reserve Bank Account Computation (Notes 1-10).

** In the event the net capital requirement is computed under the alternative method, this reserve formula must be prepared in accordance with the requirements of paragraph (a)(1)(ii) of Rule 15c3-1.

Name of Firm: ___________________________________

As of: ____

EXEMPTIVE PROVISION UNDER RULE 15c3-3

If an exemption from Rule 15c3-3 is claimed, identify below the section upon which such exemption is based (check one only):

A. (k)(1) – $2,500 capital category as per Rule 15c3-3 .... ____ 4550

B. (k)(2)(A) – "Special Account for the Exclusive Benefit of Customers" maintained .... ____ 4560

C. (k)(2)(B) – All customer transactions cleared through another broker-dealer on a fully disclosed basis

Name of clearing firm: ____ 4335 ____ 4570

D. (k)(3) – Exempted by order of the Commission (include copy of letter) .... ____ 4580

Name of Firm: ____

As of: ____

FOCUS Report FORM SBS Part 1	COMPUTATION FOR DETERMINATION OF THE AMOUNT TO BE MAINTAINED IN THE SPECIAL ACCOUNT FOR THE EXCLUSIVE BENEFIT OF SECURITY-BASED SWAP CUSTOMERS – RULE 18a-4, APPENDIX A
	Items on this page to be reported by a: Stand-Alone SBSD Broker-Dealer SBSD

CREDIT BALANCES

1. Free credit balances and other credit balances in the accounts carried for security-based swap customers .... $ ____________ 9999
2. Monies borrowed collateralized by securities in accounts carried for security-based swap customers (see Note B)........ $ ____________ 9999
3. Monies payable against security-based swap customers' securities loaned (see Note C) .... $ ____________ 9999
4. Security-based swap customers' securities failed to receive (see Note D) .... $ ____________ 9999
5. Credit balances in firm accounts attributable to principal sales to security-based swap customers .... $ ____________ 9999
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days .... $ ____________ 9999
7. **Market value of short security count differences over 30 calendar days old........ $ ____________ 9999
8. **Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days........ $ ____________ 9999
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days .... $ ____________ 9999
10. Other (List: ____________________________) .... $ ____________ 9999
11. TOTAL CREDITS (sum of Lines 1-10) .... $ ____________ 9999

DEBIT BALANCES

12. Debit balances in accounts carried for security-based swap customers, excluding unsecured accounts and accounts doubtful of collection (see Note E)........ $ ____________ 9999
13. Securities borrowed to effectuate short sales by security-based swap customers and securities borrowed to make delivery on security-based swap customers' securities failed to deliver .... $ ____________ 9999
14. Failed to deliver of security-based swap customers' securities not older than 30 calendar days .... $ ____________ 9999
15. Margin required and on deposit with Options Clearing Corporation for all option contracts written or purchased in accounts carried for security-based swap customers (see Note F) .... $ ____________ 9999
16. Margin related to security future products written, purchased or sold in accounts carried for security-based swap customers required and on deposit in a qualified clearing agency account at a clearing agency registered with the Commission under section 17A of the Exchange Act (15 U.S.C. 78q-1) or a derivative clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) (see Note G) .... $ ____________ 9999
17. Margin related to cleared security-based swap transactions in accounts carried for security-based swap customers required and on deposit in a qualified clearing agency account at a clearing agency registered with the Commission pursuant to section 17A of the Exchange Act (15 U.S.C. 78q-1) .... $ ____________ 9999
18. Margin related to non-cleared security-based swap transactions in accounts carried for security-based swap customers required and held in a qualified registered security-based swap dealer account at another security-based swap dealer........ $ ____________ 9999
19. Other (List: ____________________________)........ $ ____________ 9999
20. **Aggregate debit items .... $ ____________ 9999
21. **TOTAL 18a-4a DEBITS (sum of Lines 12-19) .... $ ____________ 9999

RESERVE COMPUTATION

22. Excess of total debits over total credits (Line 21 less Line 11)........ $ ____________ 9999
23. Excess of total credits over total debits (Line 11 less Line 21)........ $ ____________ 9999
24. Amount held on deposit in "Reserve Bank Account(s)," including value of qualified securities, at end of reporting period .... $ ____________ 9999
25. Amount of deposit (or withdrawal) including $ __________ 9999 value of qualified securities .... $ ____________ 9999
26. New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including $ __________ 9999 value of qualified securities .... $ ____________ 9999
27. Date of deposit (MM/DD/YY)........ $ ____________ 9999

** In the event the net capital requirement is computed under the alternative method, this reserve formula must be prepared in accordance with the requirements of paragraph (a)(1)(ii) of Rule 15c3-1.

Name of Firm: ____________________

As of: ____________________

FOCUS Report FORM SBS Part 1	INFORMATION FOR POSSESSION OR CONTROL REQUIREMENTS UNDER RULE 18a-4
	Items on this page to be reported by a: Stand-Alone SBSD Broker-Dealer SBSD

State the market valuation and number of items of:

1. Security-based swap customers' excess securities collateral not in the respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frame specified under Rule 18a-4. Notes A and B .... $ ____________ [9999]
   A. Number of items.......... ____________ [9999]
2. Security-based swap customers' excess securities collateral for which instructions to reduce possession or control had not been issued as of the report date under Rule 18a-4. .... $ ____________ [9999]
   A. Number of items.......... ____________ [9999]
3. The system and procedures utilized in complying with the requirement to maintain physical possession or control of security-based swap customers' excess securities collateral have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 18a-4 .... Yes ____________ [9999] No ____________ [9999]

Notes:

A – Do not include in Line 1 security-based swap customers' excess securities collateral required by Rule 18a-4, to be in possession or control but for which no action was required by the respondent as of the report date or required action was taken by respondent within the time frames specified under Rule 18a-4.

B – State separately in response to Line 1 whether the securities reported in response thereto were subsequently reduced to possession or control by the respondent.

Name of Firm: ______________________

As of: ______________________

FOCUS Report FORM SBS Part 2	BALANCE SHEET (INFORMATION AS REPORTED ON FFIEC FORM 031 – SCHEDULE RC)
	Items on this page to be reported by a: Bank SBSD Bank MSBSP

Assets	Totals	
1. Cash and balances due from depository institutions (from FFIEC Form 031's Schedule RC-A)		
A. Noninterest-bearing balances and currency and coin	$ ________	0081b
B. Interest-bearing balances	$ ________	0071b
2. Securities		
A. Held-to-maturity securities	$ ________	1754b
B. Available-for-sale securities	$ ________	1773b
3. Federal funds sold and securities purchased under agreements to resell		
A. Federal funds sold in domestic offices	$ ________	B987b
B. Securities purchased under agreements to resell	$ ________	B989b
4. Loans and lease financing receivables (from FFIEC Form 031's Schedule RC-C)		
A. Loans and leases held for sale	$ ________	5369b
B. Loans and leases, net of unearned income	$ ________	B528b
C. LESS: Allowance for loan and lease losses	$ ________	3123b
D. Loans and leases, net of unearned income and allowance (Line 4B minus Line 4C)	$ ________	B529b
5. Trading assets (from FFIEC Form 031's Schedule RC-D)	$ ________	3545b
6. Premises and fixed assets (including capitalized leases)	$ ________	2145b
7. Other real estate owned (from FFIEC Form 031's Schedule RC-M)	$ ________	2150b
8. Investment in unconsolidated subsidiaries and associated companies	$ ________	2130b
9. Direct and indirect investments in real estate ventures	$ ________	3656b
10. Intangible assets		
A. Goodwill	$ ________	3163b
B. Other intangible assets (from FFIEC Form 031's Schedule RC-M)	$ ________	0426b
11. Other assets (from FFIEC Form 031's Schedule RC-F)	$ ________	2160b
12. Total assets (sum of Lines 1 through 11)	$ ________	2170b

Name of Firm: ______________________

As of: ______________________

BALANCE SHEET (INFORMATION AS REPORTED ON FFIEC FORM 031 – SCHEDULE RC)

Items on this page to be reported by a: Bank SBSD
Bank MSBSP

Liabilities	**Totals**	
13. Deposits		
A. In domestic offices (sum of totals of Columns A and C from FFIEC Form 031's Schedule RC-E, part I)	$ ________	2200b
1. Noninterest-bearing	$ ________	6631b
2. Interest-bearing	$ ________	6636b
B. In foreign offices, Edge and Agreement subsidiaries, and IBFs (from FFIEC Form 031's Schedule RC-E, part II)	$ ________	2200b
1. Noninterest-bearing	$ ________	6631b
2. Interest-bearing	$ ________	6636b
14. Federal funds purchased and securities sold under agreements to repurchase		
A. Federal funds purchased in domestic offices	$ ________	B993b
B. Securities sold under agreements to repurchase	$ ________	B995b
15. Trading liabilities	$ ________	3548b
16. Other borrowed money (includes mortgage indebtedness and obligations under capitalized leases) (from FFIEC Form 031's Schedule RC-M)	$ ________	3190b
17. Not applicable.		
18. Not applicable.		
19. Subordinated notes and debentures	$ ________	3200b
20. Other liabilities (from FFIEC Form 031's Schedule RC-G)	$ ________	2930b
21. Total liabilities (sum of Lines 13 through 20)	$ ________	2948b
22. Not applicable.		
Equity Capital		
23. Perpetual preferred stock and related surplus	$ ________	3828b
24. Common stock	$ ________	3230b
25. Surplus (exclude all surplus related to preferred stock)	$ ________	3839b
26A. Retained earnings	$ ________	3632b
B. Accumulated other comprehensive income	$ ________	B530b
C. Other equity capital components	$ ________	A130b
27A. Total bank equity capital (sum of Lines 23 through 26.C)	$ ________	3210b
B. Non-controlling (minority) interests in consolidated subsidiaries	$ ________	3000b
28. Total equity capital (sum of Lines 27A and 27B)	$ ________	G105b
29. Total liabilities and equity capital (sum of Lines 21 and 28)	$ ________	3300b

Name of Firm: ______________________

As of: ______________________

FOCUS Report FORM SBS Part 2	REGULATORY CAPITAL (INFORMATION AS REPORTED ON FFIEC FORM 031 – SCHEDULE RC-R)
	Items on this page to be reported by a: Bank SBSD Bank MSBSP

Capital	Totals	
1. Total bank equity capital (from FFIEC Form 031's Schedule RC, Line 27A)	$ ________	3210b
2. Tier 1 capital	$ ________	8274b
3. Tier 2 capital	$ ________	5311b
4. Tier 3 capital allocated for market risk	$ ________	1395b
5. Total risk-based capital	$ ________	3792b
6. Total risk-weighted assets	$ ________	A223b
7. Total assets for leverage capital purposes	$ ________	L138b

Capital Ratios (Column B is to be completed by all banks. Column A is to be completed by banks with financial subsidiaries.)	Column A		Column B	
8. Tier 1 Leverage ratio	$ ________	7273b	$ ________	7204b
9. Tier 1 risk-based capital ratio	________	7274b	$ ________	7206b
10. Total risk-based capital ratio	________	7275b	$ ________	7205b

Name of Firm: ____________________

As of: ____________________

INCOME STATEMENT (INFORMATION AS REPORTED ON FFIEC FORM 031 – SCHEDULE RI)

Items on this page to be reported by a: Bank SBSD
Bank MSBSP

	Totals	
1. Total interest income	$ ________	4107b
2. Total interest expense	$ ________	4073b
3. Total noninterest income	$ ________	4079b
4. Total noninterest expense	$ ________	4093b
5. Realized gains (losses) on held-to-maturity securities	$ ________	3521b
6. Realized gains (losses) on available-for-sale securities	$ ________	3196b
7. Income (loss) before income taxes and extraordinary items and other adjustments	$ ________	4301b
8. Net income (loss) attributable to bank	$ ________	4340b
9. Trading revenue (from cash instruments and derivative instruments) (sum of Memoranda Lines 8a through 8e on FFIEC Form 031's Schedule RI)		
A. Interest rate exposures	$ ________	8757b
B. Foreign exchange exposures	$ ________	8758b
C. Equity security and index exposures	$ ________	8759b
D. Commodity and other exposures	$ ________	8760b
E. Credit exposures	$ ________	F186b
Lines 9F and 9G are to be completed by banks with $100 billion or more in total assets that are required to complete lines 9A through 9E above.		
F. Impact on trading revenue of changes in the creditworthiness of the bank's derivative counterparties on the bank's derivative assets) (included on Lines 8a through 8e on FFIEC Form 031's Schedule RI)	$ ________	K090b
G. Impact on trading revenue of changes in the creditworthiness of the bank on the bank's derivative liabilities (included in Lines 8a through 8e on FFIEC Form 031's Schedule RI)	$ ________	K094b
10. Net gains (losses) recognized in earnings on credit derivatives that economically hedge credit exposures held outside the trading account		
A. Net gains (losses) on credit derivatives held for trading	$ ________	C889b
B. Net gains (losses) on credit derivatives held for purposes other than trading	$ ________	C890b
11. Credit losses on derivatives	$ ________	A251b

Name of Firm: ______________________

As of: ______________________

FOCUS Report FORM SBS Part 2	COMPUTATION FOR DETERMINATION OF THE AMOUNT TO BE MAINTAINED IN THE SPECIAL ACCOUNT FOR THE EXCLUSIVE BENEFIT OF SECURITY-BASED SWAP CUSTOMERS – RULE 18a-4, APPENDIX A
	Items on this page to be reported by a: Bank SBSD

CREDIT BALANCES

1. Free credit balances and other credit balances in the accounts carried for security-based swap customers	$ ______	9999		
2. Monies borrowed collateralized by securities in accounts carried for security-based swap customers (see Note B)	$ ______	9999		
3. Monies payable against security-based swap customers' securities loaned (see Note C)	$ ______	9999		
4. Security-based swap customers' securities failed to receive (see Note D)	$ ______	9999		
5. Credit balances in firm accounts attributable to principal sales to security-based swap customers	$ ______	9999		
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days	$ ______	9999		
7. Market value of short security count differences over 30 calendar days old	$ ______	9999		
8. Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days	$ ______	9999		
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days	$ ______	9999		
10. Other (List: ______)	$ ______	9999		
11. TOTAL CREDITS			$ ______	9999

DEBIT BALANCES

12. Debit balances in accounts carried for security-based swap customers, excluding unsecured accounts and accounts doubtful of collection (see Note E)	$ ______	9999		
13. Securities borrowed to effectuate short sales by security-based swap customers and securities borrowed to make delivery on security-based swap customers' securities failed to deliver	$ ______	9999		
14. Failed to deliver of security-based swap customers' securities not older than 30 calendar days	$ ______	9999		
15. Margin required and on deposit with Options Clearing Corporation for all option contracts written or purchased in accounts carried for security-based swap customers (see Note F)	$ ______	9999		
16. Margin related to security future products written, purchased or sold in accounts carried for security-based swap customers required and on deposit in a qualified clearing agency account at a clearing agency registered with the Commission under section 17A of the Exchange Act (15 U.S.C. 78q-1) or a derivative clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) (see Note G)	$ ______	9999		
17. Margin related to cleared security-based swap transactions in accounts carried for security-based swap customers required and on deposit in a qualified clearing agency account at a clearing agency registered with the Commission pursuant to section 17A of the Exchange Act (15 U.S.C. 78q-1)	$ ______	9999		
18. Margin related to non-cleared security-based swap transactions in accounts carried for security-based swap customers required and held in a qualified registered security-based swap dealer account at another security-based swap dealer	$ ______	9999		
19. Other (List: ______)	$ ______	9999		
20. TOTAL 18a-4a DEBITS			$ ______	9999

RESERVE COMPUTATION

21. Excess of total debits over total credits (Line 21 less Line 11)	$ ______	9999
22. Excess of total credits over total debits (Line 11 less Line 21)	$ ______	9999
23. Amount held on deposit in "Reserve Bank Account(s)," including value of qualified securities, at end of reporting period	$ ______	9999
24. Amount of deposit (or withdrawal) including $ ______ 9999 value of qualified securities	$ ______	9999
25. New amount in Reserve Bank Account(s) after adding deposit or subtracting withdrawal including $ ______ 9999 value of qualified securities	$ ______	9999
27. Date of deposit (MM/DD/YY)	$ ______	9999

Name of Firm: ______

As of: ______

FOCUS Report FORM SBS Part 2	INFORMATION FOR POSSESSION OR CONTROL REQUIREMENTS UNDER RULE 18a-4
	Items on this page to be reported by a: Bank SBSD

State the market valuation and number of items of:

1. Security-based swap customers' excess securities collateral not in the respondent's possession or control as of the report date (for which instructions to reduce to possession or control had been issued as of the report date) but for which the required action was not taken by respondent within the time frame specified under Rule 18a-4. Notes A and B .... $ ____________ 9999

   A. Number of items .... ____________ 9999

2. Security-based swap customers' excess securities collateral for which instructions to reduce possession or control had not been issued as of the report date under Rule 18a-4. .... $ ____________ 9999

   A. Number of items .... ____________ 9999

3. The system and procedures utilized in complying with the requirement to maintain physical possession or control of security-based swap customers' excess securities collateral have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 18a-4 .... Yes ____________ 9999 No ____________ 9999

Notes:

A – Do not include in Line 1 security-based swap customers' excess securities collateral required by Rule 18a-4, to be in possession or control but for which no action was required by the respondent as of the report date or required action was taken by respondent within the time frames specified under Rule 18a-4.

B – State separately in response to Line 1 whether the securities reported in response thereto were subsequently reduced to possession or control by the respondent.

Name of Firm: ______________________________

As of: ______________________________

COMPUTATION OF CFTC MINIMUM CAPITAL REQUIREMENTS

Items on this page to be reported by: A Futures Commission Merchant

NET CAPITAL REQUIRED

A. Risk-based requirement

i. Amount of customer risk

Maintenance margin .... $ ________ [7415]

ii. Enter 8% of Line A.i........ $ ________ [7425]

iii. Amount of non-customer risk

Maintenance margin .... $ ________ [7435]

iv. Enter 8% of Line A.iii .... $ ________ [7445]

v. Enter the sum of Lines A.ii and A.iv........ $ ________ [7455]

B. Minimum dollar amount requirement .... $ ________ [7465]

C. Other NFA requirement........ $ ________ [7475]

D. Minimum CFTC net capital requirement

Enter the greatest of Lines A.v, B, or C .... $ ________ [7490]

Note: If amount on Line D is greater than the minimum net capital requirement computed on Item 3760, then enter this greater amount on Item 3760. The greater of the amount required by the SEC or CFTC is the minimum net capital requirement.

CFTC early warning level – enter the greatest of 110% of Line A.v. or 150% of Line B or 150% of Line C or $375,000 .... $ ________ [7495]

Name of Firm: ________

As of: ________

FOCUS Report FORM SBS Part 3	STATEMENT OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION FOR CUSTOMERS TRADING ON U.S. COMMODITY EXCHANGES
	Items on this page to be reported by a: A Futures Commission Merchant

SEGREGATION REQUIREMENTS

1. Net ledger balance				
A. Cash			$ ______	7010
B. Securities (at market)			$ ______	7020
2. Net unrealized profit (loss) in open futures contracts traded on a contract market			$ ______	7030
3. Exchange traded options				
A. Add: Market value of open option contracts purchased on a contract market			$ ______	7032
B. Deduct: Market value of open option contracts granted (sold) on a contract market			$ (______)	7033
4. Net equity (deficit) (total of Lines 1, 2 and 3)			$ ______	7040
5. Accounts liquidating to a deficit and accounts with debit balances – gross amount	$ ______	7045		
Less: amount offset by customer owned securities	$(______)	7047	$ ______	7050
6. Amount required to be segregated (add Lines 4 and 5)			$ ______	7060

FUNDS IN SEGREGATED ACCOUNTS

7. Deposited in segregated funds bank accounts		
A. Cash	$ ______	7070
B. Securities representing investments of customers' funds (at market)	$ ______	7080
C. Securities held for particular customers or option customers in lieu of cash (at market)	$ ______	7090
8. Margin on deposit with derivative clearing organizations of contract markets		
A. Cash	$ ______	7100
B. Securities representing investments of customers' funds (at market)	$ ______	7110
C. Securities held for particular customers or option customers in lieu of cash (at market)	$ ______	7120
9. Net settlement from (to) derivative clearing organizations of contract markets	$ ______	7130
10. Exchange traded options		
A. Value of open long option contracts	$ ______	7132
B. Value of open short option contracts	$ (______)	7133
11. Net equities with other FCMs		
A. Net liquidating equity	$ ______	7140
B. Securities representing investments of customers' funds (at market)	$ ______	7160
C. Securities held for particular customers or option customers in lieu of cash (at market)	$ ______	7170
12. Segregated funds on hand (describe: ______)	$ ______	7150
13. Total amount in segregation (add Lines 7 through 12)	$ ______	7180
14. Excess (deficiency) funds in segregation (subtract Line 6 from Line 13)	$ ______	7190
15. Management target amount for excess funds in segregation	$ ______	9999
16. Excess (deficiency) funds in segregation over management target amount excess	$ ______	9999

Name of Firm: ______

As of: ______

FOCUS Report FORM SBS Part 3	STATEMENT OF CLEARED SWAPS CUSTOMER SEGREGATION REQUIREMENTS AND FUNDS IN CLEARED SWAPS CUSTOMER ACCOUNTS UNDER SECTION 4D(F) OF THE COMMODITY EXCHANGE ACT
	Items on this page to be Reported by: A Futures Commission Merchant

CLEARED SWAPS CUSTOMER REQUIREMENTS

1. Net ledger balance
   A. Cash .... $ ____ 8500
   B. Securities (at market) .... $ ____ 8510
2. Net unrealized profit (loss) in open cleared swaps .... $ ____ 8520
3. Cleared swaps options
   A. Market value of open cleared swaps option contracts purchased .... $ ____ 8530
   B. Market value of open cleared swaps option contracts granted (sold) .... $ (____) 8540
4. Net equity (deficit) (add Lines 1, 2, and 3) .... $ ____ 8550
5. Accounts liquidating to a deficit and accounts with debit balances – gross amount .... $____ 8560
   Less: amount offset by customer owned securities .... $(____) 8570 $ ____ 8580
6. Amount required to be segregated for cleared swaps customers (add Lines 4 and 5) .... $ ____ 8590

FUNDS IN CLEARED SWAPS CUSTOMER SEGREGATED ACCOUNTS

7. Deposited in cleared swaps customer segregated accounts at banks
   A. Cash .... $ ____ 8600
   B. Securities representing investments of cleared swaps customers' funds (at market) .... $ ____ 8610
   C. Securities held for particular cleared swaps customers in lieu of cash (at market) .... $ ____ 8620
8. Margins on deposit with derivatives clearing organizations in cleared swaps customer segregated accounts
   A. Cash .... $ ____ 8630
   B. Securities representing investments of cleared swaps customers' funds (at market) .... $ ____ 8640
   C. Securities held for particular cleared swaps customers in lieu of cash (at market) .... $ ____ 8650
9. Net settlement from (to) derivatives clearing organizations .... $ ____ 8660
10. Cleared swaps options
   A. Value of open cleared swaps long option contracts .... $ ____ 8670
   B. Value of open cleared swaps short option contracts .... $ (____) 8680
11. Net equities with other FCMs
   A. Net liquidating equity .... $ ____ 8690
   B. Securities representing investments of cleared swaps customers' funds (at market) .... $ ____ 8700
   C. Securities held for particular cleared swaps customers in lieu of cash (at market) .... $ ____ 8710
12. Cleared swaps customer funds on hand (describe: ____).. $ ____ 8715
13. Total amount in cleared swaps customer segregation (add Lines 7 through 12) .... $ ____ 8720
14. Excess (deficiency) funds in cleared swaps customer segregation (subtract Line 6 from Line 13) .... $ ____ 8730
15. Management target amount for excess funds in cleared swaps segregated accounts .... $ ____ 9999
16. Excess (deficiency) funds in cleared swaps customer segregated accounts over (under) management target excess .... $ ____ 9999

Name of Firm: ____
As of: ____

FOCUS Report FORM SBS Part 3	STATEMENT OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION FOR CUSTOMERS' DEALER OPTIONS ACCOUNTS
	Items on this page to be reported by a: A Futures Commission Merchant

Item				
1. Amount required to be segregated in accordance with 17 C.F.R. § 32.6			$ ________	7200
2. Funds/property in segregated accounts				
A Cash	$ ________	7210		
B. Securities (at market value)	$ ________	7220		
C. Total funds/property in segregated accounts			$ ________	7230
3. Excess (deficiency) funds in segregation (subtract Line 2C from Line 1)			$ ________	7240

Name of Firm: ____________________

As of: ____________________

FOCUS Report FORM SBS Part 3	STATEMENT OF SECURED AMOUNTS AND FUNDS HELD IN SEPARATE ACCOUNTS FOR FOREIGN FUTURES AND FOREIGN OPTIONS CUSTOMERS PURSUANT TO CFTC REGULATION 30.7
	Items on this page to be reported by a: A Futures Commission Merchant

FOREIGN FUTURES AND FOREIGN OPTIONS SECURED AMOUNTS

______________________ 9999 Amount required to be set aside pursuant to law, rule, or regulation of a foreign government or a rule of a self-regulatory organization authorized thereunder

1. Net ledger balance – Foreign futures and foreign options trading – All customers				
A. Cash			$ ____________	9999
B. Securities (at market)			$ ____________	9999
2. Net unrealized profit (loss) in open futures contracts traded on a foreign board of trade			$ ____________	9999
3. Exchange traded options			$ ____________	9999
A. Market value of open option contracts purchased on a foreign board of trade			$ ____________	9999
B. Market value of open option contracts granted (sold) on a foreign board of trade			$ ____________	9999
4. Net equity (deficit) (add Lines 1, 2, and 3)			$ ____________	9999
5. Accounts liquidating to a deficit and accounts with debit balances – gross amount	$____________	9999		
Less: Amount offset by customer owned securities	$____________	9999	$ ____________	9999
6. Amount required to be set aside as the secured amount – Net liquidating equity method (add Lines 4 and 5)			$ ____________	9999
7. Greater of amount required to be set aside pursuant to foreign jurisdiction (above) or Line 6			$ ____________	9999

Name of Firm: ______________________________

As of: ______________________________

FOCUS Report FORM SBS Part 3	STATEMENT OF SECURED AMOUNTS AND FUNDS HELD IN SEPARATE ACCOUNTS FOR FOREIGN FUTURES AND FOREIGN OPTIONS CUSTOMERS PURSUANT TO CFTC REGULATION 30.7
	Items on this page to be reported by: A Futures Commission Merchant

FUNDS DEPOSITED IN SEPARATE 17 C.F.R. § 30.7 ACCOUNTS

1. Cash in banks
   A. Banks located in the United States .... $ ______________________ 7500
   B. Other banks qualified under 17 C.F.R. § 30.7
      Name(s): ________________________________ 7510 $ ______________________ 7520 $ ______________________ 7530
2. Securities
   A. In safekeeping with banks located in the United States.................... $ ______________________ 7540
   B. In safekeeping with other banks designated by 17 C.F.R. § 30.7
      Name(s): ________________________________ 7550 $ ______________________ 7560 $ ______________________ 7570
3. Equities with registered futures commission merchants
   A. Cash.. $ ______________________ 7580
   B. Securities .... $ ______________________ 7590
   C. Unrealized gain (loss) on open futures contracts............................. $ ______________________ 7600
   D. Value of long option contracts.. $ ______________________ 7610
   E. Value of short option contracts... $ (______________________) 7615 $ ______________________ 7620
4. Amounts held by clearing organizations of foreign boards of trade
   Name(s): ________________________________ 7630
   A. Cash.. $ ______________________ 7640
   B. Securities .... $ ______________________ 7650
   C. Amount due to (from) clearing organizations - daily variation........... $ ______________________ 7660
   D. Value of long option contracts.. $ ______________________ 7670
   E. Value of short option contracts... $ (______________________) 7675 $ ______________________ 7680
5. Amounts held by members of foreign boards of trade
   Name(s): ________________________________ 7690
   A. Cash.. $ ______________________ 7700
   B. Securities .... $ ______________________ 7710
   C. Unrealized gain (loss) on open futures contracts............................. $ ______________________ 7720
   D. Value of long option contracts.. $ ______________________ 7730
   E. Value of short option contracts... $ (______________________) 7735 $ ______________________ 7740
6. Amounts with other depositories designated by a foreign board of trade
   Name(s): ________________________________ 7750 $ ______________________ 7760
7. Segregated funds on hand (describe: ______________________)... $ ______________________ 7765
8. Total funds in separate 17 C.F.R. § 30.7 accounts (Item 7370).............. $ ______________________ 7770
9. Excess (deficiency) set aside funds for secured amount
   (Line Item 7770 minus Line 7 of immediately preceding page) .... $ ______________________ 9999
10. Management target amount for excess funds in separate
   17 C.F.R. § 30.7 accounts... $ ______________________ 9999
11. Excess (deficiency) funds in separate 17 C.F.R. § 30.7 accounts
   over (under) management target excess .... $ ______________________ 9999

Name of Firm: ________________________________

As of: ________________________________

FOCUS Report FORM SBS Part 4	SCHEDULE 1 – AGGREGATE SECURITIES, COMMODITIES, AND SWAPS POSITIONS
	Items on this page to be Reported by: Stand-Alone SBSD Broker-Dealer SBSD Stand-Alone MSBSP Broker-Dealer MSBSP

Aggregate Securities, Commodities, Swaps Positions	LONG		SHORT	
1. U.S. treasury securities	$ ______	8200	$ ______	8201
2. U.S. government agency and U.S. government-sponsored enterprises	$ ______	8210	$ ______	8211
A. Mortgage-backed securities issued by U.S. government agency and U.S. government-sponsored enterprises	$ ______	9999	$ ______	9999
B. Debt securities issued by U.S. government agency and U.S. government-sponsored enterprises	$ ______	9999	$ ______	9999
3. Securities issued by states and political subdivisions in the U.S	$ ______	8220	$ ______	8221
4. Foreign securities				
A. Debt securities	$ ______	8230	$ ______	8231
B. Equity securities	$ ______	8235	$ ______	8236
5. Money market instruments	$ ______	8240	$ ______	8241
6. Private label mortgage backed securities	$ ______	8250	$ ______	8251
7. Other asset-backed securities	$ ______	8260	$ ______	8261
8. Corporate obligations	$ ______	8270	$ ______	8271
9. Stocks and warrants (other than arbitrage positions)	$ ______	8280	$ ______	8281
10. Arbitrage	$ ______	8290	$ ______	8291
11. Spot commodities	$ ______	8330	$ ______	8331
12. Security-based swaps				
A. Debt security-based swaps (other than credit default swaps)				
1. Cleared	$ ______	9999	$ ______	9999
2. Non-cleared	$ ______	9999	$ ______	9999
B. Equity security-based swaps				
1. Cleared	$ ______	9999	$ ______	9999
2. Non-cleared	$ ______	9999	$ ______	9999
C. Credit default security-based swaps				
1. Cleared	$ ______	9999	$ ______	9999
2. Non-cleared	$ ______	9999	$ ______	9999
D. Other security-based swaps				
1. Cleared	$ ______	9999	$ ______	9999
2. Non-cleared	$ ______	9999	$ ______	9999
13. Mixed swaps				
A. Cleared	$ ______	9999	$ ______	9999
B. Non-cleared	$ ______	9999	$ ______	9999

Name of Firm: ______________________

As of: ______________________

FOCUS Report FORM SBS Part 4	SCHEDULE 1 – AGGREGATE SECURITIES, COMMODITIES, AND SWAPS POSITIONS
	Items on this page to be Reported by: Stand-Alone SBSD Broker-Dealer SBSD Stand-Alone MSBSP Broker-Dealer MSBSP

	LONG		SHORT	
14. Swaps				
A. Interest rate swaps				
1. Cleared	$	9999	$	9999
2. Non-cleared	$	9999	$	9999
B. Foreign exchange swaps				
1. Cleared	$	9999	$	9999
2. Non-cleared	$	9999	$	9999
C. Commodity swaps				
1. Cleared	$	9999	$	9999
2. Non-cleared	$	9999	$	9999
D. Debt index swaps (other than credit default swaps)				
1. Cleared	$	9999	$	9999
2. Non-cleared	$	9999	$	9999
E. Equity index swaps				
1. Cleared	$	9999	$	9999
2. Non-cleared	$	9999	$	9999
F. Credit default swaps				
1. Cleared	$	9999	$	9999
2. Non-cleared	$	9999	$	9999
G. Other swaps				
1. Cleared	$	9999	$	9999
2. Non-cleared	$	9999	$	9999
15. Other derivatives and options	$	8295	$	8296
16. Securities with no ready market				
A. Equity	$	8340	$	8341
B. Debt	$	8345	$	8346
C. Other (include limited partnership interests)	$	8350	$	8351
17. Other securities and commodities	$	8360	$	8361
18. Total (sum of Lines 1-17)	$	8370	$	8371

Name of Firm: ____________________

As of: ____________________

FOCUS Report FORM SBS Part 4

SCHEDULE 2 – CREDIT CONCENTRATION REPORT FOR FIFTEEN LARGEST EXPOSURES IN DERIVATIVES

Items on this page to be Reported by: Stand-Alone SBSD
Broker-Dealer SBSD
Stand-Alone MSBSP
Broker-Dealer MSBSP

I. By Current Net Exposure

Counterparty Identifier	Internal Credit Rating	Gross Replacement Value Receivable (Gross Gain)	Gross Replacement Value Payable (Gross Loss)	Net Replacement Value	Current Net Exposure	Total Exposure	Margin Collected
1. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
2. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
3. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
4. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
5. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
6. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
7. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
8. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
9. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
10. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
11. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
12. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
13. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
14. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
15. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
All other counterparties	N/A	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
	Totals:	$ 7810	$ 7811	$ 7812	$ 7813	$ 7814	$ 9999

II. By Total Exposure

Counterparty Identifier	Internal Credit Rating	Gross Replacement Value Receivable (Gross Gain)	Gross Replacement Value Payable (Gross Loss)	Net Replacement Value	Current Net Exposure	Total Exposure	Margin Collected
1. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
2. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
3. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
4. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
5. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
6. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
7. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
8. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
9. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
10. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
11. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
12. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
13. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
14. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
15. 9999	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
All other counterparties	N/A	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
	Totals:	$ 7810	$ 7811	$ 7812	$ 7813	$ 7814	$ 9999

Name of Firm: ____________________________________

As of: ____

FOCUS Report
FORM SBS
Part 4

SCHEDULE 3 – PORTFOLIO SUMMARY OF DERIVATIVES EXPOSURES BY INTERNAL CREDIT RATING

Items on this page to be Reported by: Stand-Alone SBSD
Broker-Dealer SBSD
Stand-Alone MSBSP
Broker-Dealer MSBSP

Internal Credit Rating	Gross Replacement Value		Net Replacement Value	Current Net Exposure	Total Exposure	Margin Collected
	Receivable	Payable				
1. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
2. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
3. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
4. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
5. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
6. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
7. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
8. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
9. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
10. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
11. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
12. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
13. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
14. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
15. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
16. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
17. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
18. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
19. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
20. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
21. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
22. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
23. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
24. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
25. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
26. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
27. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
28. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
29. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
30. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
31. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
32. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
33. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
34. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
35. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
36. 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
Unrated 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
Totals:	$ 7822	$ 7823	$ 7821	$ 7820	$ 9999	$ 9999

Name of Firm: ______________________________

As of: ______________________________

FOCUS Report FORM SBS Part 4	SCHEDULE 4 – GEOGRAPHIC DISTRIBUTION OF DERIVATIVES EXPOSURES FOR TEN LARGEST COUNTRIES
	Items on this page to be Reported by: Stand-Alone SBSD Broker-Dealer SBSD Stand-Alone MSBSP Broker-Dealer MSBSP

I. **By Current Net Exposure**

Country		Gross Replacement Value Receivable	Gross Replacement Value Payable	Net Replacement Value	Current Net Exposure	Total Exposure	Margin Collected
1.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
2.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
3.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
4.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
5.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
6.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
7.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
8.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
9.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
10.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
Totals:		$ 7803	$ 7804	$ 7802	$ 9999	$ 7801	$ 9999

II. **By Total Exposure**

Country		Gross Replacement Value Receivable	Gross Replacement Value Payable	Net Replacement Value	Current Net Exposure	Total Exposure	Margin Collected
1.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
2.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
3.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
4.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
5.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
6.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
7.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
8.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
9.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
10.	9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999	$ 9999
Totals:		$ 7803	$ 7804	$ 7802	$ 9999	$ 7801	$ 9999

Name of Firm: ____________________________________

As of: ____

FOCUS Report FORM SBS Part 5	SCHEDULE 1 – AGGREGATE SECURITY-BASED SWAP AND SWAP POSITIONS
	Items to be Reported by: Bank SBSDs Bank MSBSPs

Aggregate Positions	LONG		SHORT	
1. Security-based swaps				
A. Debt security-based swaps (other than credit default swaps)				
1. Cleared	$ ____	9999	$ ____	9999
2. Non-cleared	$ ____	9999	$ ____	9999
B. Equity security-based swaps				
1. Cleared	$ ____	9999	$ ____	9999
2. Non-cleared	$ ____	9999	$ ____	9999
C. Credit default security-based swaps				
1. Cleared	$ ____	9999	$ ____	9999
2. Non-cleared	$ ____	9999	$ ____	9999
D. Other security-based swaps				
1. Cleared	$ ____	9999	$ ____	9999
2. Non-cleared	$ ____	9999	$ ____	9999
2. Mixed swaps				
A. Cleared	$ ____	9999	$ ____	9999
B. Non-cleared	$ ____	9999	$ ____	9999
3. Swaps				
A. Interest rate swaps				
1. Cleared	$ ____	9999	$ ____	9999
2. Non-cleared	$ ____	9999	$ ____	9999
B. Foreign exchange swaps				
1. Cleared	$ ____	9999	$ ____	9999
2. Non-cleared	$ ____	9999	$ ____	9999
C. Commodity swaps				
1. Cleared	$ ____	9999	$ ____	9999
2. Non-cleared	$ ____	9999	$ ____	9999
D. Debt index swaps (other than credit default swaps)				
1. Cleared	$ ____	9999	$ ____	9999
2. Non-cleared	$ ____	9999	$ ____	9999
E. Equity index swaps				
1. Cleared	$ ____	9999	$ ____	9999
2. Non-cleared	$ ____	9999	$ ____	9999
F. Credit default swaps				
1. Cleared	$ ____	9999	$ ____	9999
2. Non-cleared	$ ____	9999	$ ____	9999

Name of Firm: ____________________

As of: ____________________

FOCUS Report FORM SBS Part 5	SCHEDULE 1 – AGGREGATE SECURITY-BASED SWAP AND SWAP POSITIONS
	Items to be Reported by: Bank SBSDs Bank MSBSPs

G. Other swaps				
1. Cleared	$ ______	9999	$ ______	9999
2. Non-cleared	$ ______	9999	$ ______	9999
4. Other derivatives	$ ______	9999	$ ______	9999
5. Total (sum of Lines 1-4)	$ ______	9999	$ ______	9999

Name of Firm: ______________________

As of: ______________________

OMB APPROVAL
OMB Number: Expires: Estimated average burden hours per response:

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FOCUS REPORT FORM SBS INSTRUCTIONS

GENERAL INSTRUCTIONS
Who Must File
Filing Requirements
Consolidated Reporting
Currency
Rounding
U.S. Generally Accepted Accounting Principles
Definitions
SPECIFIC INSTRUCTIONS
COVER PAGE
Part 1
- Statement of Financial Condition
- Computation of Net Capital (Filer Authorized to Use Models)
- Computation of Net Capital (Filer Not Authorized to Use Models)
- Computation of Minimum Regulatory Capital Requirements (Broker-Dealer)
- Computation of Minimum Regulatory Capital Requirements (Non-Broker-Dealer)
- Computation of Tangible Net Worth
- Statement of Income (Loss)
- Capital Withdrawals
- Capital Withdrawals – Recap
- Financial and Operational Data
- Computation for Determination of Reserve Requirements – Rule 15c3-3, Exhibit A and Related Notes
- Information for Possession or Control Requirements under Rule 15c3-3
- Computation for Determination of PAB Requirements
- Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Appendix A
- Information for Possession or Control Requirements under Rule 18a-4

Part 2
- Balance Sheet (Information as Reported on FFIEC Form 031 – Schedule RC)
- Regulatory Capital (Information as Reported on FFIEC Form 031 – Schedule RC-R)
- Income Statement (Information as Reported on FFIEC Form 031 – Schedule RI)
- Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Appendix A
- Information for Possession or Control Requirements under Rule 18a-4

Part 3
- Computation of CFTC Minimum Capital Requirements
- Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges
- Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under Section 4d(f) of the Commodity Exchange Act
- Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts
- Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to CFTC Regulation 30.7

Part 4

Schedule 1 – Aggregate Securities, Commodities, and Swaps Positions
Schedule 2 – Credit Concentration Report for Fifteen Largest Exposures in Derivatives
Schedule 3 – Portfolio Summary of Derivatives Exposures by Internal Credit Rating
Schedule 4 – Geographic Distribution of Derivatives Exposures for Ten Largest Countries

Part 5

Schedule 1 – Aggregate Security-Based Swap and Swap Positions

GENERAL INSTRUCTIONS

FOCUS Report Form SBS ("Form SBS") constitutes the basic report required of those firms registered with the Securities and Exchange Commission ("Commission") as security-based swap dealers ("SBSDs") or major security-based swap participants ("MSBSPs"). The instructions issued from time-to-time must be used in preparing Form SBS and are considered an integral part of this report.

Who Must File

An SBSD or MSBSP must file Form SBS. The Form consists of five Parts, which apply to an SBSD or MSBSP based on the firm's registration status: (1) an SBSD or MSBSP that is not also registered as a broker-dealer or bank (respectively, a "stand-alone SBSD" or "stand-alone MSBSP"); (2) an SBSD or MSBSP that also is registered as a broker-dealer (respectively, a "broker-dealer SBSD" or "broker-dealer MSBSP"); (3) an SBSD or MSBSP supervised by a prudential regulator (respectively, a "bank SBSD" or "bank MSBSP"); or (4) any of the above if the SBSD or MSBSP also is registered as a futures commission merchant ("FCM"). An SBSD or MSBSP must complete: (1) Parts 1 and 4 of Form SBS if it is a stand-alone SBSD, broker-dealer SBSD, stand-alone MSBSP, or broker-dealer MSBSP; or (2) Parts 2 and 5 of Form SBS if it is a bank SBSD or bank MSBSP. In addition to completing those parts, the SBSD or MSBSP also must complete Part 3 if is also registered as an FCM.

Filing Requirements

Form SBS must be filed by nonbank SBSDs and nonbank MSBSPs within 17 business days of the end of the month in accordance with 17 C.F.R. § 240.17a-5 or 17 C.F.R. § 240.18a-7, as applicable. Form SBS must be filed by bank SBSDs and bank MSBSPs within 17 business days of the end of the quarter in accordance with 17 C.F.R. § 240.18a-7.

Form SBS must be filed with the firm's designated examining authority ("DEA"), or if none, then with the Commission or its designee. The name of the SBSD or MSBSP and the report's effective date must be repeated on each sheet of the report submitted. If no response is made to a line item or subdivision thereof, it constitutes a representation that the SBSD or MSBSP has nothing to report.

Consolidated Reporting

In computing net capital, firms should consolidate their assets and liabilities in accordance with 17 C.F.R. §§ 240.15c3-1c or 18a-1c, as applicable.

Currency

Foreign currency may be expressed in terms of U.S. dollars at the rate of exchange as of the report's effective date and, where carried in conjunction with the U.S. dollar, balances for the same accountholder may be consolidated with U.S. dollar balances and the gross or net position reported in its proper classification, provided the foreign currency is not subject to any restriction as to conversion.

Rounding

As a general rule, money amounts should be expressed in whole dollars. No valuation should be used which is higher than the actual valuation, *i.e.*, for $170,000.85, use $170,000 but not $170,001. However, for *any* or *all-short* valuations, round up the valuation to the nearest dollar, *i.e.*, for $180,000.17, use $180,001 but not $180,000. Money amounts should be expressed in whole dollars.

U.S. Generally Accepted Accounting Principles

Financial statements must be prepared in conformity with U.S. generally accepted accounting principles, applied on a basis consistent with that of the preceding report and must include, in the basic statement or accompanying footnotes, all informative disclosures necessary to make the statement a clear expression of the organization's financial and operational condition. The broker or dealer must report all data after proper accruals have been made for income and expense not recorded in the books of account and adequate reserves have been provided for deficits in customer or broker accounts, unrecorded liabilities, security differences, dividends and similar items.

The amount of terms (including commitment fees and the conditions under which lines may be withdrawn) of unused lines of credit for short-term financing must be disclosed, if significant, in notes to the financial statements.

Definitions

"Alternative standard" refers to the alternative standard for computing net capital based on aggregate debit items, in accordance with 17 C.F.R. § 240.15c3-1.

"Aggregate indebtedness" is defined in 17 C.F.R. § 240.15c3-1.

"Bona fide arbitrage" is defined in 17 C.F.R. § 240.15c3-1.

"Open contractual commitment" is defined in 17 C.F.R. § 240.15c3-1.

"Current net exposure" is defined as the net replacement value minus the fair market value of collateral collected that may be applied under applicable rules (e.g., taking into account haircuts to the fair market value of the collateral required under applicable rules).

"Customer" and "non-customer" are defined in 17 C.F.R. § 240.15c3-1.

"Exempted securities" is defined in section 3 of the Securities Exchange Act of 1934.

"Gross replacement value" and "Gross replacement value – receivable" are defined as the amount that would need to be paid to enter into identical contracts with respect to derivatives positions that have a positive mark-to-market value to the firm (*i.e.*, are receivable positions of the firm), without applying any netting or collateral.

"Gross replacement value – payable" is defined as the amount that would need to be paid to enter into identical contracts with respect to derivatives positions that have a negative mark-to-market value to the firm (i.e., are payable positions of the firm), without applying any netting or collateral.

"Margin collected" is defined as the amount of margin collateral collected that can be applied against the firm's total exposure under applicable rules.

"Net capital" is defined in 17 C.F.R. §§ 240.15c3-1 or 18a-1, as applicable.

"Net replacement value" is defined as the amount of the "gross replacement value – receivable" minus the amount of the "gross replacement value – payable" that may be netted for each counterparty in accordance with applicable rules.

"Omnibus" refers to an arrangement whereby one firm settles transactions and holds securities in an account on behalf of another firm and its customers. The clearing firm only knows the other firm and does not know the customers of the carrying firm.

"Prudential regulator" is defined in section 3 of the Securities Exchange Act of 1934.

"Ready market" is defined in 17 C.F.R. §§ 240.15c3-1 or 18a-1, as applicable.

"Secured demand note" ("SDN") is defined in 17 C.F.R. § 240.15c3-1d.

"Securities not readily marketable" is defined in 17 C.F.R. §§ 240.15c3-1 or 18a-1, as applicable.

"Security-based swap customer" is defined in 17 C.F.R. § 240.18a-4.

"Total exposure" is defined as the sum of the following:

- The current net exposure,
- The amount of initial margin for cleared security-based swaps and swaps required by a clearing agency or derivatives clearing organization (regardless of whether the margin has been collected),
- The "margin amount" for non-cleared security-based swaps calculated under 17 C.F.R. § 240.18a-3,

- The initial margin for non-cleared swaps calculated under the CFTC's rules (regardless of whether the margin has been collected), and
- The maximum potential exposure as defined in 17 C.F.R. §§ 240.15c3-1 or 18a-1, as applicable, for any over-the-counter derivatives not included above.

SPECIFIC INSTRUCTIONS

COVER PAGE

The cover page must be answered in its entirety. If a line does not apply, the firm should write "None" or "N/A" on the line, as applicable.

13 Name of reporting entity. Provide the name of the firm filing Form SBS, as it is registered with the Commission. Do not use DBAs or divisional names. Do not abbreviate.

20-23, 99 Address of principal place of business. Provide the physical address (not post office box) of the firm's principal place of business.

30 Name of person to contact in regard to this report. The identified person need not be an officer or partner of the firm, but should be a person who can answer any questions concerning this specific report.

31 (Area code) Telephone no. Provide the direct telephone number of the contact person whose name appears on Line Item 30.

31, 35, 37, 39 Official use. This item is for use by regulatory staff only. Leave blank.

32, 34, 36, 38 Name(s) of subsidiaries or affiliates consolidated in this report. Provide the name of the subsidiaries or affiliate firms whose financial and operational data are combined in Form SBS with that of the firm filing Form SBS.

PART 1

Statement of Financial Condition

This section must be prepared by stand-alone SBSDs, broker-dealer SBSDs, stand-alone MSBSPs, and broker-dealer MSBSPs. Firms should report their assets as allowable or non-allowable in accordance with 17 C.F.R. § 240.15c3-1, 17 C.F.R. § 240.18a-1, or 17 C.F.R. § 240.18a-2, as applicable. With respect to liabilities, the columns entitled "A.I. Liabilities" and "Non-A.I. Liabilities" should only be completed by broker-dealers electing to comply with the aggregate indebtedness standard under 17 C.F.R. § 240.15c3-1.

120 Total securities – includes encumbered securities. Report here the market value of total securities that are encumbered. Securities should be treated as encumbered when the firm transfers them to a creditor and that creditor has the right by contract or custom to sell or re-pledge the collateral. Encumbered inventory may be reported on a settlement date basis even if total inventory is reported on a trade date basis. Firms that introduce their proprietary accounts do not need to report the value of encumbered securities held by the carrying/clearing firm.

200 Allowable – cash. Report unrestricted cash balances. Do not report:

- Bank-negotiable certificates of deposits or similar bank money market instruments. Report bankers' acceptances, certificates of deposit, commercial paper, and money market instruments on Line Item 849.
- Petty cash. Report it on Miscellaneous Non-Allowable Assets (Line Item 720).
- Cash used to collateralize bank loans or other similar liabilities (compensating balances). Report these funds on Line Item 720.

- Overdrafts in unrelated banks. Report such overdrafts as Bank Loan (includible) (Line Item 1460) or as Drafts Payable (Line Item 1630).

210 Allowable – cash segregated in compliance with federal and other regulations. Report cash segregated pursuant to federal or state statutes or regulations, or the requirements of any foreign government or instrumentality thereof.

220 Allowable – receivables from brokers/dealers and clearing organizations – failed to deliver – includible in the formula for reserve requirement under Rule 15c3-3a. Do not report continuous net settlement ("CNS") fails to deliver here. Report them on Line Item 280.

999 Allowable – receivables from brokers/dealers and clearing organizations – failed to deliver – includible in the formula for the deposit requirement under Rule 18a-4a. Do not report CNS fails to deliver here. Report them on Line Item 999 (Clearing organizations – Includible in the formula for the deposit requirement under Rule 18a-4a).

230 Allowable – receivables from brokers/dealers and clearing organizations – failed to deliver – other. Do not report CNS fails to deliver here. Report them on Line Item 290.

260 Allowable – receivables from brokers/dealers and clearing organizations – omnibus accounts – includible in the formula for reserve requirement under Rule 15c3-3a. If applicable, report here net ledger balances and losses and gains on commodities future contracts.

999 Allowable – receivables from brokers/dealers and clearing organizations – omnibus accounts – includible in the formula for the deposit requirement under Rule 18a-4a. If applicable, report here net ledger balances and losses and gains on commodities future contracts.

270 Allowable – receivables from brokers/dealers and clearing organizations – omnibus accounts – other. If applicable, report here net ledger balances and losses and gains on commodities future contracts.

280 Allowable – receivables from brokers/dealers and clearing organizations – clearing organizations – includible in the formula for reserve requirement under Rule 15c3-3a. Report CNS fails to deliver allocating to customers here. CNS balances may be reported on a net basis by category (*i.e.*, customer, non-customer).

999 Allowable – receivables from brokers/dealers and clearing organizations – clearing organizations – includible in the formula for the deposit requirement under Rule 18a-4a. Report CNS fails to deliver allocating to security-based swap customers here. CNS balances may be reported on a net basis by category (*i.e.*, customer, non-customer).

290 Allowable – receivables from brokers/dealers and clearing organizations – clearing organizations – other. Report CNS fails to deliver here. CNS balances may be reported on a net basis by category (*i.e.*, customer, non-customer). Report deposits of cash with clearing organizations.

292 Allowable – trade date receivable. Report pending or unsettled trades that net to a receivable balance, as of trade date, across all counterparties.

300 Allowable – receivables from brokers/dealers and clearing organizations – other. Report other allowable receivables from brokers/dealers and clearing organizations, including floor brokerage, commissions, trade date adjustment, and all other allowable gross receivables from brokers/dealers and clearing organizations not already reported.

320 Allowable – receivables from customers – securities accounts – partly secured accounts. Report those portions of partly secured customer accounts that have been secured by securities deemed to have a ready market. The remaining portion of the ledger debit balance is considered nonallowable; report it as partly secured customer receivables (Line Item 560).

360 Allowable – securities purchased under agreements to resell. Report the gross contract value receivable (contract price) of reverse repurchase agreements that are deemed to be adequately secured. Contract price includes accrued interest on the contract at the repurchase agreement's rate (not the underlying securities). Buy-sell agreements are considered financing transactions and are reported on this line item. If a firm does not take possession of the collateral securing a reverse repurchase agreement, it will be treated as a nonallowable asset and reported on Line Item 605. Reverse repurchase deficits (including buy-sell deficits) should be reported on Line Item 3610.

480 Allowable – investment in and receivables from affiliates, subsidiaries and associated partnerships. This amount should not be netted against a payable from different affiliates, subsidiaries, and associated partnerships.

500 Allowable – other assets – dividends and interest receivable. Dividends receivable and payable should not be netted; they should be recorded in separate accounts.

520 Allowable – other assets – loans and advances. Report amounts related to loans and advances made to employees and others that are secured by readily marketable securities, and meet the margin requirements of Regulation T (12 C.F.R. § 220), 17 C.F.R. § 240.18a-3, and/or the firm's DEA, as applicable. Do not report loans and advances to partners, directors, and officers. Report them in the appropriate category under "Receivable from non-customers", on either Line Item 340 or Line Item 350.

530 Allowable – other assets – miscellaneous. Report allowable assets not readily classifiable into other previously identified categories. Examples of assets reported on this line item include: future income tax benefits arising as a result of unrealized losses; good faith deposits; and deferred organization expenses, prepaid expenses, and deferred charges.

536 Allowable – other assets – collateral accepted under ASC 860. Report here the market value of securities received that are required to be reported under ASC 860.

Securities held as collateral for stock loan transactions are recognized as both an asset (Securities accepted under ASC 860 (Line Item 536)) and as a liability (Obligation to return securities (Line Item 1686)).

Example: A firm loans 100 shares of stock valued at $1050 and receives stock collateral valued at $1000. The market value of the collateral received should be reported on the FOCUS as follows:

Debit	FOCUS Item 536	Securities accepted under SFAS 140	$1000
Credit	FOCUS Item 1686	Obligation to return securities	$1000

Reclass firm inventory at market value of $1050 to Encumbered Inventory (Line Item 120) if loaned and applicable.

537 Allowable – other assets – SPE assets. Report here financial assets that were previously transferred to a special purpose entity ("SPE") that do not qualify for sale treatment under ASC 860. Financial assets that have been transferred to a qualifying SPE do not need to be reported on Form SBS. Financial assets that have been transferred to a SPE that is not a qualifying SPE fail to qualify for sale treatment generally because effective control over the assets is still maintained.

550 Nonallowable – receivables from brokers/dealers and clearing organizations – other. Report nonallowable or aged receivables from brokers/dealers and clearing organizations including floor brokerage, commissions, trade date adjustment, and all other nonallowable gross receivables from brokers/dealers and clearing organizations not already reported. Do not net unrelated receivables versus payables.

560 Nonallowable – receivables from customers – securities accounts – partly secured accounts. Report those portions of partly secured customer accounts that have not been secured by securities deemed to have a ready market. See 17 C.F.R. § 240.15c3-1 or 17 C.F.R. § 240.18a-1, as applicable. Report deficits in partly secured accounts of the introducing firm. Both the carrying broker and the introducing broker must report this if their clearing agreement states that such deficits are the liability of the introducing broker.

605 Nonallowable – securities purchased under agreements to resell. Report the gross contract value receivable (contract price) of reverse repurchase agreements that are not deemed to be adequately secured. If collateral that secures a reverse repurchase receivable is non-marketable or illiquid, then the amount receivable is nonallowable and should be reported here. Contract price includes accrued interest on the contract at the repurchase agreement's rate (not the underlying securities).

670 Nonallowable – investment in and receivables from affiliates, subsidiaries and associated partnerships. This amount should not be netted against payables from different affiliates or subsidiaries.

690 Nonallowable – other assets – dividends and interest receivable. Dividends receivable and payable are not to be netted; they should be recorded in separate accounts.

710 Nonallowable – other assets – loans and advances. Do not report unsecured loans and advances to partners, directors, and officers. Report them on Line Item 600.

750 Total – cash. This line item is equal to Line Item 200.

760 Total – cash segregated in compliance with federal and other regulations. This line item is equal to Line Item 210.

770 Total – receivables from brokers/dealers and clearing organizations – failed to deliver. This line item is the sum of Line Items 220, 999, and 230.

780 Total – receivables from brokers/dealers and clearing organizations – securities borrowed. This line item is the sum of Line Items 240, 999, and 250.

790 Total – receivables from brokers/dealers and clearing organizations – omnibus accounts. This line item is the sum of Line Items 260, 999, and 270.

800 Total – receivables from brokers/dealers and clearing organizations – clearing organizations. This line item is the sum of Line Items 280, 999, and 290.

802 Total – trade date receivable. This line item is equal to Line Item 292.

810 Total – receivables from brokers/dealers and clearing organizations – other. This line item is the sum of Line Items 300 and 550.

820 Total – receivables from customers. This line item is the sum of Line Items 310, 320, 330, 335, 560, 570, 580, and 590.

830 Total – receivables from non-customers. This line item is the sum of Line Items 340, 350, and 600.

840 Total – securities purchased under agreements to resell. This line item is the sum of Line Items 360 and 605.

849 Allowable – total securities, including security-based swaps, and spot commodities and swaps owned at market value. Report the long market value for securities, spot commodities, and swaps netted, including the value of derivative contracts that is allowable under 17 C.F.R. §§ 240.15c3-1 or 18a-1, as applicable.

850 Total – total securities, including security-based swaps, and spot commodities and swaps owned. This line item is equal to Line Item 849.

860 Total – securities owned not readily marketable. This line item is the sum of Line Items 440 and 610.

870 Total – other investments not readily marketable. This line item is the sum of Line Items 450 and 620.

880 Total – securities borrowed under subordination agreements and partners' individual and capital securities accounts. This line item is the sum of Line Items 460 and 630.

890 Total – secured demand notes. This line item is the sum of Line Items 470 and 640.

900 Total – memberships in exchanges. This line item is the sum of Line Items 650 and 660.

910 Total – investment in and receivables from affiliates, subsidiaries and associated partnerships. This line item is the sum of Line Items 480 and 670.

920 Total – property, furniture, equipment, leasehold improvements, and rights under lease agreements. This line item is the sum of Line Items 490 and 680.

930 Total – other assets. This line item is the sum of Line Items 500, 510, 520, 530, 536, 537, 690, 700, 710, and 720.

940 Total – assets. This line item is the sum of Line Items 540 and 740.

950 Payable to customers – securities accounts – including free credits. Do not report here funds in commodity accounts segregated in accordance with the Commodity Exchange Act. Do not report credits related to short sales of securities. Do not report here amounts reported on Line Item 999 (Security-based swap accounts payable to customers – free credits).

999 Payable to customers – security-based swap accounts – including free credits. Do not report credits related to short sales of securities. Do not report here amounts reported on Line Item 950.

960 Securities sold but not yet purchased – arbitrage. Report that part of Line Item 1620 that is deemed to be part of a bona fide arbitrage.

970 Liabilities subordinated to claims of creditors – cash borrowings – from outsiders. Report that portion of subordinated liabilities (cash borrowings) reported on Line Item 1710 that are owed to the firm's non-partners, non-members, or non-stockholders (outsiders).

980 Liabilities subordinated to claims of creditors – cash borrowings – includes equity subordination. Report that portion of subordinated liabilities (cash borrowings) reported on Line Item 1710 that are considered equity pursuant to 17 C.F.R. § 240.15c3-1 or 17 C.F.R. § 240.18a-1, as applicable, for debt to debt-equity requirements. See also 17 C.F.R. § 240.15c3-1d and 17 C.F.R. § 240.18a-1d regarding events of acceleration and default.

990 Liabilities subordinated to claims of creditors – securities borrowings – from outsiders. This amount represents that portion of Line Item 1720 that is securities borrowing from the firm's non-partners, non-members, or non-stockholders (outsiders).

1000 Liabilities subordinated to claims of creditors – pursuant to secured demand note collateral agreements – from outsiders. Report that portion of liabilities subordinated pursuant to SDN collateral agreements (Line Item 1730) that are owed to the firm's non-partners, non-members, or non-stockholders (outsiders).

1010 Liabilities subordinated to claims of creditors – pursuant to secured demand note collateral agreements – includes equity subordination. Report that portion of liabilities subordinated pursuant to SDN collateral agreements (Line Item 1730) that are considered equity pursuant to 17 C.F.R. § 240.15c3-1 or 17 C.F.R. § 240.18a-1, as applicable, for debt to debt-equity requirements.

See also 17 C.F.R. § 240.15c3-1d and 17 C.F.R. § 240.18a-1d regarding events of acceleration and default.

1020 Partnership and LLC – including limited partners. Report that portion of Line Item 1780 that represents the capital contributions of limited partners to the limited partnership. Limited liability companies ("LLCs") should leave this line item blank.

1480 Securities sold under repurchase agreements. Report here the gross contract value (contract price) of securities sold under repurchase agreements. Contract price includes accrued interest on the contract at the repurchase agreement's rate (not the underlying securities). Buy-sell agreements resembling repurchase agreements are also reported here.

1490 Payable to brokers/dealers and clearing organizations – failed to receive – includible in the formula for reserve requirements under Rule 15c3-3a. Do not report here CNS failed to receive relating to customers. Report them on Line Item 1550.

9999 Payable to brokers/dealers and clearing organizations – failed to receive – includible in the formula for the deposit requirement under Rule 18a-4a. Do not report here CNS failed to receive relating to security-based swap customers. Report them on Line Item 9999 (Clearing organizations - includible in the formula for the deposit requirement under 17 C.F.R. § 240.18a-4a).

1500 Payable to brokers/dealers and clearing organizations – failed to receive – other. Do not report here CNS failed to receive relating to non-customers. Report them on Line Item 1560.

1530 Payable to brokers/dealers and clearing organizations – omnibus accounts – includible in the formula for reserve requirements under Rule 15c3-3a. Report here customer-related credit balances in accounts carried by other firms pursuant to omnibus agreements.

9999 Payable to brokers/dealers and clearing organizations – omnibus accounts – includible in the formula for the deposit requirement under Rule 18a-4a. Report here security-based swap customer-related credit balances in accounts carried by other firms pursuant to omnibus agreements.

1540 Payable to brokers/dealers and clearing organizations – omnibus accounts – other. Report here non-customer and proprietary-related credit balances in accounts carried by other firms pursuant to omnibus agreements. FCMs should also report on this line item omnibus accounts used to clear proprietary and non-customer accounts that liquidate to a deficit (payable to the other FCM). An omnibus account that the reporting FCM carries at another FCM liquidating to a deficit should not be netted against omnibus accounts that liquidate to an equity.

1550 Payable to brokers/dealers and clearing organizations – clearing organizations – includible in the formula for reserve requirements under Rule 15c3-3a. CNS fails to receive allocating to customers are also included on this line item. CNS balances may be reported on a net basis by category (customers or non-customers); however, they should be allocated broadly for purposes of the formulas under 17 C.F.R. § 240.15c3-3a and 17 C.F.R. § 240.18a-4a.

9999 Payable to brokers/dealers and clearing organizations – clearing organizations – includible in the formula for the deposit requirement under Rule 18a-4a. CNS fails to receive allocating to security-based swap customers are also included on this line item. CNS balances may be reported on a net basis by category (customers, security-based swap customers, non-customers and non-security-based swap customers); however, they should be allocated broadly for purposes of the formulas under 17 C.F.R. § 240.15c3-3a and 17 C.F.R. § 240.18a-4a.

1560 Payable to brokers/dealers and clearing organizations – clearing organizations – other. CNS balances may be reported on a net basis by category (customers or non-customers).

1562 Trade date payable. Report here pending or unsettled trades that net to a payable balance as of trade date, across all counterparties.

1570 Payable to brokers/dealers and clearing organizations – other. Report here all other payables to broker/dealers including commissions, floor brokerage, and trade date or settlement date adjustments. When a firm is required to prepare its net capital computation on a trade date basis, any net receivables (or payables) resulting from adjusting proprietary positions to reflect the trade date basis of accounting should be reported here. Do not net payables and receivables with unrelated entities.

1686 Accounts payable and accrued liabilities and expenses – obligation to return securities. Report here the market value of securities that are required to be reported pursuant to ASC 860. Report here the market value of securities received in a stock loan transaction in which the firm lent out one security and received another security in lieu of cash.

1687 Accounts payable and accrued liabilities and expenses – SPE liabilities. Report here liabilities of SPEs that offset financial assets previously transferred to the SPE that do not qualify for sale treatment under ASC 860. Liabilities reported here contrast with the assets reported on Line Item 537.

1710 Liabilities subordinated to claims of creditors – cash borrowings. SBSDs should report here cash borrowings that are subordinated to the claims of creditors, and meet the minimum requirements of 17 C.F.R. § 240.15c3-1d or 17 C.F.R. § 240.18a-1d, if applicable. These liabilities are added to net worth in the computation of net capital (see Line Item 3520).

Computation of Net Capital (Filer Authorized to Use Models)

This section must be prepared by stand-alone SBSDs, broker-dealer SBSDs, and broker-dealer MSBSPs that are authorized by the Commission to calculate net capital using internal models in accordance with 17 C.F.R. §§ 240.15c3-1e and 240.18a-1(d), as applicable.

3490 Deduct ownership equity not allowable for net capital. Report as a deduction any capital accounts, included as part of ownership equity on the Statement of Financial Condition, that are not allowable in the determination of net capital (*i.e.*, partners' securities contributed to the firm through their individual and capital accounts).

3525 Other (deductions) or allowable credits. Report deductions or addbacks that are net of any related tax benefit.

Reported amounts must also be reported on the section entitled "Capital Withdrawals."

Do not deduct from net worth or include in aggregate indebtedness any net receivables or payables resulting from the recording of proprietary positions on a trade date basis.

3610 Other deductions and/or charges. These charges include the following:

- Securities borrowed deficits,
- Stock loan deficits,
- Repurchase and reverse repurchase deficits,
- Aged fail-to-receive,
- The 1% deduction for fails to deliver and stock borrows allocating to fails to receive that have been excluded from the customer reserve or deposit requirement formula, as applicable,
- Other operational charges not comprehended elsewhere, and
- The 1% deduction for stock borrows collateralized by an irrevocable letter of credit.

3630 Other additions and/or allowable credits. Report adjustments to ownership equity related to unrealized profit or loss and to deferred tax provisions, pursuant to 17 C.F.R. § 240.15c3-1 or 17 C.F.R. § 240.18a-1, as applicable. Report also any flow-through capital that has been approved by the Commission pursuant to 17 C.F.R. § 240.15c3-1c, if applicable.

Unrealized losses on open contractual commitments are treated as charges when computing the net worth and the debt/equity total. See 17 C.F.R. § 240.15c3-1 or 17 C.F.R. § 240.18a-1, as applicable. Unrealized profits on open contractual commitments are allowed to reduce haircuts, but not to otherwise increase net worth or net capital.

Computation of Net Capital (Filer Not Authorized to Use Models)

This section must be prepared by stand-alone SBSDs, broker-dealer SBSDs, and broker-dealer MSBSPs that are not authorized by the Commission to calculate net capital using internal models in accordance with 17 C.F.R. § 240.15c3-1e or 17 C.F.R. § 240.18a-1(d), as applicable.

Follow the instructions in the immediately preceding section entitled "Computation of Net Capital (Filer Authorized to Use Models)" to the extent it contains instructions corresponding with the applicable line item number (unless contrary instructions are provided below).

3732 Haircuts on securities – arbitrage. Report the deduction applied to securities considered part of a bona fide arbitrage, pursuant to 17 C.F.R. § 240.15c3-1 or 17 C.F.R. § 240.18a-1, as applicable.

3734 Haircuts on securities – other securities. This line item should include deductions applied to securities of an investment company registered under the Investment Company Act of 1940.

3736 Haircuts on securities – other. The deductions reported here should include charges related to foreign currency exposure or charges related to swaps.

Computation of Minimum Regulatory Capital Requirements (Broker-Dealer)

This section must be prepared by broker-dealer SBSDs and broker-dealer MSBSPs. The calculation of excess tentative net capital should only be completed by broker-dealers that are authorized to calculate net capital using internal models.

3870 Ratio requirement – 2% of aggregate debit items. FCMs must report here the greater of:

- 2% of aggregate debit items, or
- 4% of funds required to be segregated pursuant to the Commodity Exchange Act.

Computation of Minimum Regulatory Capital Requirements (Non-Broker-Dealer)

This section must be prepared by stand-alone SBSDs. The calculation of excess tentative net capital should only be completed by stand-alone SBSDs that are authorized to calculate net capital using internal models.

Computation of Tangible Net Worth

This section must be prepared by stand-alone MSBSPs and broker-dealer MSBSPs.

Statement of Income (Loss)

This section must be prepared by stand-alone SBSDs, broker-dealer SBSDs, stand-alone MSBSPs, and broker-dealer MSBSPs.

The Statement of Income (Loss) is largely based on the Supplemental Statement of Income (Loss) from FINRA's Supplemental Statement of Income ("SSOI"). Follow the instructions in the section of the SSOI Instructions entitled "Specific Instructions" to the extent it contains instructions corresponding with the applicable line item number (unless contrary instructions are provided below).

For the purposes of the Statement of Income (Loss), "registered offering" means an offering registered with the SEC.

Capital Withdrawals

This section must be prepared by stand-alone SBSDs, broker-dealer SBSDs, and broker-dealer MSBSPs.

Name of lender or contributor. Report the name of the lender or contributor to whom the scheduled liability relates (*i.e.*, name of partner, shareholder or subordinated lender). If an amount reported in this column relates to a discretionary liability or other addback to capital, include a description of the addback (*i.e.*, "discretionary liability").

Amount to be withdrawn. These amounts can include:

- Equity capital that the firm expects to distribute within the next six months;
- Subordinated liabilities that are scheduled to mature within the next six months;
- Accruals and other addbacks to net capital that will not be eligible for inclusion in net capital within the next six months.

Capital Withdrawals – Recap

This section must be prepared by stand-alone SBSDs, broker-dealer SBSDs, and broker-dealer MSBSPs.

With respect to Lines 1 through 4, report equity and subordinated liabilities maturing or proposed to be withdrawn within the next six months and accruals which have not been deducted in the computation of net capital.

Financial and Operational Data

This section must be prepared by stand-alone SBSDs, broker-dealer SBSDs, and broker-dealer MSBSPs. In addition to the specific instructions below, firms should refer to the instructions accompanying Notes A and B of this section on Form SBS itself.

4980 Actual number of tickets executed during the reporting period. For agency transactions, count both street side and customer side as one transaction. Count as one transaction multiple executions at the same price that result in one confirmation. In the case of principal transactions, count separately dealer-to-dealer and retail transactions. Carrying and clearing firms should include in the total ticket count transactions emanating from those firms for whom they clear on a fully disclosed basis. Firms that introduce accounts on a fully disclosed basis should include transactions introduced in their ticket count.

4990 Number of corrected customer confirmations mailed after settlement date. Include confirmations for which the incorrect original was mailed to the customer. Consider individually multiple corrections on confirmations.

5374 Customers' and security-based swap customers' accounts under Rules 15c3-3 or 18a-4, as applicable. Report the aggregate market value of specific securities, other than exempted securities, which exceeds 15% of the value of all securities which collateralize all margin receivables pursuant to Note E to 17 C.F.R. § 240.15c3-3a or Note E to 17 C.F.R. § 240.18a-1a, as applicable.

5378 Total of personal capital borrowings due within six months. Report the total borrowed cash and/or securities that, in computing net capital, are included as proprietary capital or subordinated debt.

5760 Open transfers and reorganization account items over 40 days not confirmed or verified – number of items. The term "reorganization account items" includes, but is not limited to, transactions in the following: (1) "rights" subscriptions, (2) warrants exercised, (3) stock splits, (4) redemptions, (5) conversions, (6) exchangeable securities, and (7) spin-offs.

5820 Security suspense and differences with related money balances – long – debits. When computing net capital, regard short positions and related credits as proprietary commitments if they remain unresolved seven business days after discovery.

5825 Security suspense and differences with related money balances – short – debits. When computing net capital, regard long positions and related debits as proprietary commitments if they remain unresolved seven business days after discovery.

5830 Market value of short and long security suspense and differences without related money – debits. When computing net capital, regard the market value of short security differences as deductions if they remain unresolved seven business days after discovery. Do not net unrelated differences in the same security or in other securities.

5840 Market value of security record breaks – debits. Report the market values of short security record breaks that are unresolved seven business days after discovery.

5850 Correspondents, SBSDs, and MSBSPs – long – debits. Report here the debit amount applicable to all unresolved reconciling items (favorable or unfavorable) with correspondents, SBSDs, and/or MSBSPs that are long and unresolved within seventeen business days from record date. Do not net these items.

5855 Correspondents, SBSDs, and MSBSPs – short – debits. Report here the debit amount applicable to all unresolved reconciling items (favorable or unfavorable) with correspondents, SBSDs, and/or MSBSPs that are short and unresolved within seventeen business days from record date. Do not net these items.

5860 Depositories – debits. Report here the debit amount or short value applicable to all unresolved reconciling items (favorable or unfavorable) with depositories that are unresolved within seven business days from the date of receipt of the statement of account from the carrying entity. Do not net these items.

5870 Clearing organizations – long – debits. Report here the debit amount applicable to all unresolved reconciling items (favorable or unfavorable) with clearing organizations that are long and unresolved within

seven business days from the date of receipt of the statement of account from the carrying entity. Do not net these items.

5875 Clearing organizations – short – debits. Report here the debit value applicable to all unresolved reconciling items (favorable or unfavorable) with clearing organizations that are short and unresolved within seven business days from the date of receipt of the statement of account from the carrying entity. Do not net these items.

6012 Money suspense and balancing differences – deductions. A difference, open at the report date and unresolved for seven business days after discovery, must be deducted regardless of whether the difference is resolved prior to Form SBS′ filing date.

6020 Security suspense and differences with related money balances – long – credits. When computing net capital, regard long positions and related credits as proprietary commitments if they remain unresolved seven business days after discovery.

6025 Security suspense and differences with related money balances – short – credits. When computing net capital, regard long positions and related credits as proprietary commitments if they remain unresolved seven business days after discovery.

6040 Market value of security record breaks – credits. Report the market values of long security record breaks that are unresolved seven business days after discovery.

6042 Market value of security record breaks – deductions. The market values of short security record breaks are deductions to net capital only if they remain unresolved seven business days after discovery.

6050 Correspondents, SBSDs, and MSBSPs – long – credits. Report here the credit amount applicable to all unresolved reconciling items (favorable or unfavorable) with correspondents, SBSDs, and/or MSBSPs that are long and unresolved within seventeen business days from record date.

6055 Correspondents, SBSDs, and MSBSPs – short – credits. Report here the credit amount applicable to all unresolved reconciling items (favorable or unfavorable) with correspondents, SBSDs, and/or MSBSPs that are short and unresolved within seventeen business days from record date. Do not net these items.

6060 Depositories – credits. Report here the credit amount or long value applicable to all unresolved reconciling items (favorable or unfavorable) with depositories that are unresolved within seven business days from the date of receipt of the statement of account from the carrying entity. Do not net these items.

6070 Clearing organizations – long – credits. Report here the credit amount applicable to all unresolved reconciling items (favorable or unfavorable) with clearing organizations that are long and unresolved within seven business days from the date of receipt of the statement of account from the carrying entity. Do not net these items.

6075 Clearing organizations – short – credits. Report here the credit value applicable to all unresolved reconciling items (favorable or unfavorable) with clearing organizations that are short and unresolved within seven business days from the date of receipt of the statement of account from the carrying entity. Do not net these items.

6160 Open transfers and reorganization account items over 40 days not confirmed or verified – credits. Report here credits relating to open transfers and reorganization account items that have not been confirmed or verified for over forty days. See the instructions accompanying Line Item 5760 for a discussion of the term "reorganization account items."

6162 Open transfers and reorganization account items over 40 days not confirmed or verified – deductions. Report here the total deductions relating to open transfers and reorganization account items that have not been confirmed or verified for over forty days. See the instructions accompanying Line Item 5760 for a discussion of the term "reorganization account items."

6182 Aged fails to deliver – deductions. Report deductions for fails to deliver that are five business days or longer (or 21 business days for municipal securities).

6187 Aged fails to receive – deductions. Report deductions for fails to receive that are outstanding for more than 30 calendar days.

Computation for Determination of Reserve Requirements – Rule 15c3-3, Exhibit A and Related Notes

This section must be prepared by broker-dealer SBSDs and broker-dealer MSBSPs. See also the notes accompanying 17 C.F.R. § 240.15c3-3a.

Note that broker-dealer SBSDs must also complete the "Computation for Determination of Reserve Requirements – Rule 18a-4, Appendix A" with regard to security-based swap customers' accounts (while limiting this calculation under 17 C.F.R. § 240.15c3-3a to customers' accounts). The term "customer" is defined in 17 C.F.R. § 240.15c3-3.

Information for Possession or Control Requirements under Rule 15c3-3

This section must be prepared by broker-dealer SBSDs and broker-dealer MSBSPs.

Note that broker-dealer SBSDs must also complete the Computation for Determination of Reserve Requirements under 17 C.F.R. § 240.18a-4a with regard to security-based swap customers' security-based swap accounts (while limiting this calculation under 17 C.F.R. § 240.15c3-3a to security accounts).

Computation for Determination of PAB Requirements

This section must be prepared by broker-dealer SBSDs and broker-dealer MSBSPs.

Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Appendix A

This section must be prepared by stand-alone SBSDs and broker-dealer SBSDs. See also the notes accompanying 17 C.F.R. § 240.18a-4a.

Note that broker-dealer SBSDs must also complete the "Computation for Determination of Reserve Requirements – Rule 15c3-3, Exhibit A and Related Notes" with regard to customers' accounts (while limiting this calculation under 17 C.F.R. § 240.18a-4a to security-based swap customers' accounts). The term "security-based swap customer" is defined in 17 C.F.R. § 240.18a-4.

Information for Possession or Control Requirements under Rule 18a-4

This section must be prepared by stand-alone SBSDs and broker-dealer SBSDs.

Note that broker-dealer SBSDs must also complete the Computation for Determination of Reserve Requirements under 17 C.F.R. § 240.15c3-3a with regard to customers' security accounts (while limiting this calculation under 17 C.F.R. § 240.18a-4a to security-based swap accounts).

PART 2

Balance Sheet (Information as Reported on FFIEC Form 031 – Schedule RC)

This section must be prepared by bank SBSDs and bank MSBSPs.

This section should be prepared in accordance with the FFIEC Instructions, including "Schedule RC – Balance Sheet." Thus, dollar amounts should be reported in thousands. In addition, the data reported on this section should only be updated quarterly.

Regulatory Capital (Information as Reported on FFIEC Form 031 – Schedule RC-R)

This section must be prepared by bank SBSDs and bank MSBSPs.

This section should be prepared in accordance with the FFIEC Instructions, including "Schedule RC-R – Regulatory Capital." Thus, dollar amounts should be reported in thousands. In addition, the data reported on this section should only be updated quarterly.

Note that the line numbers on this section and Schedule RC-R do not match, so firms should refer to the line item numbers (appended with the letter "b" in Form SBS) when matching Schedule RC-R's instructions with this section.

Income Statement (Information as Reported on FFIEC Form 031 – Schedule RI)

This section must be prepared by bank SBSDs and bank MSBSPs.

This section should be prepared in accordance with the FFIEC Instructions, including "Schedule RI – Income Statement." Thus, dollar amounts should be reported in thousands. In addition, the data reported on this section should only be updated quarterly.

Note that the line numbers on this section and Schedule RI do not match, so firms should refer to the line item numbers (appended with the letter "b" in Form SBS) when matching Schedule RI's instructions with this section.

Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Appendix A

This section must be prepared by bank SBSDs.

This section should be prepared in accordance with the instructions accompanying the section in Part 1 of Form SBS entitled "Computation for Determination of the Amount to be Maintained in the Special Account for the Exclusive Benefit of Security-Based Swap Customers – Rule 18a-4, Appendix A."

Information for Possession or Control Requirements under Rule 18a-4

This section must be prepared by bank SBSDs.

This section should be prepared in accordance with the instructions accompanying the section in Part 1 of Form SBS entitled "Information for Possession or Control Requirements under Rule 18a-4."

PART 3

Computation of CFTC Minimum Capital Requirements

This section must be prepared by all SBSDs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act, and all MSBSPs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act.

This section should be prepared in accordance with the Commodity Futures Trading Commission's Form 1-FR-FCM ("CFTC Instructions"), including the instructions accompanying the section entitled "Statement of the Computation of the Minimum Capital Requirements."

Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges

This section must be prepared by all SBSDs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act, and all MSBSPs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act.

This section should be prepared in accordance with the CFTC Instructions, including the section entitled "Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges."

Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under Section 4d(f) of the Commodity Exchange Act

This section must be prepared by all SBSDs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act, and all MSBSPs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act.

This section should be prepared in accordance with the CFTC Instructions, including the section entitled "Statement of Cleared Swaps Customer Segregation Requirements and Funds in Cleared Swaps Customer Accounts under Section 4d(f) of the Commodity Exchange Act."

Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts

This section must be prepared by all SBSDs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act, and all MSBSPs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act.

This section should be prepared in accordance with the CFTC Instructions, including the section entitled "Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts."

Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to CFTC Regulation 30.7

This section must be prepared by all SBSDs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act, and all MSBSPs registered with the CFTC as futures commission merchants pursuant to section 4d of the Commodity Exchange Act.

This section should be prepared in accordance with the CFTC Instructions, including the section entitled "Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers."

PART 4

Schedule 1 – Aggregate Securities, Commodities, and Swaps Positions

This schedule must be prepared by stand-alone SBSDs, broker-dealer SBSDs, stand-alone MSBSPs, and broker-dealer MSBSPs.

For the applicable security-based swap, mixed swap, or swap, report the month-end gross replacement value for cleared and non-cleared receivables in the long column, and report the month-end gross replacement value for cleared and non-cleared payables in the short column. Reports totals on the "Total" row.

Terms may be defined by reference to other sections of the instructions accompanying Form SBS (*e.g.*, Line Item 8290 (Arbitrage) may be defined by reference to Line Item 422 (Arbitrage)). Derivatives should be defined by referenced to the section of the instructions entitled "Definitions of Derivatives."

Schedule 2 – Credit Concentration Report for Fifteen Largest Exposures in Derivatives

This schedule must be prepared by stand-alone SBSDs, broker-dealer SBSDs, stand-alone MSBSPs, and broker-dealer MSBSPs.

On the penultimate row of each table, entitled "All other counterparties," report the requested information for all of the firm's counterparties except for the fifteen counterparties already listed on the applicable table.

Counterparty identifier. In the first table, list the fifteen counterparties to which the firm has the largest current net exposure, beginning with the counterparty to which the firm has the largest current net exposure.

In the second table, list the fifteen counterparties to which the firm has the largest total exposure, beginning with the counterparty to which the firm has the largest total exposure.

Identify each counterparty by its unique counterparty identifier.

Internal credit rating. Report the applicable counterparty's internal credit rating as assigned by the firm.

Gross replacement value – receivable. For the applicable counterparty, report here the gross replacement value of the firm's derivatives receivable positions. Report total on the "Totals" row.

Gross replacement value – payable. For the applicable counterparty, report here the gross replacement value of the firm's derivatives payable positions. Report total on the "Totals" row.

Net replacement value. For the applicable counterparty, report here the net replacement value of the firm's derivative positions. Report total on the "Totals" row.

Current net exposure. For the applicable counterparty, report here the firm's current net exposure to derivative positions. Report total on the "Totals" row.

Total exposure. For the applicable counterparty, report here the firm's total exposure to derivative positions. Report total on the "Totals" row.

Margin collected. For the applicable counterparty, report here the margin collected to cover the firm's derivative positions. Report total on the "Totals" row.

Schedule 3 – Portfolio Summary of Derivatives Exposures by Internal Credit Rating

This schedule must be prepared by stand-alone SBSDs, broker-dealer SBSDs, stand-alone MSBSPs, and broker-dealer MSBSPs.

Internal credit rating. Report here the firm's internal credit rating scale. Each row should contain a separate symbol, number, or score in the firm's rating scale to denote a credit rating category and notches within a category in descending order from the highest to the lowest notch. For example, the following symbols would each represent a notch in a rating scale in descending order: AAA, AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB-, BB+, BB, BB-, CCC+, CCC, CCC-, CC, C and D.

Gross replacement value – receivable. For the applicable internal credit rating notch, report here the gross replacement value of the firm's derivatives receivable positions with counterparties rated at that notch. Report total on the "Totals" row.

Gross replacement value – payable. For the applicable internal credit rating notch, report here the gross replacement value of the firm's derivatives payable positions with counterparties rated at that notch. Report total on the "Totals" row.

Net replacement value. For the applicable internal credit rating notch, report here the net replacement value of the firm's derivative positions with counterparties rated at that notch. Report total on the "Totals" row.

Current net exposure. For the applicable internal credit rating notch, report here the firm's current net exposure to derivative positions with counterparties rated at that notch. Report total on the "Totals" row.

Total exposure. For the applicable internal credit rating notch, report here the firm's total exposure to derivative positions with counterparties rated at that notch. Report total on the "Totals" row.

Margin collected. For the applicable internal credit rating notch, report here the margin collected to cover the firm's derivative positions with counterparties rated at that notch. Report total on the "Totals" row.

Schedule 4 – Geographic Distribution of Derivatives Exposures for Ten Largest Countries

This schedule must be prepared by stand-alone SBSDs, broker-dealer SBSDs, stand-alone MSBSPs, and broker-dealer MSBSPs.

Country. Identify the 10 largest countries according to the firm's current net exposure or total exposure in derivatives. In the first table, countries should be ordered according to the size of the firm's current net exposure in derivatives to them (beginning with the largest and ending with the smallest). In the first table, countries should be

ordered according to the size of the firm's total exposure in derivatives to them (beginning with the largest and ending with the smallest). A firm's counterparty is deemed to reside in the country where its main operating company is located.

Gross replacement value – receivable. For the applicable country, report here the gross replacement value of the firm's derivatives receivable positions. Report total on the "Totals" row.

Gross replacement value – payable. For the applicable country, report here the gross replacement value of the firm's derivatives payable positions. Report total on the "Totals" row.

Net replacement value. For the applicable country, report here the net replacement value of the firm's derivative positions. Report total on the "Totals" row.

Current net exposure. For the applicable country, report here the firm's current net exposure to derivative positions. Report total on the "Totals" row.

Total exposure. For the applicable country, report here the firm's total exposure to derivative positions. Report total on the "Totals" row.

Margin collected. For the applicable country, report here the margin collected to cover the firm's derivative positions. Report total on the "Totals" row.

Part 5

Schedule 1 – Aggregate Security-Based Swap and Swap Positions

This schedule must be prepared by bank SBSDs and bank MSBSPs.

For the applicable security-based swap, mixed swap, or swap, report the quarter-end gross replacement value for cleared and non-cleared receivables in the long column, and report the quarter-end gross replacement value for cleared and non-cleared payables in the short column. Report total on the "Total" row.

Derivatives should be defined by referenced to the section of the instructions entitled "Definitions of Derivatives."

By the Commission.

Kevin M. O'Neill
Deputy Secretary

Date: April 17, 2014