ING MIZUHO

November 16, 2018

Brent Fields
Secretary
Securities and Exchange Commission
Three Lafayette Centre
100 F St, NE
Washington, DC 20549-1090

Re: Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers; RIN 3235-AL12; File No. S7-08-12

Dear Mr. Fields:

The undersigned appreciates this opportunity to provide comments to the Securities and Exchange Commission (the "**Commission**" or "**SEC**") in response to the above-captioned proposal (the "**Proposed Rule**")[1] regarding capital requirements for security-based swap dealers ("**SBSDs**") that are not subject to capital rules of a Prudential Regulator ("**nonbank SBSDs**"),[2] which the Commission has re-opened for comment (the "**Comment Request**").[3]

As described below, we recommend that the Commission modify the Proposed Rule to permit a U.S. nonbank SBSD to use internal, risk-based capital models approved and periodically assessed by a Prudential Regulator, the Commodity Futures Trading Commission ("**CFTC**"), the National Futures Association ("**NFA**"), or its home country consolidated supervisor, without requiring additional pre-approval of those models by the Commission. Of course, the Commission would have access to information regarding the other regulator's oversight of those models (including associated model governance) as necessary to fulfill its ongoing monitoring responsibilities for the SBSD.

[1] Securities and Exchange Commission, *Proposed Rule, 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, 77 Fed. Reg. 70214 (Nov. 23, 2012).

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

[3] 83 Fed. Reg. 53007 (Oct. 19, 2018).

This change is necessary to avert a disruptive change to the operating model of U.S. nonbank SBSDs with foreign parent companies. Without this change, to avert such disruption the Commission should substantially extend the transition period for SBSD capital requirements to provide enough time for Commission review and approval of internal capital models or withdrawal of such entities from the U.S. SBS markets.

We also recommend that the Commission and the CFTC work together to harmonize their capital requirements for nonbank SBSDs that are dually registered as swap dealers ("**SDs**"). To the extent harmonization is not achievable, we suggest a mutual recognition framework designed to achieve an efficient allocation of responsibility between the agencies. This framework would reduce incentives to divide dealing activities into separate legal entities.

Background

The Proposed Rule would apply a net liquid assets test for calculation of capital for nonbank SBSD based on that historically applied to broker-dealers. This test uses standardized haircuts for calculation of market and credit risk or, for some limited purpose broker-dealers, Commission-approved internal models for computing these haircuts.

The standardized haircut approach tends to significantly overstate the risk of a security-based swap ("SBS") portfolio for some market participants because it provides limited or no recognition of risk offsets arising from hedging strategies commonly employed by SBSDs. It also limits the ability to transact with commercial end users, whom Congress determined should not post margin.

Discussion

Use of Models

Due to the punitive capital charges generated by a standardized approach, effectively all nonbank SBSDs will need to obtain approval to use internal capital models in order to conduct business in a commercially viable manner. However, the model approval process can take well over a year (and sometimes multiple years) for the Commission to complete, with a concomitant drain on the Commission's limited resources. The model oversight process similarly consumes significant resources on an ongoing basis. These resource issues will be magnified because the SBSD regime is likely to increase significantly the number of Commission registrants using internal models beyond the small number of alternative net capital broker-dealers and OTC derivatives dealers currently using them.

At the same time, in many instances SBSDs will already be subject to supervision by another regulator with respect to their use of models, leading to duplication of efforts and potentially inconsistent exercise of supervisory authority. To address these issues,

we recommend that the Commission permit a nonbank SBSD to use internal credit and market risk models approved by either (i) a Prudential Regulator, (ii) the CFTC, (iii) the NFA, or (iv) a foreign regulator that is either based in a G20 jurisdiction or is a member of the Basel Committee or the Board of the International Organization of Securities Commissions (each of (i), (ii), (iii) and (iv), a "**Qualifying Regulator**").

Second, we recommend that the Commission generally defer to the Qualifying Regulator's ongoing oversight of the nonbank SBSD's models (including associated model governance). The Commission would have access to information regarding the Qualifying Regulator's model oversight as necessary to fulfill its ongoing monitoring responsibilities for the SBSD.

For a U.S. nonbank SBSD to qualify for this treatment, we would propose the following conditions:

- the models used by the nonbank SBSD should: (1) cover the material risks arising from the SBS activities of the nonbank SBSD; (2) satisfy the Qualifying Regulator's implementation of Basel 2.5 or Basel 3 capital standards; and (3) be subject to prior approval and periodic assessment by the Qualifying Regulator;

- the nonbank SBSD should make available to the Commission sufficient information regarding its models and related internal risk management controls and governance processes to assess them for compliance with SBSD capital requirements.

Recognizing Qualifying Regulators' model approvals and oversight as described above would conserve Commission resources without compromising the Commission's objective of ensuring strong quantitative and qualitative standards for internal capital models.

In contrast, if forced to compute capital charges under a standardized approach, U.S. nonbank SBSD subsidiaries would not be able to conduct business as the excessive amount of capital required would make SBS dealing activities unsustainable. Transitioning U.S. SBS dealing activities to a non-U.S. affiliate would, in turn, be costly and disruptive for affected SBSDs and their U.S. counterparties and likely lead to a migration of personnel and resources to the non-U.S. affiliate, making the examination process less seamless for the Commission and reducing U.S. employees. In a worst case scenario, it could result in security-based swap dealer businesses being closed causing a reduction in liquidity in already thinly-traded markets.

Transition Period

If the relief requested above with respect to recognition of models approved by Qualifying Regulators is not granted, it will be particularly important that the capital requirements for nonbank SBSDs be phased in over a period sufficient to prevent

significant market disruption. Additionally, existing registrants are likely to be required to transition U.S. SBS dealing activities to non-U.S. affiliates, which will require considerable time, cost and effort to implement from governance, operational and documentation perspectives. To address these issues, we respectfully request that the Commission provide a period of at least four years from adoption before its capital requirements fully take effect.

Coordination with the CFTC

Organizations dealing in swaps and SBS typically do so through the same legal entity. This structure can result in the Commission's capital rules applying to all swap and SBS activities of an entity in which less than 1% of such activities involve SBS. In addition, the SEC's and CFTC's capital rules continue to differ from each other in several key respects. For example, as currently proposed, the agencies' respective rules take different approaches to swaps with commercial end users - the Commission's rules imposing significantly greater capital charges on such swaps.[4] As a result, the impact of the capital rules adopted by the Commission (or CFTC) on products regulated by the CFTC (or Commission) can vastly outstrip the materiality of such products relative to the risk and business profile of the registrant.

To address such anomalous situations, we believe that the capital and margin rules of the SEC and CFTC should be harmonized. If harmonization is not achievable, the rules should be coordinated so that (1) the SEC defers to the capital and margin rules of the CFTC for an SBSD that is not a broker-dealer and whose SBS constitute a very small proportion of its business (e.g., less than 10% of the notional amount of its outstanding combined swap and SBS positions) and (2) the CFTC defers to the capital and margin rules of the SEC for an SD that is a broker-dealer, is not a futures commission merchant and whose swaps constitute a very small portion of its business. Without this coordination, or otherwise completely harmonized rules, registrants would face incentives to split their trading activities into multiple legal entities, with resulting loss of netting and risk management efficiencies.

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We appreciate the opportunity to submit these comments in connection with the Proposed Rule. If you have any questions or if we can be of assistance to the Commission, please do not hesitate to contact Colin Lloyd (212-225-2809) of Cleary

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[4] The CFTC has proposed that nonbank SDs could elect a "bank-based" approach to capital requirements, which would be modeled on the Federal Reserve's capital requirements for bank holding companies and thus generally require capital equal to 8 percent of standardized credit risk charges for uncollateralized current exposure to a commercial end user, rather than 100 percent as would be required under the Proposed Rules for a nonbank SBSD that did not have credit risk model approval. And even for a nonbank SBSD that did have credit risk model approval, the rule text contained in the Comment Request would limit the ability of a nonbank SBSD to use credit risk models to compute capital charges for current exposure to commercial end users to circumstances where the deductions for such exposures do not exceed 10 percent of the tentative net capital of the SBSD. The CFTC has not proposed any similar limitation.

Gottlieb Steen & Hamilton LLP, outside counsel to the undersigned.

Respectfully submitted,

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